JAPAN’S NEW CIVIL PROCEDURE CODE: HAS IT FOSTERED A RULE OF LAW DISPUTE RESOLUTION MECHANISM?

Carl F. Goodman

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* Adjunct Professor, Georgetown University Law Center; Senior Researcher, Tokyo University, Faculty of Law Spring 2003; Georgetown University Law Center, LL.M. (1965); Brooklyn Law School, J.D. (1961); City College of New York, B.B.A. (1958). Thanks are extended to the Fulbright Program administered by The Japan–United States Educational Commission, which provided the funding for the research project on which this article is based. In addition, the Northeast Asia Council of the Association for Asian Studies provided a supplemental grant to assist in covering expenses for travel internal to Japan. Additional thanks are extended to the Faculty of Law of Tokyo University (where the author was a Senior Researcher), which provided assistance in the project and under whose sponsorship the research was undertaken, and especially to Professor K. Asaka of Todai for his invaluable personal and professional assistance and advice. Thanks are also extended to the many professors of law who assisted in arranging interviews in various parts of Japan and especially to Professor Hiroyuki Hata of Hiroshima. A warm thank you is extended to the Supreme Court of Japan, Judicial Secretariat, which provided statistical information and access to judges who assisted in understanding the statistics and explained the actual workings of the judicial system from the Court’s perspective. Finally, a thank you is warmly extended to the international law firm of Jones Day (of which the author is a retired partner) and its Tokyo office (most especially to Nobutoshi Yamanouchi of that office), which provided logistical support and assisted in arranging interviews in Tokyo.
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I. INTRODUCTION

Japan is a country whose present legal system dates to only the late Nineteenth Century. In this relatively short period, Japan’s legal system has undergone dramatic changes and has been influenced by both the civil law and common law systems of Europe and the United States (“U.S.”). The modern Japanese legal system started as a civil law system based on French and German models; however, before World War II, the nation modified its legal system in order to strengthen government control at the expense of individual rights. After the war, during the U.S. occupation of the nation, Japan modified its system to accommodate American common law notions.

Throughout this period of legal adaptation, the Japanese tended to avoid using the legal system to resolve disputes, and instead used more traditional models of alternative dispute resolution, which are characterized by conciliation, compromise and mediation. This Japanese anti-litigation preference seems consistent with norms existing prior to Japan’s adoption of its modern legal system in the late Nineteenth Century. More recently, the Japanese government has adopted a policy of strengthening the “Rule of Law” in Japanese society. The

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2. Id. at 29–31.
3. Id.
4. Id.
5. Tetsuya Obuchi, Role of the Court in the Process of Informal Dispute Resolution in Japan: Traditional and Modern Aspects, with Special Emphasis on In-Court Compromise, 20 Law in Japan 74, 75 (1987).
6. Id. at 78.
7. The “Rule of Law” concept is not easily defined. Stated attributes of Westernized Rule of Law systems include: utilizing the legal system as a primary means of ordering society; governing in a manner that adheres to the law; resolving disputes based on the application of preexisting, general, abstract and depersonalized rules to a given set of facts; and resolving disputes in terms of a winner and loser. Rudolf B. Schlesigner et al., Comparative Law 320–22 (6th ed. 1998); U.S. Justice Sandra Day O’Connor has recently defined the Rule of Law to mean: “that laws should be enacted by democratically elected bodies and enforced by independent judiciaries.” Sandra Day O’Connor, The Majesty of the Law 33 (2003) [hereinafter O’Connor]. Inherent in these definitions are two basic underpinnings of the Rule of Law idea: (1) an independent judicial system to resolve disputes through enforcement and application; and (2) laws adopted by the society that are not so
Japanese Diet rewrote Japan’s Civil Procedure Code in 1996 (“New Code”), to make litigation more readily available as part of the nation’s policy to strengthen the Rule of Law in Japan. In 2003, the Author undertook a study, involving interviews with bengoshi (licensed practicing lawyers) and statistical analyses, to determine whether the New Code had made litigation the official dispute resolution mechanism of a Rule of Law society — a more favored method of resolving disputes. This Article sets forth the results of that study.

Following this introduction, Part II offers a short synopsis of the recent legal changes made in Japan and discusses the Civil Procedure system in Japan and the research project underlying this Article’s study. This Part deals with some of the major changes brought about in the New Code and discusses the reasoning behind those changes.

8. Legal professionals in Japan fall into various categories. At the top of the list are the bengoshi, or licensed lawyers, who are authorized to represent parties in litigation before the courts and to generally give legal advice. However, there are other legal professionals in Japan, some of whom perform functions that are typically undertaken by lawyers in the U.S. Thus, legal scriveners prepare documents, such as wills, and assist in the drafting of pleadings although they are not licensed lawyers. In addition, patent attorneys give advice on patent law matters, but they are not licensed lawyers. Most Japanese law departments of major companies are not staffed with bengoshi but are staffed with highly trained and knowledgeable graduates of hogakubu law faculties at Japanese Universities that provide four-year undergraduate law programs. Bengoshi are licensed under the “Bengoshi Ho” or Practicing Attorney’s Act (1949 c. 205, art. 4) (Japan). To become a bengoshi a candidate must pass a difficult Bar examination, attend the Legal Training and Research Institute, pass another exam after completing the Institute and be registered with the local Bar Association. See HIDEO TANAKA, THE JAPANESE LEGAL SYSTEM 563 (University of Tokyo Press, 1976) [hereinafter TANAKA, THE JAPANESE LEGAL SYSTEM]. “Admission to the Japanese Bar is a prerequisite for practicing law, and admission to the Bar is accomplished by registering on the Lawyer’s List (Bengoshi Kaiim Meibo) maintained by the Japan Federation of Bar Associations.” TAKAAKI HATTORI & DAN FENNO HENDERSON, CIVIL PROCEDURE IN JAPAN REVISED § 2.04(1) (Yasuhei Taniguchi et al. eds., Juris Publishing 2d ed. 2002) [hereinafter CIVIL PROCEDURE IN JAPAN REVISED]. “Bengoshi, a translation of the English word ‘barrister’ is in use today. The term first appeared in an occupation title in the draft of the Lawyers Law which was prepared for submission to the Diet in 1890. The term daigennin had currency before 1890.” Richard W. Rabinowitz, The Historical Development of the Japanese Bar, 70 HARV. L. REV. 61, 64 n.5 (1956).
Part III then moves on to the effect that these changes have had on litigation as a means of resolving disputes. Specifically, Part III.A. considers the effect of the legal changes on the pace of litigation in both the Trial Court (District Court) (III.A.1.) and Appeals Courts levels (High Court and Supreme Court) (III.A.2.). Part III.A.4. explores potential reasons why the accelerated pace of litigation has not resulted in an increase in the use of litigation as a dispute resolution mechanism. Part III.B. discusses the effect of the changes made in the procedures dealing with production of evidence. Part III.B.1. then analyzes the new inquiry procedures and links the system’s malfunction to procedural inadequacy stemming from the lack of sanctions for failing to respond to inquiries. Part III.B.2. examines the New Code’s effect on document production and the consequences of the Japanese legal system’s “self-use” document exception, which serves to effectively restrict the meaningful production of evidence. Part III.C. deals with the New Code’s outcome on Japanese litigation and its effect on the Commercial Code as applied to stockholder derivative suits in Japan.

Part III.D. deals with the Japanese alternative to the class action — the Representative Action — and explores whether the New Code’s changes, designed to enhance the use of such actions, has had the desired effect. Part III.E. considers the relatively new phenomenon in Japan of the “Complicated Case” and the anticipated future modifications and adaptations of provisions in the New Code that can be expected to deal with “Complicated Cases.” Part III.F. discusses the relations between the Japanese Bench and Bar and how the legal changes set to increase the size of the legal profession by approximately threefold, could enhance the Rule of Law in Japan.

The conclusion, in Part IV, makes some suggestions for future changes and areas deserving of further study if the objective of strengthening the judicial system as a Rule of Law dispute resolution mechanism is to be realized in Japan.

II. AN OVERVIEW OF THE JAPANESE LEGAL SYSTEM

A. Japan’s Legislative Reforms

In 1996, the Japanese legislature completely rewrote the nation’s Civil Procedure Code. The rewriting of the New Code took five years to complete; however, lengthy discussion and debates regarding the need for such a fundamental change in Japan’s Civil Procedure Code long preceded the rewriting effort. The New Code was an amalgam of the old Japanese Civil Procedure Code (“Old Code”) and reforms designed to speed-up the pace of Japanese litigation and create reliable means of resolving disputes. Some heralded the New Code as ushering in major change for Japan’s civil procedure for the Twenty-first Century. Others wondered whether the New Code would actually result in major change or would simply serve as a set of “baby steps,” having little impact on how litigation in Japan would be handled in the future. Several English language articles have explained the changes in the New Code at its inception.

The New Code went into effect on April 1, 1998. In the summer of 2003, as a response to the continued negative perception of litigation in Japan, the Japanese Diet (Japan’s Parliament) enacted legislation requiring the completion of cases

11. Id.
12. Ota, supra note 9, at 564–66.
16. Ota, supra note 9, at 561.
17. Article 41 of Japan’s Constitution provides that “the Diet shall be the highest organ of the State Power and shall be the sole law-making organ of the State.” KENPÔ [Japanese Constitution], art. 41. The Diet consists of two Houses: the House of Representatives and the House of Councilors. KENPÔ,
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at the trial court level within two-years of initiation. ¹⁸ This legislation, as well as the New Code and the 2001 Report of the Judicial Reform Council are considered part of Japan’s ongoing effort to strengthen the concept of the Rule of Law in Japanese society.¹⁹

One of the main characteristics of a society governed by the concept of the Rule of Law is that the legal system’s dispute resolution mechanism (i.e., the judicial system) provides a reliable means of resolving legal disputes within a nation.²⁰ A reliable judicial system must in turn provide its litigation participants with a reasonable opportunity to obtain reasonable relief when warranted, and a reasonable opportunity to defend against unwarranted, specious, or malicious claims. Although a

¹⁸. 15 Heisei [Act to Accelerate Court Procedures] Statute No. 107, art. 2. (2003) (Japan). See also Lower House Approves Speedy Trial Legislation, JAPAN ECON. NEWSWIRE, May 13, 2003, available at LEXIS, News & Business Library, Japan Economic Newswire File. The Asahi Shinbun reported that a unanimous lower House of the Japanese Diet approved a bill “to limit lower court trials to less than two years” in an effort to speed up the justice system. Id. The Asahi Shinbun described the Japanese judicial system as operating “snail-like.” See id. As the statistics referred to infra show, this description appears to unduly criticize the pace of litigation in the Japanese court system, at least as it applies to average dispositions of civil cases handled after passage of the New Code. The Japanese Diet enacted the two-year law on July 9, 2003. According to the Japan Times, the law applies to both civil and criminal cases at the District Court, Summary Court and Family Court. Trials to be Expedited as Judicial Reform Bills Pass, JAPAN TIMES ONLINE, July 10, 2003, available at http://japantimes.co.jp/cgi-bin/getarticle.pl5?nn20030710b1.htm [hereinafter Trials to be Expedited]. For a discussion of how such legislation may adversely affect the Rule of Law concept in Japan, see infra notes 209, 210, 212 and Part III.A.4.


²⁰. SCHLESIGNER ET AL., supra note 7, at 11; O’CONNOR, supra note 7, at 65–79.
Rule of Law judicial system requires the fair treatment of all its participants, reality reveals that defendants are usually unwilling or at least non-initiating participants to litigation. In the criminal law arena, the State, typically through the prosecutor’s office, initiates litigation. In a criminal case, the judicial system in carrying out a Rule of Law mandate must provide the accused defendant with a reasonable opportunity to defend him or herself in a timely proceeding, e.g., a fair trial. Both the Japanese and U.S. legal systems attempt to implement these ideals through Constitutional provisions guaranteeing the accused defendant in criminal cases the right to counsel, the privilege against self-incrimination, and a right to a speedy trial before an impartial tribunal. How well these systems work to make these legal provisions a reality is not the subject

21. In Japan, the prosecutor’s office retains responsibility for bringing forward criminal prosecutions. However, Japanese law does permit limited civilian review of prosecutor decisions not to prosecute. For a discussion of prosecution review commissions, see Goodman, THE RULE OF LAW IN JAPAN, supra note 19, at 293 and Mark D. West, Prosecution Review Commissions: Japan’s Answer to the Problem of Prosecutorial Discretion, 92 Colum. L. Rev. 684, 693 (1992).

22. See, e.g., Frank v. Mangum, 237 U.S. 309, 347 (1915) (Holmes, J. dissenting); Brady v. Maryland, 373 U.S. 83 (1963); Moore v. Dempsey, 261 U.S. 86 (1923); Vacher v. France, 24 Eur. Ct. H.R. 482 (1996) (setting aside a French criminal conviction because the defendant was not given a fair hearing when his appeal was denied without receiving warning regarding any time limits for his response to the government’s assertions on appeal nor did the law specify any such time limits).

23. U.S. Const. amend. VI (“to have the assistance of counsel for his defense”). KENPO, art. 37 para. 3 (“At all times the accused shall have the assistance of competent counsel who shall, if the accused is unable to secure the same by his own efforts, be assigned to his use by the State.”).

24. U.S. Const. amend. V (“nor shall be compelled in any criminal case to be a witness against himself”); KENPO, art. 38 (“No person shall be compelled to testify against himself.”); X and 5 Others v. State, 1993 (O) No. 1189, 53 Minshu No. 3 at 514 (Sup. Ct., Grand Bench, Mar. 24, 1999) (Japan) (“In order to exercise investigative power, there may be instances where it is necessary to hold the suspect in custody and interrogate the suspect.”). See generally Daniel H. Foote, Confessions and the Right to Silence in Japan, 21 GA. J. INT’L & COMP. L. 415 (1991) (discussing the historical and current importance of confessions in the Japanese criminal system). See also Goodman, THE RULE OF LAW IN JAPAN, supra note 19, at 312–14.

25. U.S. Const. amend. VI (“the accused shall enjoy the right to a speedy and public trial”); KENPO, art. 37 (“In all criminal cases the accused shall enjoy the right to a speedy and public trial by an impartial tribunal.”).
of this Article or the study behind it, which solely focuses on civil non-administrative law adjudication.  

In a civil justice system, the allegedly aggrieved plaintiff initiates litigation. In order to carry out a Rule of Law mandate, a civil justice system must not only provide plaintiffs with a reliable, speedy and useable system, but it must also guarantee the defendant’s right to defend him or herself in order to ensure that both plaintiffs and defendants feel sufficiently confident with the legal system. In the case of Japan, because of structural impediments, some potential plaintiffs may not feel such necessary confidence in the Japanese legal system. 

In fact, many aggrieved Japanese potential litigants reject the existing judicial system in favor of alternative dispute resolution mechanisms (“ADRs”) due to its unfavorable reputation. In fact, many Japanese citizens perceive the nation’s judicial system as failing to offer timely and adequate relief, and/or they believe that the Japanese judicial system is an unreliable or inefficient mechanism for resolving disputes. For this reason, many Japanese litigants turn to ADR. As a result, Japanese

26. The Judicial Reform Council in Japan has made a number of suggestions in the criminal law area, including the creation of a public defender system, reform of the interrogation of suspects system, and lay participation in criminal trials. For a discussion of the Japanese criminal justice system and the Judicial Reform Council’s recommendations, see GOODMAN, THE RULE OF LAW IN JAPAN, supra note 19, at ch.13 (elaborating on Japan’s criminal law system).


[C]onciliation has been widely used as a means of settling disputes, while regular adjudicative procedures have not been used very frequently...the primary reason why a great number of people choose conciliation rather than the formal adjudication process seems to be...to avoid the time and expense required to go through the formal legal process.
society’s acceptance of the Rule of Law model may be subject to question. This Article does not wish to challenge the utility of ADR as an adjunct to the national legal system, or as part of a Rule of Law judicial system — far from it. ADR, as an adjunct to a judicial system, is in fact a characteristic of a Rule of Law society, but the “A” must represent a true “alternative” and not an adequate forum replacement.

In order for a judicial system to serve as a reliable means of resolving legal disputes, it must: (1) be reasonably quick (justice inordinately delayed is in fact justice denied); (2) be reasonably available (a system that taxes the complaining party so much as to make the cost benefit analysis weigh in favor of not using the system does not provide a Rule of Law solution to le-


29. See Kanako Takahara, Calls for Overhaul of Judge System Mount, JAPAN TIMES ONLINE, Dec. 20, 1999, available at http://www.japantimes.co.jp/cgi-bin/getarticle.pl?nn19991220b8.htm (“Discontent with the judicial system among lawyers, politicians and business people has prompted a Cabinet advisory panel to launch discussions aimed at giving the system its first overhaul of the postwar era…”). It is suggested that it is precisely because of such discontent that the Judicial Reform Council has made recommendations designed to make the Rule of Law a more integral part of Japanese society.

30. For example, the U.S. is a Rule of Law society where ADR plays both the role of an alternative and adjunct to the nation’s judicial system. The Federal Arbitration Act permits arbitration (a form of ADR) regardless of whether state law prohibits it. Federal Arbitration Act, 9 U.S.C. §§ 1–16 (2003). In addition, the Federal Arbitration Act requires that it must be interpreted as an effort by Congress to fully utilize its authority under the Interstate Commerce Clause in a manner that is consistent with the Congressional intent to override any pre-existing legal biases against arbitration. See Allied-Bruce Terminix Companies, Inc. v. Dobson, 513 U.S. 265 (1995). See also Mitsubishi Motors v. Solar Chrysler-Plymouth, 473 U.S. 614 (1985) (specifying that federal law favors arbitration).

31. See Prompt Justice, LAS VEGAS REV.-J. ONLINE EDITION (June 12, 2002), at http://www.reviewjournal.com/lvrj_home/2002/June-12-Wed-2002/opinion/1893674.html (commenting on the “Short Trial Pilot Program” in Clark County Nevada, which has as its goal reducing the inordinate delay in civil proceedings before the court). “[I]n the current civil context no one really wins when justice lies a decade down the road...creating frustrations which can only encourage some to take the law into their own hands...or give up on [the] Justice System entirely.” Id.
gal problems); (3) provide a neutral judicious decision-maker; and (4) offer a procedure for resolving disputes that gives a virtuous plaintiff a reasonable opportunity to be made whole. These factors, however, are not absolutes and different Rule of Law societies may properly draw different boundaries, making their systems: (1) work faster or slower; (2) more or less expensive; or (3) more or less plaintiff friendly when it comes to obtaining and admitting evidence — all within a zone of reasonableness.

B. A Comparison of the U.S. and Japanese Legal Systems

1. The U.S. Civil Judicial System

In the U.S., the nation expects its civil judicial system to perform law enforcement and social policy functions, which other societies delegate to the elected branches and bureaucracies.


33. See generally ALI/UNIDROIT Principles, supra note 27.

34. While a neutral decision-maker is a sine qua non of a Rule of Law judicial system, the mechanisms for decision-making may properly vary. Thus, the American preference for a jury system is clearly not a Rule of Law requirement although the early English law alternatives — trial by combat or by ordeal — would not be consistent with a Rule of Law society as understood in the Twenty-first Century. Civil law societies do not provide for trial by jury in either criminal or civil cases, although in some civil law countries a panel of judges and laypersons may decide criminal cases. See NORMAN DORSEN ET AL., COMPARATIVE CONSTITUTIONALISM 1058–59 (West Group 2003).

In countries where French or German approaches to procedure prevail, many criminal trials are conducted by a single judge or by a panel of judges without a jury. Where there is a panel of judges, the panel often comprises a mixture of professional and lay judges, who work together at all stages of the case.

Id. Prior to World War II, Japan experimented with a modified form of jury-trial in criminal cases. This form of jury-trial was suspended during the war and remains suspended. YOSHIYUKI NODA, INTRODUCTION TO JAPANESE LAW 137–38 (Anthony H. Angelo trans., Univ. of Tokyo Press 1976).

35. Richard L. Marcus, Reining in the U.S. Litigator: The New Role of U.S. Judges, Speech at the Chuo-o University Symposium on Multiple Roles and Interaction of Judges and Attorneys in Modern Civil Litigation (June 1, 2003), quoting R. KAGAN, ADVERSARIAL LEGALISM 47 (2001) (“Whereas European policies generally rely on hierarchically organized national bureaucracies to hold local officials accountable to national policies, the U.S. congress mobilized a distinctly U.S. army of enforcers — a decentralized, ideologically motivated
Within the U.S. civil judicial system, the legal system draws its boundaries in such a way as to favor plaintiffs. Filing fees remain low as a consequence, and do not increase with the amount of damages sought. Similarly, the U.S. licenses a substantial number of lawyers assuring an ample supply of professional legal talent available for plaintiffs while allowing lay juries to determine the quantum of damages.\(^{36}\) The collateral judgment rule, under which a plaintiff may recover damages from a defendant even after a third person has made the plaintiff whole,\(^ {37}\) also serves as a boundary that favors plaintiffs.

As the size of jury awards increase along with the number of available attorneys, lawyers are willing to assume cases on a contingent fee basis. The contingency fee arrangement works as judges leniently grant high fees,\(^ {38}\) which then guarantees a ready pool of attorneys.\(^ {39}\) The “American Rule” for attorneys’ fees,\(^ {40}\) where unsuccessful plaintiffs need not concern themselves with the expenses of reimbursing successful defendants’ attorneys, limits a potential plaintiff’s “costs” when thinking about litigation in terms of a cost-benefit analysis. Together with fee-shifting statutes that require some unsuccessful defendants to pay plaintiffs’ attorney fees but not \textit{visa versa}, the U.S. rule tilts the playing field in favor of initiating litigation.\(^ {41}\)

Once in court, the U.S. notice of claim pleading\(^ {42}\) and liberal discovery rules\(^ {43}\) similarly assist plaintiffs.\(^ {44}\) The U.S. jury’s au-


\(^{37}\) See, \textit{e.g.}, Halek v. United States, 178 F.3d 481 (7th Cir. 1999).

\(^{38}\) Goodman, \textit{The Somewhat Less Reluctant Litigant}, \textit{supra} note 15, at 792.

\(^{39}\) \textit{Id.} at 793.

\(^{40}\) Alyeska Pipeline Service Co. v. Wilderness Society, 421 U.S. 240, 247 (1975).

\(^{41}\) Goodman, \textit{The Somewhat Less Reluctant Litigant}, \textit{supra} note 15, at 792.

\(^{42}\) \textit{Fed. R. Civ. P.} 8. (stating that a plaintiff need not plead facts sufficient to prove his or her case but must simply notify the other side of the basis for the claim).

\(^{43}\) See \textit{generally} \textit{Fed. R. Civ. P.} 26–37 (stating that evidence can be obtained from the defendant during the course of the litigation).
authority to determine the award amount of compensatory and punitive damages with some but limited judicial supervision has led to a fear of “runaway” juries that has now become such a part of American folklore that it has inspired the subject of a film based on a best selling novel on this matter.

The “pro-plaintiff” U.S. judicial system has recently come under challenge as failing to serve the “public interest.” Naturally most opponents of this system are those who typically represent deep-pocket defendants, who are required to pay damage awards, such as insurers and hospitals. Meanwhile, plaintiffs

45. The problem of excessive damages is particularly felt in the punitive damage arena. In BMW of North America, Inc. v. Gore, the U.S. Supreme Court attempted to limit the amount of punitive damages that may be awarded by “federalizing” and “constitutionalizing” the issue of grossly excessive punitive damage awards. See BMW of North America, Inc. v. Gore, 517 U.S. 559, 574–75 (1996). The Court set aside a punitive damage award as excessive and set forth guideposts for lower courts to use in assessing the reasonableness of jury punitive damage awards. Id. at 573. In another case, the Court was much more specific than in Gore in setting the permissible limits on punitive damage awards. See generally State Farm Mutual Auto. Ins. Co. v. Campbell, 538 U.S. 408 (2003). But see Simon v. San Paolo U.S. Holding Co., 7 Cal. Rptr. 3d 367, 113 Cal. App. 4th 1137 (2d Dist. 2003) & Henly v. Phillip Morris, 5 Cal. Rptr. 3d 42, 112 Cal. App. 4th 198 (1st Dist. 2003).
and their representatives, who are trial lawyers for the most part, respond that defendants who commit wrongs should not escape liability and that punitive damages serve to rehabilitate and deter “bad” actors and adequately compensate plaintiffs for their injuries. The parties, however, greatly differ on what compensation is adequate. The general public has begun to become involved in this debate as labor stoppages by physicians complaining about the high cost of malpractice insurance have made national headlines. In addition, political parties in the U.S. have lined up along traditional partisan grounds — the Democratic Party supporting plaintiffs and the trial lawyers, and the Republican Party supporting big companies and their


52. Id. The Republican Party, both through the President and its Representatives in Congress, has supported limiting the size of damage awards:

In his weekly radio address, Bush pushed for Congress to limit damage awards in medical malpractice cases...“We need to address the broader problems of frivolous litigation,” Bush said. “We need effective legal reforms that will make sure that settlement money from class actions and other litigation goes to those harmed and not to trial lawyers.” The White House backs pending GOP legislation that would sharply curtail lawyers’ contingency fees in lawsuit awards topping $100 Million.
The U.S. judicial system also has been hard pressed to join this political debate. The system has responded to this pressure in a measured and judicious way by refusing to resolve the problems created by politically contentious litigation, such as the asbestos litigation mess. Instead, the U.S. judicial system urges the political branches to take up their constitutionally mandated role of serving the public interest by legislating resolutions to problems such as the asbestos mess while the court steps in and attempts to control “run-away” punitive damage awards.

Whatever the merits or demerits of U.S. boundary drawing, defendants and their representatives have not yet argued that the U.S. judicial system is inconsistent with the Rule of Law, because, for example, it denies defendants a reasonable opportunity to defend themselves. Rather, while the conflicting sides differ as to where boundaries are properly drawn, all sides seem to agree that the American legal system, whatever its faults, supports a Rule of Law society. This mutual agreement, however, is not the case in Japan.


54. Id.

55. Federal judges who are appointed for life can afford to remain impartial in the political debate. However, impartiality is difficult to achieve in states that require the election of judges. The lure of campaign financing from one side or the other may taint the public’s view of the judicial system. See COMM’N ON THE 21ST CENTURY JUDICIARY, AM. B. ASS’N, JUSTICE IN JEOPARDY 1–2 (2003).


57. The author is unaware of any due process or Rule of Law challenges to the American litigation system. Indeed, Justice O’Connor has impliedly suggested that easy access to the courts by plaintiffs seeking relief is a component of the Rule of Law in the U.S.: “In our system — and our experience has
2. The Japanese Civil Judicial System

As an historic matter, Japan requires its judicial system to perform a more limited function than the U.S. judicial system. As a consequence, the Japanese judicial system has drawn its boundaries in a manner less favorable to plaintiffs. In addition, the shortage of lawyers in Japan makes a contingent fee system unworkable, even if technically lawful. The Japanese legal system’s requirement of paying a substantial part of lawyer’s fee “up front” also inhibits litigation. The Japanese courts’ filing fee system, which for most cases has a graduated fee that increases with the size of damages sought, increases the cost of getting one’s case before the court. The Japanese legal system has a fact-pleading requirement that obliges a plaintiff to plead facts sufficient to be successful at the start of the case. Meanwhile, the system provides no means for compelling the production of facts before a case’s initiation. To make matters worst, plaintiffs also have little opportunity to obtain meaningful factual discovery even after the case has begun. In addition, credible plaintiffs that are willing to under-

proved its efficacy — it is the citizens themselves, through the courts, who enforce their rights... ready access to independent courts allows any citizen to press his or her claim.” O’Connor, supra note 7.


60. See id. at 789 (discussing the barriers to litigation in Japan). See also Ota, supra note 9, at 5 (describing the process of litigation in Japan as slow, complex and expensive).

61. See Goodman, The Somewhat Less Reluctant Litigant, supra note 15, at 793 (noting that given the relatively small number of licensed lawyers permitted to handle litigation, few attorneys desire a contingent fee system). See also Ota, supra note 9, at 563 (discussing the shortage of lawyers in Japan).


63. See Goodman, The Somewhat Less Reluctant Litigant, supra note 15, at 791–92 (“In Japan... filing fees are typically based on the amount at issue in a case and can be quite high.”).

64. MINSOHō [Japanese Code of Civil Procedure], art. 133, sec. 2.2 [hereinafter MINSOHō]. See also MINJI SOSH-O KISOHU [Japanese Rules of Civil Procedure], art. 53(1) (on file with author). Under Rule 133 of the Japanese Code of Civil Procedure, the complaint must assert “the gist and ground of” of a claim. Id. If deemed inadequate by the court, the court may reject the claim and, if not amended to satisfy the court the complaint will be dismissed. Id. at art. 137.

65. Japan has no pre-trial discovery. See MINSOHO, art. 163; see also Yamanouchi & Cohen, supra note 28, at 3.
take the cost of litigation and have evidence supporting their allegations are frequently deterred from doing so by the Japanese system's low damage awards and the difficulties in executing a favorable judgment. In addition to the problems described above, the Japanese general public views the nation's judicial system as being too slow to resolve disputes. Faced with all of these obstacles, many potential plaintiffs in Japan are reluctant to litigate, and instead find ADR to be the more appropriate means for resolving disputes, whereas potential plaintiffs in other societies would find similar disputes more easily resolved by their nation's court system.

66. See generally Joseph W.S. Davis, Dispute Resolution In Japan 279 (1996).

67. See Shunko Muto, Concerning Trial Leadership in Civil Litigation: Focusing on the Judge's Inquiry and Compromise, 12 LAW IN JAPAN 23, 24 (1979) (suggesting that one basis for successful compromise of litigation is a provision under which a plaintiff actually gets paid damages rather than having to undergo the difficulties of execution after judgment). See also Mark D. West, Information, Institutions, and Extortion in Japan and the United States, Making Sense of Sokaiya Racketeers, 93 NW. U. L. REV. 767, 787 (1999) ("[C]ompanies can hire Yakuza to enforce judgments, a skill at which gangs appear to be more adept than the legal system.") [hereinafter West, Information]. A bengoshi interviewed in Nagoya supported settlement of litigation by compromise by noting both that: (1) it is easy for the losing defendant in litigation to hide assets; and (2) there are high costs to obtaining execution. Interview with bengoshi (A) in Nagoya, Japan (on file with author). As a consequence, it is "better for the plaintiff to get quick money." Id. The settlement may result in the plaintiff getting less money, but at least the plaintiff gets the settlement money. Id. As used throughout this article the terms bengoshi and lawyer are used interchangeably. For a discussion of the varying legal professionals in Japan, see notes 8, 21 & 76–78.

68. Kojima, supra note 15, at 687 (explaining that grave concerns about the delay and cost of litigation have diverted the Japanese people from the justice system). See also John O. Haley, Litigation in Japan: A New Look at the Problem, 10 WILLAMETTE J. OF INT'L L. & DISP. RESOL. 121, 134 (2002) (discussing the decrease in litigation time in Japan from 17.3 months in 1973 to 9.3 months in 1997 and tying such decrease in delay to the increased use of litigation in the 1970's) [hereinafter Haley, Litigation in Japan: A New Look at the Problem].

69. See Obuchi, supra note 5, at 88. See also Sato Yasunobu, Cultural Conflict in Dispute Processing Under Globalization: International Cooperation for Legal Aid, at http://www.gsid.nagoya-u.ac.jp (last visited Oct. 30, 2003). Yasunobu argues that one purpose of supporting ADR over litigation is the advancement of Japanese industry over the rights of Japanese citizens:
the Japanese judicial system have even suggested that plaintiffs’ growing reliance on “extra-legal” means of resolution, such as resort to organized crime organizations, controlled violence\(^70\) and *Sokaiya*\(^71\) have stemmed from the system’s inability, or at least the perceived inability, to obtain adequate relief for plaintiffs within a reasonably time.\(^72\) As a result, one of the Judicial Reform Council’s prime recommendations was aimed at reducing the amount of time required to resolve civil litigations.\(^73\) Thus, Japan’s civil litigation system may be seen as defendant-oriented while the U.S. civil litigation system may be seen as plaintiff-oriented.

It cannot be denied that the Japanese people prefer conciliation to litigation...even though litigation is initiated, it is not uncommon that a judge mediates for settlement in private in his/her chamber. Thus, the judiciary has long been left small and ineffective. This seems to have been part of a tacit industrial policy in order to discourage the promotion of human rights and the development of individual's legal consciousness in exchange for the rapid national economic growth measured by GNP or GDP.


71. *Sokaiya* are generally seen as corporate troublemakers who, for an extortionist price, will either remain mute themselves or will cause other shareholders to remain quiet at corporate annual meetings. Professor West defines *Sokaiya* as follows: “A *Sokaiya* (literally ‘general meeting operator’) is usually a nominal shareholder who either attempts to extort money from a company’s managers by threatening to disrupt its annual shareholders’ meeting with embarrassing or hostile questions or who works for a company’s management to suppress dissent at the meeting.” Mark D. West, *Why Shareholders Sue: The Evidence from Japan*, 30 J. of L. Stud. 351, 374 (2001) [hereinafter West, \textit{Why Shareholders Sue}]. See also Mark D. West, *The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States*, 150 U. Pa. L. Rev. 527, 564 (2001) [hereinafter West, \textit{The Puzzling Divergence of Corporate Law}].


Unlike in the U.S., where the public does not feel that the judicial system’s pro-plaintiff orientation creates a Rule of Law society issue, the people of Japan have raised such a concern with respect to the capability of their nation’s judicial system.\footnote{The public’s concern is reflected in the Diet’s recent legislative action in creating the Law Reform Council and mandating it to examine and make recommendations concerning Japan’s legal system. \textit{See} Judicial Reform Council, \textit{Points at Issue in the Judicial Reform}, \textit{at} http://www.kantei.go.jp/foreign/judiciary/0620reform.html (last visited Jan. 12, 2003). The Council noted that the Judiciary Committee of the House of Representatives in the Diet directed it to consider such questions as the judicial appointments system, quality and quantity of legal professionals, public participation in the judicial system, etc. \textit{Id.}} In response, the Judicial Reform Council (the “Council”) made recommendations for liberalizing the judicial system, to make the judicial system’s relief more readily obtainable. The Council’s proposals were grounded in the public’s general Rule of Law concerns and were designed to carry out the Council’s view that the Rule of Law should more fully infiltrate Japanese society.\footnote{See generally Recommendations of the Judicial Reform Council, supra note 19.} To this end, the Council has suggested, among other things, increasing the number of licensed \textit{bengoshi} authorized to represent parties in court by more than three times the number annually admitted at the time the Council began its work.\footnote{At the time the Council started its work, approximately 1,000 new lawyers were admitted each year. This figure was twice the previous total of only 500 newly admitted lawyers as late as the late 1980s. \textit{See} LEGAL TRAINING AND RESEARCH INSTITUTE OF JAPAN 8–9 (S. Ct. of Japan 1977). The Council recommends that 3,000 new lawyers be admitted each year beginning in 2010. \textit{See} Recommendations of the Judicial Reform Council, supra note 19, at ch. 1, pt. 3, § 2(2) (“How the Legal Profession Supporting the Justice System Should Be”). \textit{See also} Major Legal Reform Handed to Koizumi, supra note 19 (“When the current bar exam is phased out in 2010, the number of those who pass the new bar exam should reach 3,000 a year, up from the current 1,000.”). Of these lawyers, a certain number become judges and prosecutors and it has been recommended that at least some of the additional lawyers be allocated to the judges’ pool in order to increase the number of judges.} The Council also urged for the expansion of the roles of other Japanese legal professionals, such as judicial scriveners\footnote{TANAKA, THE JAPANESE LEGAL SYSTEM, supra note 8, at 563. Professor Tanaka sets forth the functions of judicial scriveners as follows:

The functions of judicial scriveners are (a) to draft documents to be filed in courts, public prosecutors’ offices or local offices of the Minis-
patent attorneys,\textsuperscript{78} in order for them to play a more active role in litigation.\textsuperscript{79} In addition, the Council recommended increasing the pool of judges so as to reduce the backlog of cases and free judges from their tight schedules to work on more recently filed cases.\textsuperscript{80} Further, the Council proposes to speed up the pace of litigation by enhancing the legal workforce’s lawyering skills by suggesting a new and hopefully better educational system with innovative teaching methods for lawyers.\textsuperscript{81} The Japanese government has already accepted these recommendations and by 2006 and 2007 the first of the new crop of newly trained bengoshi will enter the field.\textsuperscript{82} Similarly, efforts are under way to recruit practicing lawyers to become judges.\textsuperscript{83}

\textit{Id.} 78. The function of patent attorneys is “to act on behalf of other persons in matters related to patents, ‘utility models’...designs and trademarks.” Id. at 564.

79. In the case of scriveners, the Council has suggested that they be allowed to represent parties in Summary Court proceedings and that the law be amended to allow for Summary Court jurisdiction in damage actions seeking amounts which take into account economic trends. \textit{Recommendations of the Judicial Reform Council, supra} note 19, ch. III, pt. 3, § 7 & ch. II, pt. 1, § 5(3) (“Utilization of Specialists in Fields Adjoining the Law” & “Expansion of the Jurisdiction of Summary Courts & Substantial Increase in the Upper Limit on Amount in Controversy in Procedures for Small-Claims Litigation”).


81. \textit{Id.} at pt. 2.

82. In April 2004, Japan will usher in a new era of legal training with the opening of the new law schools recommended by the Law Reform Council. These schools will be graduate level schools and the first class of graduates will graduate in two years time. Under the new curriculum, graduates of a hogakubu faculty who are admitted to the new law school may graduate after a two-year class while graduates of other faculties will require three years of legal education. As a consequence the first crop of new graduates — most of whom will hopefully pass the new Bar Examination — will graduate in 2006 and the next class of three year students in 2007. \textit{See Major Legal Reform Handed to Koizumi, supra} note 19 (“To nurture high-quality lawyers, the report calls for establishment of law schools by April 2004 that require two or three years of study....Starting in 2006, when the first graduates of the new schools are expected, a new bar exam should be established...”). In November of 2003, the Ministry of Education, Culture, Sports, Science and Technology

\textit{try of Justice on behalf of other persons, and (b) to take the necessary steps relating to the registration of transfers of title to land or other transactions in a registration office...In connection with (a) above, judicial scriveners often give legal advice to laymen in the course of drafting legal documents.}
The Council’s work does not stand-alone; the New Code preceded it. One of the New Code’s main objectives is to modify the Japanese Civil Procedure so as to alleviate some of the problems that are at the core of the Rule of Law debate and ultimately, which weaken the judicial system as a means of dispute resolution. The New Code made procedural, and some have suggested substantive, changes in the method by which cases are tried and also altered many evidence-gathering procedures during the trial. By limiting the right of appeal to Japan’s Supreme Court, the New Code attempts to speed up the date of “final judgment” by making the nation’s High Court decision final, at least in most cases, which, at the same time, frees the Supreme Court to devote its time and effort to more important legal issues. As counter-currents exists to the Judicial Reform Council’s work (such as strengthening ADR to make it at least an equal partner with the Judicial system in resolving disputes and scrapping the “American Rule” on attorney’s fees in favor of licensed sixty-six new American style law schools. 66 Institutions Win Approval to Open U.S.-style Law Schools, JAPAN TIMES ONLINE, Nov. 22, 2003, available at http://www.japantimes.co.jp/cgi-bin/getarticle.pl5?nn20031122a6.htm.

83. As explained in Part III.F. of this Article, such efforts are not likely to be successful absent substantial additional changes that do not appear to be forthcoming.

84. Kojima, supra note 15, at 687–88. Professor Kojima pinpoints making civil trials understandable and the judicial system accessible as goals of the New Code:

The reasons for the adoption of the new code can be summarized in three points...Second, civil trials today have raised grave concerns over the considerable delay and high costs of litigation, and this has diverted the Japanese people from the Justice System — the so-called “departure from justice symptom” (shihobanare). Unless civil trials are made easily understandable and accessible, the social functions of the civil justice system would be seriously undermined.

Id.


a “loser pays” system), the “pro-plaintiff orientation” debate also comes out in favor of altering Japan’s Civil Procedure Code. These forces of the status quo are accommodated, at least to some extent, in the New Code through such obstacles to effective discovery as the self-use document exception to production and the failure to provide for sanctions in the new “inquiry process.”

C. The Study on Japanese Litigation

A 2001 study, about the changing Japanese legal system, concluded that the New Code’s concentrated evidence gathering procedures had a positive effect on speeding up the litigation process. The study found that statistical evidence showed that the judicial system achieved dispositions at a higher absolute number than prior to the New Code; however, since the number of cases filed has changed, the ratio of dispositions to new cases filed may not be substantially different than before. The study further found that the new “inquiries procedure” was not as helpful as originally thought would be the case.

This Article’s research purpose was to determine through interviews with Japanese bengoshi and through discussions with Japanese professors of law whether the New Code has in fact significantly improved litigation and made it a preferable tool for dispute resolution. In this regard, the present study primar-

87. Japan follows the “American Rule” on attorney’s fees. CIVIL PROCEDURE IN JAPAN REVISED, supra note 8, at § 2.04(3). The Council recommends the abolishment of the “American Rule” as a means of fostering litigation. See generally Recommendations of the Judicial Reform Council, supra note 19. Modification of the Rule to permit successful plaintiffs to obtain counsel fees while not shifting the burden of litigation costs to unsuccessful plaintiffs, would foster litigation but abolition of the rule would not. Abolition would change the risk/reward and cost/benefit analysis for a plaintiff — especially a small plaintiff that could not afford to pay a winning defendant’s council fees — and result in less litigation.
88. See infra notes 255–71 and accompanying text.
89. See infra Part IV.B.1.
90. See generally Mochizuki, supra note 14, at 286–87; see also Taniguchi, supra note 10, at 772–91.
91. See Ota, supra note 9, at 569–70.
92. MINSOH Ō, art. 182.
93. Ota, supra note 9, at 577.
94. MINSOH Ō, art. 163.
95. See generally Ota, supra note 9.
ily concentrated on new litigation rates than on disposition rates. Further, this Article’s study focused on trial practice and lawyer attitudes towards the judicial system and their advice to clients concerning litigation as a dispute resolution mechanism. For this purpose, this Article’s study utilized a detailed questionnaire to structure interviews and in some cases interview subjects answered the questionnaire in writing before their oral interview. A copy of the questionnaire follows this Article in Appendix A.

These interviews took place in various parts of Japan in order to assure that the results would not be skewed toward the major litigation centers of Tokyo and Osaka. In this regard, bengoshi were interviewed in Hiroshima, Fukuoka, Kobe, Kyoto, Nagoya, Osaka, Saitama, Sapporo, Sendai, and Tokyo. Similarly, law professors from various localities were interviewed and a High Court Judge was interviewed outside of Tokyo. Judges of the Tokyo District Court and officials of the Judicial Secretariat were interviewed in Tokyo. This Article’s study reviewed the resulting statistical data, including the Judicial Secretariat’s information, in an attempt to determine whether the New Code has had an effect on litigation rates, disposition rates and litigation in general. In addition, all interviewed bengoshi were requested to recommend one change in the nation’s civil procedure law that they felt would provide a significant solution to the present problems facing Japan’s litigation system.

The results of this Article’s study are presented below. In summary, the study concluded that while the New Code represents a major change in procedure on its face, the New Code’s actual effect in areas other than the speed of disposition proved

96. Statistical information referred to herein and all statistical information compiled in the charts set out herein come from two sources: (a) Hosoh Jiho [compilation of annual statistics] for the years involved, and (b) statistics compiled by and provided by the Japanese Supreme Court’s Secretariat. In the case of overlapping statistics, there were slight but insignificant differences. In most cases, the statistics were identical. In some situations, only one set of statistics was available, such as the Secretariat’s provisional 2002 data. Appreciation is extended to Professor M. Tanabe of Hiroshima University Faculty of Law who assisted locating and translating the Hosoh Jiho statistical data. All 2002 data reported herein is provisional. (Statistical information is on file with the Brooklyn Journal of International Law). [The Article’s use of this statistical data is hereinafter referred to as “The Japanese Court System’s Statistics.”]
disappointing. Litigation appears to be moving faster, although the trend to faster resolution was started prior to the New Code’s amendment. Many Japanese lawyers expressed the view that the present trend is not significantly different or faster than the trend prior to the New Code. However, when the average time of disposition was evaluated, it appeared that the present trend appears to be significantly different from and faster than the trend prior to the New Code’s enactment.

Nevertheless, most Japanese lawyers see the New Code as having little, if any, effect on the speed of litigation, as compared to the trend started prior to the New Code, although most agree that cases do move quicker today than prior to the New Code.97 There also appears to be agreement among Japanese lawyers that the New Code complements and carries forward the trend to faster litigation initiated prior to the New Code. The courts’ and lawyers’ attitudes toward moving litigation faster are most significant in this regard.98 Nonetheless, while it would seem that quicker resolution of litigation would lead to greater use of litigation to resolve disputes, this does not appear to be the case in Japan. This phenomenon requires explanation and further study, and this Article presents some thoughts on this issue.

Similarly, as Japanese litigation procedures improved, such as by the use of consolidated evidence gathering procedures, the expectation was that lawyers and litigants would have greater confidence in the judicial system as a Rule of Law dispute resolution mechanism. This too does not appear to be the case, even though the courts implemented consolidation procedures in more cases and at an even higher percentage in cases involving testimony by two or more witnesses. Moreover, the New Code’s procedural devices, which are designed to make it easier for parties to obtain factual information, appear to have some, but little effect on the quality of information received. In fact, most lawyers interviewed were not more inclined to recommend liti-

97. Ota, supra note 9, at 577.
98. See generally Interview notes with Japanese legal professionals (on file with the author).
Japan’s reform of its Civil Procedure Code is an ongoing process and it is anticipated that further amendments will be adopted to address issues that have come to light recently under the new procedure. Thus, in July 2003, the Japanese government adopted changes to assist the nation’s court system in dealing with complicated cases involving expertise that the judges simply do not possess, such as an in-depth understanding of medical malpractice, intellectual property, and construction engineering cases.

In addition, the Japanese government enacted changes that allowed prospective litigants to obtain information prior to the actual filing of a lawsuit. However, it remains to be seen whether the new provisions will make more evidence available to their clients today than they were prior to the New Code’s adoption.99

A lawyer in Hokkaido noted that he would be prepared to recommend litigation more frequently if he noticed a change in aid to plaintiffs, but he has not seen such a change. Interview with lawyer (K) in Hokkaido, Japan (on file with author). Another lawyer in Sapporo, who primarily represents corporate clients, noted that he would not recommend litigation more frequently and that his clients were not being sued more frequently under the New Code than under the Old Code. Interview with lawyer (C) in Sapporo, Japan (on file with author). A lawyer in Hiroshima specifically tied the self-use document production exception (MINSOHÔ, art. 220, para. 4(c–d)) to his willingness to recommend litigation, noting that he would recommend litigation more often if documents normally withheld by the defendant under this exception were produced. Interview with lawyer (M) in Hiroshima, Japan (on file with author). See MINSOHÔ, art. 220, para. 4(c–d) (defining the self-use document production exception). For a discussion of self-use documents, see infra notes 251–67. A lawyer in Sendai noted that in the past he informed clients that civil cases were decided faster, but this fact did not change his attitude and he does not recommend litigation any more frequently today than he did under the Old Code. Interview with lawyer (H) in Sendai, Japan (on file with author). A lawyer in Tokyo stated that he was not prepared to recommend litigation more frequently under the New Code because there was still no discovery and possession of evidence was necessary before the suit was filed in order to prove a case. Interview with bengoshi (S) in Tokyo, Japan (on file with author). A bengoshi in Hiroshima based his unwillingness to recommend litigation on the difficulties of executing on a successful judgment. Interview with bengoshi (V) in Hiroshima, Japan (on file with author).

99. A lawyer in Hokkaido noted that he would be prepared to recommend litigation more frequently if he noticed a change in aid to plaintiffs, but he has not seen such a change. Interview with lawyer (K) in Hokkaido, Japan (on file with author). Another lawyer in Sapporo, who primarily represents corporate clients, noted that he would not recommend litigation more frequently and that his clients were not being sued more frequently under the New Code than under the Old Code. Interview with lawyer (C) in Sapporo, Japan (on file with author). A lawyer in Hiroshima specifically tied the self-use document production exception (MINSOHÔ, art. 220, para. 4(c–d)) to his willingness to recommend litigation, noting that he would recommend litigation more often if documents normally withheld by the defendant under this exception were produced. Interview with lawyer (M) in Hiroshima, Japan (on file with author). See MINSOHÔ, art. 220, para. 4(c–d) (defining the self-use document production exception). For a discussion of self-use documents, see infra notes 251–67. A lawyer in Sendai noted that in the past he informed clients that civil cases were decided faster, but this fact did not change his attitude and he does not recommend litigation any more frequently today than he did under the Old Code. Interview with lawyer (H) in Sendai, Japan (on file with author). A lawyer in Tokyo stated that he was not prepared to recommend litigation more frequently under the New Code because there was still no discovery and possession of evidence was necessary before the suit was filed in order to prove a case. Interview with bengoshi (S) in Tokyo, Japan (on file with author). A bengoshi in Hiroshima based his unwillingness to recommend litigation on the difficulties of executing on a successful judgment. Interview with bengoshi (V) in Hiroshima, Japan (on file with author).

100. See Taniguchi, supra note 10, at 790 (noting that we need to “keep a close eye on the practices developing under the New Code and initiate necessary legislation promptly”).

101. See Trial to be Expedited, supra note 18.
or will simply change the timing of evidence gathering. This Article will discuss these recent changes. In addition to discussing the results of the research, this Article attempts to make some small suggestions as to changes that may more closely align Japan’s civil procedure with the Rule of Law society proposed by the Council’s 2001 Report.

III. JAPAN’S 1996 REFORMS IN PRACTICE

The New Code’s major reforms relate to procedures geared to speed up the pace of litigation and procedures to make evidence more freely available to parties. In a sense, the two ideas run together in the hope that providing evidence earlier in the process can have an effect on the speed of the litigation process overall. Thus, providing evidence at the earliest stages of issue identification may serve to resolve issues or at least shorten a trial’s duration. In addition to evidence changes, the New Code’s major structural reforms were: (1) to add a new semi-public procedure through which the parties and their counsel could, at an early stage, both define the issues and facts relating to those issues and discuss settlement, all outside the glare of a public proceeding; and (2) to consolidate evidence gathering at the trial stage.

In Japan, unlike in the U.S., trials do not take place on a daily basis with witnesses appearing one after the other until all evidence has been presented to the trier of fact. U.S. courts designed such trial practices to meet the needs of its citi-
zen jurors. Jurors, who having taken time out of their daily lives to perform their civic duty, need to get back to their daily lives as quickly as possible. For this reason, the U.S. court system cannot expect its citizen jurors to remember testimony heard weeks before they are called on to make their decision. The existence of a jury trial right in all cases at common law in which the matter in dispute exceeds twenty dollars requires a procedure that condenses the time for trial to as small a capsule of time as is possible. To achieve this goal, American lawyers — who in the U.S. are in charge of a case's investigation stage and also play a major role in the trial stage — must be well prepared. U.S. attorneys also have to prepare their witnesses in advance in order for testimony to go quickly and succinctly at trial. U.S. pre-trial procedure involves extensive discovery and taking the testimony of witnesses and potential witnesses outside of court and before trial, all of which serve to prepare the lawyers, parties and witnesses for the trial. By avoiding surprise, the U.S. pre-trial discovery procedures also serve to shorten the length of the trial, which in turn serves the time concerns of citizen jurors. Thus, while U.S. trials are relatively quick affairs, pre-trial procedures may take several years.


108. U.S. Const. amend. VII (“In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any court of the United States, than according to the rules of the common law.”).


112. See Wagnild, supra note 110, at 17. Prior to World War II, Japan experimented with a form of jury trial in criminal cases. Oda, supra note 1, at 66–68. This system permitted a defendant, in certain categories of cases, to ask for a jury trial. Id. at 77–79. However, the determination of the jury was not binding on the court, and if the court disagreed with the jury, it would order a new trial. Id. On the other hand, if the judge supported the jury verdict, the defendant would lose the right to appeal the verdict. Id. Not surpris-
In civil law countries, such as Japan, a right to a trial by jury does not exist.\textsuperscript{113} As a consequence, a professional judge (or panel of judges) try cases on a full time occupational basis.\textsuperscript{114} Such a judge may be expected to keep detailed records of proceedings and to refer to those records when working on a case.\textsuperscript{115} For this reason, there is no need to have as compact a trial as in the U.S.; the “trial” in Japan consists of the proceedings before the court that occur after the filing and serving of the complaint.\textsuperscript{116} Under Japanese law, the trial is a public event and all trial proceedings are held in open court.\textsuperscript{117} While open court may serve a significant public interest in allowing the public to see how the court system operates,\textsuperscript{118} open court is not the best

\textsuperscript{113} Id. The Judicial Reform Council has suggested a form of lay participation in major crime cases in Japan, although it has rejected the U.S. style jury. \textit{Recommendations of the Judicial Reform Council}, supra note 19. The likelihood is that Japan will experiment with a more German form of lay participation in some major criminal cases in the future. \textit{See also Major Legal Reform Handed to Koizumi}, supra note 19 (“The report recommends the introduction of jurors in serious criminal trials. They would be randomly selected from registered voters to serve throughout a case and to consult with judges before handing out a verdict and sentence.”). A recent proposal calls for a panel of three professionals and six lay judges in cases where the death penalty or life imprisonment may be implicated. Hiroshi Matsubara, \textit{Citizen Judge System Close to Reality}, JAPAN TIMES ONLINE, available at http://www.apantimes.co.jp/cgi-bin/getarticle.pl?nn20040129b2.htm (last visited Feb. 11, 2004).

\textsuperscript{114} \textit{See} Taniguchi, supra note 10, at 769–70.

\textsuperscript{115} Id.

\textsuperscript{116} The trial stage is also referred to as the “Plenary” or “Oral” Hearing.

\textsuperscript{117} \textit{KENPO}, art. 82. The Japanese Constitution in Article 82 states:

\begin{quote}
Trials shall be conducted and judgment declared publicly...Where a court unanimously determines publicity to be dangerous to public order or morals, a trial may be conducted privately, but trials of political offenses, offenses involving the press or cases wherein the rights of people as guaranteed in Chapter III of this Constitution are in question shall always be conducted publicly.
\end{quote}

\textit{Id}.

\textsuperscript{118} In the U.S., one of the functions of the jury trial is to educate the public as to how the justice system operates by making the public a part of the actual operation of the system through service on the jury. \textit{Akhil Reed Amar & Alan Hirsh, For the People: What the Constitution Really Says About Your Rights} 54 (1998). This same function is part of the reason for suggestions for more lay participation in criminal judicial proceedings in Japan. \textit{See}
place for discussions of procedural nuances and settlement conferences. The New Code seeks to avoid this problem by institutionalizing a new procedural device called the “Preparatory Proceeding for Oral Argument,”119 where the court, parties, and invited persons with an interest in the matter can meet outside the public glare and discuss both the issues and the potential settlement of the case.120 This procedural device was not actually created by the New Code but had been used on an experimental basis in some courts prior to adoption of the New Code.121 However, the New Code does provide a lawful basis for this procedure.122 In practice, the Japanese pre-trial procedure appears to work as follows: first, the plaintiff files its case in court; second, the court conducts a first public Preliminary Oral Hearing;123 and, third, the court follows up this Preliminary Oral Hearing with a more informal proceeding to try to better define the issues and the evidence necessary to resolve the issues in the case.124


120. See MINSOHŌ, arts. 168–74 (setting out the procedures for the “Preparatory Proceeding” for oral argument).
121. Miki, supra note 85, at 4–5. A Preparatory Procedure prior to the formal trial was common in pre World War II civil procedure. See Kohji Tanabe, The Processes of Litigation: An Experiment with the Adversary System, in TANAKA, THE JAPANESE LEGAL SYSTEM, supra note 8, at 507 (“under the prewar code, after an action was commenced by filing a complaint, the judge either conducted ‘preparatory procedure’…usually of several hearings, or one or several sessions of ‘formal oral proceedings’…preliminary in nature. In these, he attempted to fix the issues of fact and law…..”).
122. See Ota, supra note 9, at 570. Professor Ota notes:

As a way to legally authorize the new procedure, the New Code introduced the “oral argument preparation procedure” and abolished the preparation proceeding. The oral argument procedure is open to people with interests. The Benron-ken-Wakai was basically a settlement procedure with a color of oral argument, while the new oral argument preparation procedure is structured as a preparation procedure with a color of oral argument. Under this scheme, the most important factor (settlement negotiation) retreats behind a facade.

Id.
123. MINSOHŌ, arts. 164–67.
These informal or Preparatory Proceedings for Oral Argument may be held in an informal setting with a roundtable at which all participants are at the same level. Counsel from a distant location may appear by telephone and in some cases may even appear by video. At these proceedings, the court may suggest, after hearing the views and concerns of the counsel for the parties, the production of documents or the response to inquiries, and will attempt to expedite the case by narrowing the issues to be tried and the witnesses and documents necessary for trial. At some point, settlement discussions may be broached. The end result of such informal sessions (if settlement is not achieved) will be a kind of pre-trial order prepared by the court, which provides a road map for the trial itself. Unlike U.S. pre-trial orders, the Japanese roadmap does not have any preclusive effect and the parties may attempt (and probably would be successful in such attempt) to introduce new or different issues and facts at the actual trial or Oral Proceeding.

Prior to the preparation of such an order, a Japanese

125. Even in a “closed” (non-public) proceeding, the court may permit parties, persons invited by parties, or others to attend these closed sessions. Miki, supra note 85, at 5.
126. Interview with Judicial Secretariat at the Supreme Court of Japan (on file with author). The Supreme Court of Japan Judicial Secretariat (the branch of the Court responsible for administration of the Justice System) has openly accepted new technology. The Court has also worked hard to introduce such technology into judicial proceedings both to speed up the process of litigation and to enable litigants and bengoshi located far from the courthouse to participate without undue cost in both time and money. A lawyer in Sapporo noted that as a result of the use of telephone and video meetings facilities, he did not have to make the long trip to Tokyo to handle many matters that did not require a personal appearance in the court. Interview with lawyer (C) in Sapporo, Hokkaido (on file with author).
128. Miki, supra note 85, at 6. Article 173 of the Japanese Code of Civil Procedure requires that the parties state the results of the preparatory proceedings in oral argument. MINSOH, art. 173. Oral argument is a public proceeding and hence the results must be stated in a public proceeding. Id.
129. Under Article 157 of the Japanese Code of Civil Procedure, the court has (and had) the power to preclude a party from introducing evidence and arguments not addressed at the proper time. MINSOH, art. 157. Under Article 167, a party wishing to introduce facts or arguments not disclosed at the preparatory proceeding must advise the other party of the reason that such facts or arguments were not originally disclosed. MINSOH, art. 167. Due to the paternalistic attitude of Japanese judges and the view that the appropri-
court may attempt to bring about a settlement of the case as part of the informal discussion.\textsuperscript{130} If settlement is not achieved during the Preparatory Proceeding for Oral Argument stage, the court will announce, in open court, the results of the procedural issues (the defining and limiting of evidence), thus preserving the fiction of public hearings.\textsuperscript{131}

After such informal procedures and the “pre-trial” order, the formal procedures called the “Oral Hearings” begin.\textsuperscript{132} These formal procedures involve the receipt of evidence, and if the court deems necessary, the taking of testimony as well.\textsuperscript{133} In complicated cases involving two or more witnesses, the court will typically utilize the new “consolidated” hearing method in which testimony is consolidated so that the examination and cross-examination of a single witness is completed on the same day and in which all witnesses are heard on the same day or within a short time of each other.\textsuperscript{134} This procedure is substantially different from the old Japanese court procedure where witness testimony — even the testimony of a single witness — could be spaced over months and even years.\textsuperscript{135} To aid parties and attorneys located far from the courthouse, Japanese courts may now utilize video systems to take oral testimony; such a
system is even connected to medical facilities in order to enable those who are ill to testify.\textsuperscript{136}

At the conclusion of the Oral Proceedings (the trial’s conclusion) the court announces the date when it will issue its decision.\textsuperscript{137} Japanese courts issue these decisions in public, open-court proceedings. Prior to preparing and issuing the final decision, the court may advise the parties of its imminent holding in an effort to obtain a settlement.\textsuperscript{138}

\textbf{A. The Pace of Dispositions}

As one of the primary aims of the New Code was to speed up the civil litigation process, the first issue considered in the study underlying this Article was the speed with which civil litigation was handled after enactment of the New Code.

1. The Japanese District Courts\textsuperscript{139}

The average time of litigation from filing to resolution at the District Court level has declined. This speedier pace appears,

\begin{itemize}
\item \textsuperscript{136} Interview with officials of the Judicial Secretariat in Tokyo, Japan (on file with author).
\item \textsuperscript{137} Kojima, \textit{supra} note 15, at 699.
\item \textsuperscript{138} Advantages exist for everyone in a pre-decision settlement. From the plaintiff’s perspective, a settlement in which the plaintiff gets monetary damages may warrant a “discount” from the anticipated judgment, rather than having to face appeal and the problems of execution. From the defendant’s perspective, a sufficient discount may make it worthwhile to settle and not continue proceedings. From the court’s perspective, settlement means that the judge does not have to write an opinion, thus saving time and obviating the need to make a win-lose decision. Moreover, by obviating appeal and execution proceedings, settlement frees up valuable judicial time and relieves a burden from an already overloaded judicial system. Some of the lawyers interviewed expressed opinions regarding the judicial system’s inclination towards settlements. A lawyer in Tokyo commented that judges strongly advocate for settlements because the parties’ burdens of litigation are great, and if there is a compromise, judges do not have to write an opinion (even at the appeal stage). Interview with lawyer (S) in Tokyo, Japan (on file with author). Additionally, a lawyer in Nagoya stated that settlements save judicial time at both the District Court and High Court level — an important factor since judges have no clerks and must write opinions themselves. Interview with lawyer (A) in Nagoya, Japan (on file with author).
\item \textsuperscript{139} This section discusses cases filed at the District Court as a first level court. The District Court also acts as an appellate court for cases started in the Summary Court.
\end{itemize}
at least in part, to have been achieved through the adoption of and utilization of the procedures contained in the New Code. 140
In this regard, practitioners were asked: “Have the new preliminary procedure provisions speeded up the pace of litigation?” Although the majority of bengoshi interviewees were of the view that litigation moved faster under the New Code than had been the case prior to amendment, most bengoshi accredited the accelerated pace of litigation to the legal community’s change in attitude rather than to changes brought forth by the New Code itself. 141 These interviewees specifically noted that the pace of litigation had already been speeded up prior to the New Code’s adoption. The statistical data discussed infra, though, supports the view that the New Code’s procedures are responsible, at least in part, for the accelerated pace of decisions, although the attitude of judges and lawyers, for example, clearly does have some impact on the quickened pace of litigation.

The accelerated pace of litigation does not, however, appear to have had a positive effect on the use of litigation as a dispute resolution mechanism — at least at the District Court level. 142

140. Miki, supra note 85, at 16–17. Professor Miki concludes that the New Code has been successful in speeding up the pace of civil litigation.

The average length of civil litigation cases has shortened over the past decade and currently almost 90% of civil cases at first instance are concluded within two years, by either judgment or settlement. This must be a result of not a few judges and attorneys pushing themselves to improve their traditional way of practice. While, as already mentioned, the embryonic movement of this change had started before the reform of the Code of Civil Procedure, the New Code has provided the movement with a firm foundation. In this aspect, the 1996 reform has proven successful.

Id.

141. See, e.g., Interview with lawyer (H) in Sendai City, Japan (on file with author). The interview subject noted that long before the change in the New Code, the Court and the Bar made efforts to accelerate the pace of litigation and that such efforts had been very effective. Id. Note that while crediting the Code reform with placing the speedier procedures on a “firm foundation,” Professor Miki also credits the attitude of judges and lawyers for the speedier resolution of civil cases. Miki, supra note 85.

142. This Article concerns itself only with District Court litigation since Summary Courts limit damages available to 1,200,000 yen — and this sum is a new increase from the prior 900,000 yen limit. Recommendations of the Judicial Reform Council, supra note 19, ch. II, pt. 1, § 5(3). Statistical evi-
Thus, most (but not all) lawyers interviewed indicated that they were not suggesting litigation to clients at any higher rate than had been the case prior to the New Code’s adoption. Statistical evidence supports the view that the New Code has not resulted in litigation being adopted more frequently to resolve disputes than was previously the case. An analysis of statistical data shows that the number of new “ordinary civil cases” filed since the New Code came into effect is not significantly greater than the number of such cases filed prior to the New Code’s applicability. The data on the number of ordinary civil cases from 1996 to 2002 exhibits the following increase:

\[
\text{143.} \quad \text{The data shown herein is not consistent with the data used in Professor Ota’s paper. See Ota, supra note 9, at 580. Professor Ota’s data appears to show a dramatic increase in new cases between 1997 and 1998 and a continuation of this new higher rate of filings after 1998. See id. However, Professor Ota’s data includes appeals filed in the District Court under a new procedure and under new data reporting procedures adopted in 1998. When these cases — which do not represent new litigation filed but rather are appeals of cases previously filed in the District Court — are factored out, the data is consistent. The data is not exact since Professor Ota’s study includes filings of new administrative cases and certain other cases such as expedited bills and notes cases, whereas the data herein deals solely with ordinary civil cases. The data reported herein is consistent with data contained in Judge Michiharu Hayashi’s work. J. Michiharu Hayashi, Actual Situations and Problems After the New Code of Civil Procedure was Enacted in 1998, 181 MINJIHO JOHO 2–13 (2001). See also The Japanese Court System’s Statistics, supra note 96.}
\]
Cases From 1996-2002

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of New Cases Filed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>142,959</td>
</tr>
<tr>
<td>1997</td>
<td>146,588</td>
</tr>
<tr>
<td>1998</td>
<td>152,678</td>
</tr>
<tr>
<td>1999</td>
<td>150,952</td>
</tr>
<tr>
<td>2000</td>
<td>156,850</td>
</tr>
<tr>
<td>2001</td>
<td>155,541</td>
</tr>
<tr>
<td>2002</td>
<td>153,960 (provisional date)</td>
</tr>
</tbody>
</table>

The data makes clear that the courts are disposing of cases at a faster rate than before the New Code, reducing the court backlog; however, this reduction is at least partly due to the fact that new cases are not being filed at an accelerated pace to match the speed of dispositions. The data indicates that such a distinction does exist:

144. The data cannot be explained away by the suggestion that raising the jurisdictional limit for Summary Court cases has taken away cases from the District Court and placed them in Summary Court. For example, the total number of newly filed cases in Summary Court and District Court in 1998 was 468,157; in 1999, 473,669; in 2000, 466,264; and in 2001, 475,000. These statistics indicate a small increase of only 6,500 cases from 1998 through 2001 and an increase of less than 2,000 cases from 1999 through 2001. See The Japanese Court System's Statistics, supra note 96. Yet, in this period, the new “small claims” one-day trial procedure was adopted. See Ota, supra note 9, at 570–71. This procedure should have resulted in cases that would never have reached the judicial system being filed in Summary Court and, thus, could well account for the slight increase noted. In fact, the number of small claim cases has been steadily on the rise, this is one of the great successes of the New Code. Thus, the number of small claims cases beginning in 1998 when introduced is as follows: 1998: 8,348; 1999: 10,027; 2000: 11,128; 2001: 13,504. See The Japanese Court System's Statistics, supra note 96. If these cases are factored out of the total remaining cases filed in the District Court and Summary Court together, the statistics indicate an increase from 459,809 in 1998 to 462,119 in 2001, or an increase of only .5%. Id.

Moreover, since the New Code’s adoption, the average speed at which cases are disposed of by the District Court has accelerated at a pace much faster than was true before the New Code. The Judicial Secretariat’s\footnote{The General Secretariat of the Supreme Court is the internal department of the court system for judicial administration. \textit{See} Court System of Japan, \textit{An Overview of the Judicial System: The Supreme Court}, at http://www.courts.go.jp/english/soshikie_2.html (last visited Nov. 15, 2003). \textit{See also} The Japanese Court System’s Statistics, supra note 96.} data shows:

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|}
\hline
Year & Completed District Court Cases & Pending District Court Cases \\
\hline
1996 & 145,858 & 110,396 \\
1997 & 147,373 & 109,611 \\
1998 & 156,683 & 105,606 \\
1999 & 154,395 & 102,163 \\
2000 & 158,781 & 100,232 \\
2001 & 157,451 & 98,322 \\
2002 & 155,755 (provisional data) & Unavailable \\
\hline
\end{tabular}
\end{table}

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|}
\hline
Year & All Cases Filed & Cases Involving Testimony of Two or More Witnesses \\
\hline
1992 & 10.9 & 21.8 \\
1993 & 10.1 & 21.2 \\
1994 & 9.8 & 20.9 \\
1995 & 10.1 & 21.1 \\
1996 & 10.2 & 21.3 \\
1997 & 10.0 & 20.8 \\
1998 & 9.3 & 20.8 \\
1999 & 9.2 & 20.5 \\
2000 & 8.8 & 19.7 \\
2001 & 8.5 & 19.2 \\
\hline
\end{tabular}
\end{table}

As the New Code came into effect in 1998, the comparison of pre-1998 rates and post-1998 dispositions is appropriate. Assuming that 1994’s reduction is an aberration and utilizing the
1993 and 1995 data (almost identical and bracketing the 1994 data), it would seem that in the four years prior to the New Code “all cases” proceeded at a relatively stable rate of decline of about .1 per month or experienced virtually no change from 1993 to the end of 1997. However, from 1998 through 2001, the rate of dispositions dramatically accelerated so that a full month and a half decrease had been achieved. For more complicated cases the decline in the four years prior to the New Code was approximately .4 of a month (again excluding 1994 as aberrational and using 1993 figures — if 1994 were used the decline was only .1 month) while in the four years after adoption the decline was from 20.8 months in 1997 to 19.2 months at the end of 2001 or a decline of 1.6 months.

The actual figures are even more dramatic than the data’s sharp decline because for all cases the figures include default cases where the rate of decline cannot be significantly changed, thus providing a stable base of about two months for many cases. Moreover, there is surely a minimum amount of time required to handle any case, which also applies to complicated cases that expectedly take longer than relatively easy cases. As the litigation time decreases, further time limitations become more difficult to implement given that the judicial system still needs to provide litigants with procedural justice and adequate trial of the facts.

These statistics squarely contradict the expressed feelings of bengoshi that the disposition rate under the New Code is similar to the rate before the amendments.\textsuperscript{147} Therefore, it is reasonable to conclude that the New Code is at least partially responsible for the accelerated rate of dispositions. Moreover, a

\textsuperscript{147} The data set out above shows that the disposition rate post-1998 is much greater than the disposition rate pre-1998. The figure of 9.3 months in the table above for 1998 corresponds to Professor Haley’s use of 9.3 months for 1997. See Haley, Litigation in Japan: A New Look at the Problem, supra note 68, at 134. The one-year difference may be accounted for by the date of the publication involved or by having statistics reported one year after the actual facts. In any event, although Professor Haley notes a correlation between reducing the time of litigation and an increase in litigation in the 1970s, his 2002 article does not deal with the rate of litigation since the passage of the New Code. See id. Professor Haley’s article does confirm that there is a perception in Japan that the judicial process takes too long. See id. at 127 (“Of those polled, the primary reason for hesitating to bring suit were belief that a lawsuit would take too much time (72%) and be too expensive (67.2%)”).
broader statistical analysis shows that while in the 1970s the pace of civil litigation in Japan could be considered to proceed at a “snail’s pace”\(^{148}\) (with over 15,000 cases in 1970 pending for more than 3 years and over 16,000 cases pending for over three years in 1979), the same cannot be said today. By the end of 1998, the number of cases pending for more than three years had declined to 7,614, but by the end of 2001 the number was down to 4,853.\(^{149}\)

The problem with utilizing the average time to dispose of a case as a measuring device is that averages are indeed averages. To an individual litigant the important data is how long the individual’s case actually took to be resolved. And here, practicing lawyers who most aggressively litigated their cases to judgment take as long today as before the New Code.\(^{150}\) The analysis of the time taken in resolving cases by judgment bears the following data:\(^{151}\)

### Percentage of Judgment Cases Decided in One and Two Years

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage of Cases Decided After One Year</th>
<th>Percentage of Cases Decided After Two Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>15.1</td>
<td>13.1</td>
</tr>
<tr>
<td>1997</td>
<td>15.0</td>
<td>13.4</td>
</tr>
<tr>
<td>1998</td>
<td>14.2</td>
<td>12.8</td>
</tr>
<tr>
<td>1999</td>
<td>14.4</td>
<td>13.3</td>
</tr>
<tr>
<td>2000</td>
<td>14.4</td>
<td>14.0</td>
</tr>
<tr>
<td>2001</td>
<td>14.8</td>
<td>14.7</td>
</tr>
<tr>
<td>2002</td>
<td>15.4</td>
<td>14.7</td>
</tr>
</tbody>
</table>


149. In the period from early 1994 to the end of 1997, the number of cases pending for three years or more declined from 10,074 to 8,798, a decrease of 1,276 cases. By the end of 2001, the number had declined to 4,853, a decrease of an additional 3,945 cases, triple the earlier rate of decline. It is reasonable to believe that the intervening event — the effective date of the New Code — had some effect on this accelerated pace of backlog disposition.

150. As the study’s results show, this observation especially holds true at least at the District Court level.

Thus, the percentage of litigated cases disposed of by judgment that took either one year or two years to be resolved actually increased in 2002. Nevertheless, the disposal of litigation brought to judgment in one or two years is hardly a “snail’s pace,” and may be viewed as quite fast, especially if complicated cases are involved.

2. Appeals In Japan — The High Court and Supreme Court

Appeals from District Court dispositions (when acting as a court of first instance) may be taken to the High Court. From a time perspective, a plaintiff’s main concern, when seeking relief, is when their case, in its entirety, will be completed — not simply when the court of first instance will complete its consideration of the case. Thus, it is relevant to consider the pace of litigation at the appellate level under the New Code. This is especially relevant for Japan because, unlike in the U.S. where appeals are taken “on the record” of the lower court’s or trial court’s proceedings, in Japan it is possible to introduce new evidence and even new theories in the High Court. One purpose of the New Code was to limit the use of the High Court procedure as simply an extension of the trial, and indeed not just as an extension but practically a new trial with new issues and new witnesses. Thus, part of the function of the District Court’s new preliminary procedure was to finally determine the issues in a matter, rather than leave the relevant issues open at both the trial and appeals level. The statistical evidence supports the view that, in at least this regard, the New Code has had a great deal of success — not in eliminating all the de novo trial aspects of appeal but in substantially reducing the use of the High Court as a new trial court. The following data shows

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152. See MINSOH, art. 281.
153. See, e.g., Ota, supra note 9, at 571 (discussing the use of a special procedure in order to resolve minor issues in one day).
154. Under Article 297 of the Japanese Civil Procedure Code, the provisions of Chapters one through six of the Code (governing such things as introduction of evidence, trial, oral argument proceedings, etc.) are applicable to appeals. MINSOH, art. 297.
155. See Ota, supra note 9, at 572.
156. To carry out this function, Article 298 of the Japanese Civil Procedure Code specifically makes Article 167 applicable to appeals. MINSOH, art. 298.
the steady decline of *de novo* matters on appeal in Japanese courts.\(^{157}\)

**Percentage of Cases Where the High Court Received New Evidence in Normal Civil Cases on Appeal\(^ {158}\)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Third Person Witness</th>
<th>Party Witness</th>
<th>Court Expert</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>19.0</td>
<td>18.0</td>
<td>1.4</td>
<td>0.6</td>
</tr>
<tr>
<td>1997</td>
<td>16.3</td>
<td>15.8</td>
<td>1.4</td>
<td>0.4</td>
</tr>
<tr>
<td>1998</td>
<td>15.4</td>
<td>14.9</td>
<td>1.4</td>
<td>0.4</td>
</tr>
<tr>
<td>1999</td>
<td>13.8</td>
<td>12.6</td>
<td>1.3</td>
<td>0.3</td>
</tr>
<tr>
<td>2000</td>
<td>11.4</td>
<td>9.7</td>
<td>1.2</td>
<td>0.3</td>
</tr>
<tr>
<td>2001</td>
<td>10.0</td>
<td>9.7</td>
<td>0.9</td>
<td>0.2</td>
</tr>
</tbody>
</table>

**Percentage of Cases Where the High Court Received New Evidence in Administrative Cases**

<table>
<thead>
<tr>
<th>Year</th>
<th>Third Person Witness</th>
<th>Party Witness</th>
<th>Court Expert</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>19.4</td>
<td>10.1</td>
<td>—</td>
<td>0.9</td>
</tr>
<tr>
<td>1997</td>
<td>25.5</td>
<td>10.6</td>
<td>0.2</td>
<td>0.5</td>
</tr>
<tr>
<td>1998</td>
<td>16.1</td>
<td>7.2</td>
<td>—</td>
<td>2.0</td>
</tr>
<tr>
<td>1999</td>
<td>15.6</td>
<td>5.1</td>
<td>0.4</td>
<td>—</td>
</tr>
<tr>
<td>2000</td>
<td>10.0</td>
<td>3.6</td>
<td>0.4</td>
<td>0.1</td>
</tr>
<tr>
<td>2001</td>
<td>13.7</td>
<td>3.2</td>
<td>0.5</td>
<td>0.5</td>
</tr>
</tbody>
</table>

In addition, the time taken to handle appeals at the High Court level has also declined.\(^ {159}\)

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158. A similar pattern exists where the District Court sits as an Appellate Court for Summary Court cases. Here, the witnesses (both party and third persons) per one hundred cases at the District Court and appeal level are as follows: (1996:37); (1997:34.5); (1998:27.4); (1999:26.9); (2000:26.1); and (2001:20.2). See The Japanese Court System’s Statistics, *supra* note 96.
Of course, litigants do not appeal all cases to the High Court. Nevertheless, the virtuous potential plaintiff can realistically expect, on average, that their case will be decided on average in 16.4 months (using 2001 figures) from filing with the District Court even if the case is appealed. This time frame is far more satisfying than the average 19.9 months prior to the New Code’s applicability.

However, as in the case of judgments in the District Court, the problem with averages remains. Thus, it is worthwhile to explore the percentage of judgment cases taking one or two or even three years to resolve after appeal has been filed. In such circumstances, although a litigant may find the percentages comforting, the absolute numbers remain relatively high — this difference is accounted for by the increased number of High Court appeals filed in 2002, for example, in comparison to 1997, the last pre-New Code year. The statistics expose this distinction:¹⁶⁰

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¹⁶⁰. See id.
Judgment Cases Appealed to High Court
Number and Percentage of Cases Resolved in One, Two and Three Years

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Cases Appealed</th>
<th>One Year (Number/Percent)</th>
<th>Two Years (Number/Percent)</th>
<th>Three Years (Number/Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>8259</td>
<td>3402/41.2</td>
<td>1764/21.4</td>
<td>304/3.7</td>
</tr>
<tr>
<td>1997</td>
<td>8588</td>
<td>3554/41.4</td>
<td>1743/20.3</td>
<td>344/4.0</td>
</tr>
<tr>
<td>1998</td>
<td>9024</td>
<td>3531/39.1</td>
<td>1784/19.7</td>
<td>412/4.6</td>
</tr>
<tr>
<td>1999</td>
<td>9376</td>
<td>3338/35.6</td>
<td>1388/14.8</td>
<td>348/3.7</td>
</tr>
<tr>
<td>2000</td>
<td>9812</td>
<td>3114/31.7</td>
<td>1357/13.8</td>
<td>314/3.2</td>
</tr>
<tr>
<td>2001</td>
<td>9724</td>
<td>2955/30.4</td>
<td>1157/11.9</td>
<td>259/2.7</td>
</tr>
<tr>
<td>2002</td>
<td>9817</td>
<td>2973/30.3</td>
<td>1043/10.6</td>
<td>181/1.8</td>
</tr>
</tbody>
</table>

Thus, it appears that while the average case may be resolved in only 16.4 months through appeal, cases litigated to judgment and then appealed may take significantly longer. However, the High Court has apparently significantly reduced appeal time in judgment cases from the pre-New Code percentages to the 2002 projected percentages. Of course, as the number of appeals continue to rise — from a pre-New Code total of 8588 cases appealed to a 2002 total of 9817 appeals filed — so too will the number of cases taking longer to resolve.

As asserted previously, averages may not tell the entire story. For the potential litigant the “worst case” scenario may have greater impact than the average. Since cases that take longer on appeal are likely to be the more difficult cases which may take longer at the District Court level, it is possible that such cases distort the potential average litigant’s view of the litigation process’ duration in general. Accordingly data was sought as to how long it actually took for cases to work themselves from filing to judgment in the High Court. Apparently such data is not currently available. It is suggested that in the future such data should be compiled so that a more meaningful analysis than the simple average can be made as to how long it actually takes for cases to go to judgment — at least in complicated cases that are appealed. This Article will also discuss
other issues surrounding complicated cases. For now, it is sufficient to note that a legal system that is perceived to be incapable of rendering timely relief in complicated cases is not likely to be seen as supporting a strong Rule of Law system even if the average time to resolve cases is quite reasonable or even low.

Working backwards from the High Court’s 2002 provisional data, the public’s scrutiny of these litigation issues comes to light. In 2002, the High Court decided 1043 cases that had been pending in the court for two years. Accordingly, these cases had been decided in the District Court in the year 2000. In that year, the District Court decided by judgment 1,679 cases that had been pending for four years and an additional 1,600 cases that had been pending for five years or more. If all 1043 appeal cases had been pending in the District Court for four or five years (a distinct possibility since the longer the case pended in the District Court, the longer its appeal would likely take), then all 1043 cases had been pending for six or seven years. Moreover, it is highly unlikely that any of the above mentioned 1043 High Court appeals cases decided in 2002 were decided by the District Court in less time than they were pending on appeal. Yet in 2000, of the 80,542 judgment cases decided, 61,454 were decided in one year or less and approximately 70,000 of the judgment cases were decided in two years or less. Of the cases decided in the District Court that took more than two years and were then appealed, it is clear that the average numbers distort the picture of how long it took to decide these cases.

Perception of how long it takes to resolve a case affects the public ideas as to whether the judicial system is a reasonable place to bring legal disputes. The public press, of course, influences public perception. The press, in turn, typically does

161. See infra Part III.E.
162. Ota, supra note 9, at 565 (noting that public frustration with the justice system leads some to use disreputable alternatives, such as yakuza (organized crime) or sokaiya (extortion), to resolve disputes). See id. See also Docs Who Removed Wombs from Healthy Women Lose Appeal, MAINICHI DAILY NEWS, May 29, 2003 (noting that the appeal filed by several doctors in a suit initiated in 1980s by several women who had their uterus and ovaries removed in a medical scam to overcharge the national medical insurance program was denied and the doctors were ordered to pay 510 million yen in damages), available at http://mdn.mainichi.co.jp/news/archive/200305/29/index.html.
not report on “average” cases. Rather, reported cases tend to be either more complicated or cases that are perceived to be noteworthy.\(^{163}\) It is precisely these cases that are likely to take longer at both the District and High Court levels. These high profile cases do, in fact, move at a “snail’s pace” in many instances.\(^{164}\) Moreover, the press rarely distinguishes between

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164. At the time this Article’s underlying research was conducted in Japan, the Japan Times reported that the Tokyo Police had lost (at the District Court level) a significant HIV employment discrimination case. Tokyo Loses Lawsuit Over Illegal HIV Test, JAPAN TIMES ONLINE, May 30, 2003, available at http://www.japantimes.com/cgi-bin/getarticle.pl15?nn20030530a8.htm. The Japan Times reported that the unlawful act (as found by the Court) — compelling the HIV applicant to withdraw his application for employment — occurred in July 1998, almost five years before the decision. Id. The article reported that the police intend to appeal. Id. If an appeal is filed, it is unlikely that a decision will be rendered earlier than six or seven years from the filing of the case. Whether an appeal to the Supreme Court would be taken remains to be seen. From a U.S. legal perspective, the case appears (at least from the news report) to be uncomplicated. The fact issues are relatively simple — did the authorities perform an HIV test and did they then compel the plaintiff to withdraw his application for employment upon discovering he was HIV positive? In fact, soon after the decision, the Metropolitan Police announced that they would postpone a previously scheduled weekend of HIV tests for new recruits. MPD Agree to Ditch HIV Tests for Recruits, MAINICHI DAILY NEWS, June 6, 2003, available at http://www12.mainichi.co.jp/news/mdn/search-news/892127/HIV20tests-0-2.html. Thus, it appears that there was no serious factual question as to whether the test was performed. Id. The legal question, while interesting and perhaps even novel, is not “difficult” in the sense that it does not require a great deal of time for research and debate, etc. Similarly, just two days later, the Japan Times reported that the Osaka High Court had reversed a District Court decision in a case seeking damages for a vessel sinking in 1945, which contained South Korean laborers who were returning to Korea after the war. South Koreans Appeal Ship Case, JAPAN TIMES ONLINE, June 14, 2003, available at http://japantimes.com/cgi-bin/getarticle.pl5?n20030614a9.htm. The case had been pending in the District Court for nine years and the appeal was pending for almost two years, totaling eleven years. Id. Almost half of the plaintiffs died while the case was pending, and the matter is not yet resolved as the plaintiffs have appealed to the Supreme Court which will likely take additional years during which additional plaintiffs will likely pass away. Id. The likelihood is that these cases reported in the English language press were also extensively reported on in the Japanese language press.
Many high profile criminal cases truly move at a “snail’s pace” — such as the Sarin poisoning cases. When the media lumps criminal cases with civil cases and the high profile civil cases move slowly, the public perception is likely to be that the resolution of all civil cases linger in the court system as well.

In any event, the question must be asked why any appeal at the High Court takes two or more years to be resolved. Since, the District Court has tried all of these cases on appeal already, ...
and the Japanese legislature specifically designed the New Code in part to assure that all issues would be identified in these trials’ early stages, there should be nothing to “try” at the High Court level. Therefore, the High Court cases should theoretically resolve cases in a shorter time frame. However, the fact that over 1,000 cases in 2002 took two years or more for a High Court decision indicates that the New Code’s reforms may not yet be been fully realized at the High Court level.

Because the New Code reduced the types of cases that can be appealed to the Supreme Court, it was hoped that most cases would end at the High Court level. Although the Supreme Court appears to be controlling its certiorari docket by denying certiorari in most cases filed, the fact remains that cases filed in the Supreme Court have been rising since adoption of the New Code. Unlike the U.S. Supreme Court’s narrow and limited caseload, Japan’s Supreme Court appears to be accepting more certiorari cases each year. The available statistics show that the total number of cases in which certiorari, appeal, or both were sought has been rising since the New Code’s adoption and,

168. See, e.g., Taniguchi, supra note 10, at 778–79.
170. Article 312 of the Japanese Code of Civil Procedure limits appeal as of right. MINSOH Ō, art. 312. However, Article 312 also contains a broadly worded catch-all provision generally allowing appeals when the judgment appealed from omits the reasons for the decision or the reasons are inconsistent. Article 318 gives the Supreme Court a certiorari type jurisdiction, allowing the Court to accept appeals at its discretion. Id. at art. 318.
171. See Ota, supra note 9, at 579–80. See also Certiorari 1997-2001 Chart.
172. In Japan, determining whether the Supreme Court has the ability to control its own docket is difficult because “appeal of right” cases still exist and statistics concerning Supreme Court judgments do not distinguish between meritorious appeals and those dismissed for improper filing. See MINSOH, art. 312 & 318. The Code permits the filing of a “jokoku appeal” with the Supreme Court for “jurisdictional reasons,” namely that the composition of the deciding court was improper, one of its members was ineligible to participate in the proceedings, or jurisdiction properly resided exclusively elsewhere. Id. Jokoku appeals are also granted for other reasons, such as a defect in representation, an improper denial of an oral argument, or where there is a judicial defect in reasoning, either because the court failed to give its rationale or did so inconsistently. Id. Unlike the U.S. Supreme Court, which distinguishes between a dismissal and a determination under denial of “certiorari,” dismissals of improperly filed claims in the Japanese courts are counted as judgments, making it difficult to determine whether appeals are determined on their merits or on procedure. Id.
further, that Japan’s Supreme Court is accepting more certiorari cases each year. ¹⁷³

The statistical table below sets out the disposition rate of civil cases in which litigants sought either appeal or certiorari and the disposition of such cases from 1997 (immediately before the Code went into effect) through 2001: ¹⁷⁴

**Certiori 1997-2001 Chart**

<table>
<thead>
<tr>
<th>Year</th>
<th>Filed Cases</th>
<th>Cert. Granted</th>
<th>Location of Termination of Decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>2,741</td>
<td>—</td>
<td>3,062</td>
</tr>
<tr>
<td>1998</td>
<td>2,542</td>
<td>768</td>
<td>3,040</td>
</tr>
<tr>
<td>1999</td>
<td>2,160</td>
<td>1,770</td>
<td>2,389</td>
</tr>
<tr>
<td>2000</td>
<td>2,418</td>
<td>2,106</td>
<td>2,410</td>
</tr>
<tr>
<td>2001</td>
<td>2,323</td>
<td>2,314</td>
<td>2,298</td>
</tr>
</tbody>
</table>

As the table above shows, it seems clear that attorneys are filing more certiorari cases each year. While the Supreme Court is denying more of these petitions, it is also accepting more cases each year. Similarly, bengoshi are seeking certiorari and filing appeals in more and more criminal cases each year. Thus, the number of cases in which litigants have sought Supreme Court review has increased from 4,086 in 1997 to 5,277 in 2001. Even so, the average number of months that a case is pending in the Supreme Court has been steadily falling since the effective date of the New Code: ¹⁷⁵

¹⁷⁴ See The Japanese Court System’s Statistics, supra note 96.
¹⁷⁵ Id.
Disposition of Civil Cases in the
Supreme Court — Number of Months

<table>
<thead>
<tr>
<th>Year</th>
<th>Average Number of Months Pending</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>7.6</td>
</tr>
<tr>
<td>1993</td>
<td>9.3</td>
</tr>
<tr>
<td>1994</td>
<td>7.7</td>
</tr>
<tr>
<td>1995</td>
<td>7.0</td>
</tr>
<tr>
<td>1996</td>
<td>8.7</td>
</tr>
<tr>
<td>1997</td>
<td>9.5</td>
</tr>
<tr>
<td>1998</td>
<td>8.1</td>
</tr>
<tr>
<td>1999</td>
<td>6.6</td>
</tr>
<tr>
<td>2000</td>
<td>5.4</td>
</tr>
<tr>
<td>2001</td>
<td>5.3</td>
</tr>
</tbody>
</table>

Here again, average statistics can be misleading as cases in which the Supreme Court denied certiorari should also be resolved relatively quickly, whereas some cases in the Supreme Court have been pending for several years. Adding a case’s duration in the Supreme Court, High Court and to the District Court creates a distorted picture of Japan’s entire judicial system. This distortion can, in turn, effect the public’s perception of whether they can obtain timely justice from the nation’s judicial system. As a result, the public’s support for the judicial system may waver even more significantly and also lead to a diminution in support for the Rule of Law in general. With this in mind, the judicial system may wish to explore the question of how it can gain greater control over the appeal (as distinguished from the certiorari process) and whether further legislation limiting appeals to the Supreme Court and limiting evidentiary proceedings at the High Court are warranted.176

176. Justice O’Connor’s observation concerning the experience of the U.S. Supreme Court may be instructional. Justice O’Connor writes:

When I arrived at the Court in 1981 we received about 4,000 applications a year to review particular lower-court decisions, but we accepted and decided with full opinion only about 150 a year. Recently, the Court has been receiving about 7,000 petitions a year and has been accepting fewer than 100. The number of petitions granted de-
3. Summary of Findings

It is generally agreed that the pace at which cases are disposed of in Japan, either by judgment, settlement or otherwise, has accelerated. Whether this change is due to the New Code or to the altered procedures devised and put into practice prior to the New Code’s adoption is debated, but hardly relevant. Whether “invented” or simply adopted by the New Code, the fact remains that the new practices have quickened the pace of litigation in Japan. Moreover, the judicial branch has clearly taken steps to reduce the trial disposition period.

Still, many high profile cases take several years at the District Court level to be resolved and some cases on appeal take even two or more years to be resolve. The New Code’s provisions, designed to assure that all issues and evidentiary matters are discussed and thus defined or resolved “pre-trial,” (i.e., pre-Oral Argument), do not appear to have produced that desired effect on litigation. It is probably the case that the new Preparatory Proceedings for Argument procedure has expedited the pre-Oral Argument stage of cases and has probably limited the scope of new arguments, issues, and facts brought up later on appeal; however, this procedure has not completely pre-

O’CONNOR, supra note 7, at 9–11.


178. In addition, the number of judges available to try cases at the District Court and High Court levels appears to have increased during the last few years. Thus, the total number of judges available to handle cases — excluding those of the Supreme Court and the Summary Court — has gone from 2121 judges in April of 1998 to 2296 in April of 2002, and to 2341 in April 2003. See The Japanese Court System’s Statistics, supra note 96 (specifically the data provided by the Judicial Secretariat). This increase in the number of judges available to try cases has also undoubtedly had a positive effect on the speed with which cases are resolved. It is anticipated that the number of judges in Japan will continue to increase as the new reforms take effect, increasing the number of bengoshi to approximately 3,000. See Recommendations of the Judicial Reform Council, supra note 19, at ch. III, pt. 1(1).

179. See, e.g., Docs Who Removed Wombs from Healthy Women Lose Appeal, supra note 162 (noting the final appeal in this case began in 1999 and was not concluded until May 2003).

180. See, e.g., Ota, supra note 9, at 568–70.
vented new issues from being raised at a case’s Oral Argument stage before the District Court, and it has not obviated new arguments, new issues and new evidence at the High Court appeal level. This problem may be due to the fact that the New Code does not contain a “preclusion order” procedure. In addition, the “paternalistic” judiciary’s general unwillingness to reject new arguments and evidence also hinders procedural progress, albeit substantively more thorough.

4. The Failure of the Average Accelerated Pace of Dispositions to Lead to an Increased Use of the Judicial System

The speed of average dispositions at the District Court level has not been without some potential damaging effects on litigation as a dispute resolution mechanism. Thus, speed, while useful in making litigation a reasonable method of resolving a dispute in a timely fashion, may negatively effect how potential and actual litigants view Japan’s judicial system. To the extent that litigants feel that they have not received an adequate hearing from the Japanese court system, its utility as an upholder of the Rule of Law concept is damaged. Doubts about a hearing’s adequacy may be raised when litigants feel that the system operates so quickly that they have been denied a fair opportunity to present their side of the issue. In addition, the procedures used to promote speed may raise questions as to the adequacy of the process to render what is perceived to be a “just” decision. In this connection, statistical data concerning use of witnesses in cases is consistent with the views expressed by bengoshi interviewees that judges do not permit party or third person witness testimony as frequently as they did a decade ago.

181. Id. at 576–77.
183. See, e.g., Press Release, Japan Federation of Bar Associations, Not “Speedy Trials Bill,” but “Fair and Speedy Trials Bill” (Nov. 19, 2002) (public survey showed that only 18.6% of respondents were satisfied with the current civil trial system), at http://www.nichibenren.or.jp/en/activities/meetings/20021119.html.
Some bengoshi expressed the view that when judges do not permit witness testimony and rely on written materials rather than oral testimony, they either actually deny litigants an adequate opportunity to present their, or the parties perceive the system as denying them their “day in court.”

This perception issue is significant to a Rule of Law analysis and has particular importance in Japan where judges serve as the gatekeepers to evidentiary hearings. Judges ultimately determine whether or not witnesses, including party witnesses, will testify. Therefore, litigants’ perceptions of an unfair or
inadequate judicial system reflect badly on both the court system and its judges. If wide spread, such a perception can decrease the reputation of the Japanese judicial system as a means for obtaining relief and thus can damage the use of the courts as a means for carrying out the Rule of Law. The statistical data below shows the number of witnesses allowed to testify at the District Court level.\textsuperscript{188}

### Witnesses at the District Court Level (First Instance)\textsuperscript{189}

<table>
<thead>
<tr>
<th>Year</th>
<th>Third Person Witnesses</th>
<th>Party Witnesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>38.0</td>
<td>48.7</td>
</tr>
<tr>
<td>1997</td>
<td>35.0</td>
<td>44.5</td>
</tr>
<tr>
<td>1998</td>
<td>32.3</td>
<td>41.6</td>
</tr>
<tr>
<td>1999</td>
<td>30.4</td>
<td>42.3</td>
</tr>
<tr>
<td>2000</td>
<td>29.3</td>
<td>39.4</td>
</tr>
<tr>
<td>2001</td>
<td>28.0</td>
<td>37.9</td>
</tr>
</tbody>
</table>

result of the hierarchical structure of the legal system, as well as the power of the judge as ultimate decision-maker, party objections are unlikely to be successful if a judge requests a document in lieu of oral testimony); Interview with lawyer (B) in Kyoto, Japan (on file with author) (noting that while parties bring in witnesses, the number of witnesses, as well as the number of witnesses actually testifying, is determined by the court, and as there are too few judges, they often do not have enough time to hear oral testimony). In the U.S., however, courts cannot accept a proffer of proof in place of testimony, although they may prohibit testimony that is cumulative or in violation of the Rules of Evidence. See Daubert v. Merrell Dow Pharmaceuticals, 509 U.S. 579 (1993); Kumho Tire v. Carmichael, 526 U.S. 137 (1999) (finding that U.S. judges serve as gatekeepers where expert testimony is proposed and a party objects on the grounds that the testimony is not based on generally accepted scientific or otherwise applicable professional opinion). See also FED. R. EVID. 702.

\textsuperscript{188} See The Japanese Court System’s Statistics, supra note 96.

\textsuperscript{189} Excluded from this table are District Court cases where the court acts as an appeals court for Summary Court cases. In these cases, the number of witnesses per 100 cases has declined at an even faster rate. Thus, third person witnesses have declined from 16.1 per 100 cases in 1996 to 15.0 in 1997; 11.7 in 1998; 10.4 in 1999; 10.3 in 2000; and 7.2 in 2001. The number of party witnesses has similarly declined in such appeal cases from 20.9 in 1996 to 19.5 in 1997; to 15.7 in 1998; to 16.5 in 1999; to 15.8 in 2000; and to 13.0 in 2001. The decline in witness testimony at the appeals level is consistent with the intent of the New Code to make the initial court the trial court and to reduce “new trial” at the appeal level.
Although the above data slightly differs from the data set out in Professor Ota’s 2001 study, both data compilations disclose that the District Courts are handling witness testimony more quickly than in the past. The number of cases involving witness testimony has declined, as has the number of witnesses per one hundred cases. Thus, in 2001, there were a total of only sixty-six witnesses (including both third person witnesses and party witnesses) per one hundred cases or less than one witness per case. Since less than a witness cannot testify, this means that there were no witnesses in at least one-third of the cases. As some cases clearly involved testimony from two or more witnesses, the numerical assessment above displays that the percentage of cases with no witness testimony exceeded one-third. The significance of limiting the use of witnesses may be highlighted by the realization that surely the complaining party has a story to tell and, having taken the bold step of initiating litigation so as to elaborate, the plaintiff probably wants to convey their account directly to the case’s decision-maker. Further, in many cases, the defending party would also equally like to explain their side of the dispute to the decision-maker. If the parties alone were to appear as witnesses, a case would require the minimum of two witnesses — the plaintiff and the defendant. However, in Japan, cases involving two witnesses are viewed as “complicated” and are unusual. For this reason, a losing party in Japan who wished to testify but was not permitted to in their case will find the case’s decision as unjust and will consider the Japanese court system as unfair.

Research suggests that while Japanese litigants prefer the adversary system to an inquisition system, “Japanese subjects appear uncomfortable with presenting their views in a confron-

190. A bengoshi interviewed in Saitama (just outside Tokyo) stated in his interview that the one change he would make in civil procedure would be to permit more live witness testimony. Interview with bengoshi (E) in Saitama, Japan (on file with author).

191. See, e.g., Interview with trial lawyer (H) in Sendai, Japan (on file with author) (noting that his clients wanted the chance to speak directly to the court and that this practice was not permitted as freely as in the past).

192. Cf. Supreme Court Report Illustrates Lengthy Process of Civil Trial System, supra note 177 (making special reference to trials that include the use of witnesses (i.e., 25% of all trials), and the change in length from 1991 to 2001).
tation with the opposing party.” Thus, Japanese litigants arguably do not wish to testify. While dealing with the abstract issue of a Japanese litigant’s preference to avoid confrontation, this research does not address the question of how a losing litigant views the fact that they could not testify. Here, the results could be different as losing parties may resent such testimony procedures, despite any theoretical preconceptions of apparent fairness. To complicate matters further, the failure to take witness testimony extends beyond mere refusal to hear the parties themselves.

Indeed, the facts prove even starker than the above supposition. Figures kept by the Supreme Court Secretariat show that the percentage of cases in which no witnesses testified increased, from an already high percentage of 80.9% in 1996 to 83.2% in 1998, the year the New Code went into effect, and has continued to steadily rise:

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage of Cases with No Witnesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>83.2</td>
</tr>
<tr>
<td>1999</td>
<td>84.3</td>
</tr>
<tr>
<td>2000</td>
<td>85.0</td>
</tr>
<tr>
<td>2001</td>
<td>85.5</td>
</tr>
<tr>
<td>2002</td>
<td>86.4 (provisional data)</td>
</tr>
</tbody>
</table>


194. Interview with bengoshi (C) in Sapporo, Japan (on file with author).

195. Professor Matsumura’s study used students as questionnaire subjects. See Matsumura, supra note 193. While the study showed that, in the abstract, the subjects preferred not to present their views in confrontational situations, the study did not deal with actual parties to litigation. Id. Considering the Japanese aversion to litigation, a party who has filed suit may well hold views different from the general population, represented by the students. Similarly, a party who has been sued may have attitudes altered by the experience and, thus, may not be represented by the general population view. Finally, a losing party may well have “after the event” views that differ from the generally held opinions of the population. Therefore, while the study is useful for the purposes for which it was undertaken, it does not necessarily reflect the views of parties to litigation or the views that a losing party may pass on to others about the litigation experience.

196. See The Japanese Court System’s Statistics, supra note 96.
While it is true that in default cases there is no need for witness testimony, and the data above includes a certain percentage of such cases, the declining number of witnesses in non-default cases shows that the court’s role as gatekeeper has steadily eroded the use of witness testimony. Thus, in cases utilizing witness testimony, the number of such witnesses has also steadily declined — except for cases where ten or more witnesses were called. The chart below displays this change in witness testimony.

**District Courts: Number of Witnesses and Percentage of Cases**

<table>
<thead>
<tr>
<th>Year</th>
<th>1 Witness / Percentage of Cases</th>
<th>2–4 Witnesses / Percentage of Cases</th>
<th>5–9 Witnesses / Percentage of Cases</th>
<th>10+ Witnesses / Percentage of Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>14,564 / 10.0%</td>
<td>11,647 / 8.0%</td>
<td>1,424 / 1.0%</td>
<td>172 / 0.1%</td>
</tr>
<tr>
<td>1997</td>
<td>13,933 / 9.5%</td>
<td>11,717 / 8.0%</td>
<td>1,263 / 0.9%</td>
<td>63 / —</td>
</tr>
<tr>
<td>1998</td>
<td>13,570 / 8.7%</td>
<td>11,340 / 7.2%</td>
<td>1,288 / 0.8%</td>
<td>67 / —</td>
</tr>
<tr>
<td>1999</td>
<td>12,437 / 8.1%</td>
<td>10,669 / 6.9%</td>
<td>1,084 / 0.7%</td>
<td>81 / 0.1%</td>
</tr>
<tr>
<td>2000</td>
<td>11,993 / 7.6%</td>
<td>10,618 / 6.7%</td>
<td>1,150 / 0.7%</td>
<td>67 / —</td>
</tr>
<tr>
<td>2001</td>
<td>11,597 / 7.4%</td>
<td>10,063 / 6.4%</td>
<td>1,043 / 0.7%</td>
<td>77 / —</td>
</tr>
<tr>
<td>2002</td>
<td>10,854 / 7.0%</td>
<td>9,433 / 6.1%</td>
<td>816 / 0.5%</td>
<td>110 / 0.1%</td>
</tr>
</tbody>
</table>

In view of this steadily declining willingness to use witness testimony in civil cases, it is easy to understand why some bengoshi responded that the most significant change that could be made to Japanese Civil Procedure was for the courts to permit more witness testimony. This view may also be the reason why some bengoshi felt that their clients did not receive a fair opportunity to present their case to the court. The courts’ exercise of their gatekeeper function to essentially dispose of witness testimony may have a detrimental effect on

197. See id. The data in the above chart shows that only 0.1% of cases involve ten or more witnesses, and so this increase is not significant, except perhaps to reflect the fact that the legal system is being used in some more complicated situations. This point is discussed infra at Part III.E.

198. See supra notes 176, 187, 189–91 & accompanying text.
testimony may have a detrimental effect on the public’s perception of the Japanese judicial system as a protector of the Rule of Law and as an arm of such a system. Similarly, the courts’ limitation on expert witness testimony and cross-examination for technical matters, such as patent disputes may also underlie the public’s perception that Judges are currently unable to handle technical legal expertise issues. Nonetheless, the judicial system faces a dual dilemma: on the one hand, the political departments demand faster resolution of cases; and, on the other, the same political forces fail to provide the judiciary with the resources needed to handle cases faster. The end result is that the Japanese courts must do what it can to hustle the process — and this appears to mean less witness

199. As a bengoshi in Sendai succinctly stated: “Judges like documents more than witnesses.” Interview with bengoshi (H) in Sendai, Japan (on file with author). Additionally, a bengoshi in Hiroshima noted that judges are busy, and so they are not willing to examine witnesses. Interview with bengoshi (L) in Hiroshima, Japan (on file with author). A bengoshi in Sapporo criticized the system under the New Code as being “too quick” and complained that judges “restrict witnesses;” he advocated for judges to hear more witnesses. Interview with bengoshi (C) in Sapporo, Japan (on file with author).

200. The practice of avoiding witness testimony is also problematic in Japanese criminal trials. It has been suggested that notwithstanding changes in the Constitution and the Code of Criminal Procedure for the creation of a more adversarial system, present process in Japan comes close to the pre-war system of “trial by dossier.” See GOODMAN, THE RULE OF LAW IN JAPAN, supra note 19, at 300–01. See generally Ryuichi Hirano, Diagnosis of the Current Code of Criminal Procedure, 22 LAW IN JAPAN 129 (Daniel H. Foote trans.) (1989).

201. This perception has led to an amendment to the New Code to create a modified “expert Commissioner” system (July 2003). See infra Part III.E. U.S. judges are capable of resolving highly technical expertise-laden cases after hearing direct and cross-examination of opposing expert witnesses. Japanese judges should be just as capable of resolving such questions if given direct and cross-examination of experts in open court.

202. A bengoshi interviewed in Kyoto stated that if he could make one change to the civil procedure system, he would greatly increase the number of judges. Interview with bengoshi (B) in Kyoto, Japan (on file with author). His reasons related directly to Rule of Law concerns. Id. He noted that if a judge takes the time necessary to hear a case, the lawyers are pleased, but the Judicial Secretariat is not because it causes a large backlog of cases for the judge. Id. Thus, judges must act too quickly, leaving both parties unsatisfied. As the lawyer noted “speed alone is not satisfactory.” Id. Furthermore, since “the parties are not satisfied, they do not feel they have received procedural justice.” Id.
testimony with concomitant pressures on Rule of Law concerns. Similarly, as cases have been handled more quickly on average, the percentage of ordinary civil cases in which both sides were represented by counsel at the District Court level has declined as the number of cases in which neither side is represented by counsel has increased. The data discloses:

### First Instance District Court
Ordinary Civil Cases — Percentage of Cases

<table>
<thead>
<tr>
<th>Year</th>
<th>Both Sides Represented</th>
<th>Plaintiff Only Represented</th>
<th>Defendant Only Represented</th>
<th>Neither Represented</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>42.2</td>
<td>35.5</td>
<td>3.3</td>
<td>19.0</td>
</tr>
<tr>
<td>1997</td>
<td>42.5</td>
<td>35.1</td>
<td>3.3</td>
<td>19.1</td>
</tr>
<tr>
<td>1998</td>
<td>40.9</td>
<td>34.7</td>
<td>3.6</td>
<td>30.8</td>
</tr>
<tr>
<td>1999</td>
<td>41.2</td>
<td>34.0</td>
<td>4.0</td>
<td>20.7</td>
</tr>
<tr>
<td>2000</td>
<td>41.3</td>
<td>32.9</td>
<td>4.4</td>
<td>21.4</td>
</tr>
<tr>
<td>2001</td>
<td>39.4</td>
<td>34.8</td>
<td>4.7</td>
<td>21.1</td>
</tr>
</tbody>
</table>

Apparently, litigants take more notice of cases and the need for professional assistance when an appeal has been filed to the High Court from an initial District Court decision. Thus, from 1996 to 2001, the percentage of High Court cases in which neither side was represented by counsel remained remarkably stable in the 5% to 6% range. The percentage of cases in which both sides were represented at the appeal stage in the High Court remained stable in the range of 75% to 78%.

203. *Doctors Debate in Court as Part of New System, JAPAN TIMES ONLINE, Jan. 8, 2003, available at http://www.japantimes.co.jp/cgi-bin/getarticle.pl?nn20030109b1.htm.* In a medical malpractice case, the Court heard from a panel of experts, who after giving their individual opinions on the matter, engaged in a debate concerning the issue and was finally examined by the parties. *Id.* This “conference debate” format holds great promise in cases such as medical malpractice, where expert opinion is a critical element of the case. However, lawyers interviewed had never been involved in such a process. *Id.* It is likely that this format will be overshadowed by the new procedure adopted in July 2003.

204. *See The Japanese Court System’s Statistics, supra note 96.*

205. In 1997, the percentage of cases where neither side was represented rose by 6.6% but fell back again in 1998 to 5.0%. *See id.* In 1996, the percentage was 5.9% and in 2001, the percentage was 5.8%. *Id.*

206. Summary Court jurisdiction is limited to cases seeking less than 900,000 yen (soon to be increased to 1,200,000 yen), and as is expected, a
The declining use of counsel at the initial stage may or may not represent the public’s perception of Japan’s Rule of Law and judicial process issues. On its face, the declining use of legal professionals appears to represent a decline in the Rule of Law, since these professionals represent the technical expertise of the law. The previous chart shows that while the percentage of cases in which both sides are represented by counsel is declining, the percentage of cases in which only one side is so represented is increasing. Perhaps this change reflects the belief that representation by one side, when the other side is not represented, constitutes an advantage; whereas, if neither side is represented, the playing field is level for both. Or perhaps these figures represent the view that it is the judge’s function to discover and find the facts in order to assure that substantive justice is achieved. Thus, professional lawyers, who may perform some of these functions in other societies, are simply not required in Japanese litigation. Furthermore, these figures may simply be a reflection of the limited availability of lawyers in Japan and/or the high cost of retaining counsel. Whatever the reason, the facts are that in over 21% of all cases no lawyers are involved at the trial court level and in over 60% of cases at

higher percentage of Summary Court cases are thus handled without counsel. *Recommendations of the Judicial Reform Council, supra* note 19, ch. II, pt. 1, § 5(3) (“Expansion of the Jurisdiction of Summary Courts & Substantial Increase in the Upper Limit on Amount in Controversy in Procedures for Small-Claims Litigation”). However, a significant percentage of Summary Court cases that are appealed to the District Court involve the use of counsel on the appeal. *See The Japanese Court System’s Statistics, supra* note 96. But, here too, the percentage of cases in which counsel is retained has been declining. *Id.* The statistics show that the percentage of cases appealed from the Summary Court to the District Court in which neither party was represented on the appeal are as follows: 1996: 26.1%; 1997: 29.3%; 1998: 27.5%; 1999: 30.8%; 2000: 30.4%; and 2001: 31.5%. *Id.* Interestingly, the percentage of cases in which the appellant is represented by counsel has remained stable at a relatively high rate of approximately 52%. *Id.* Apparently, losing parties at both the District Court and Summary Court level seek legal advice when they move to a higher court. *See id.*

207. To the extent that the figures may reflect the paucity of lawyers in Japan, these statistics may change over time as the Judicial Reform Council recommended an increase of the annual admission of new lawyers from the present total of approximately 1,200 to 3,000, which is a dramatic increase from the previous annual 500 amount, a number that was constant for many years. *See Recommendations of the Judicial Reform Council, supra* note 19, at ch. 1, pt. 3, § 2(2).
least one party does not have counsel. These statistics appear to be inconsistent with Professor Mattei’s view of the characteristics of a “Rule of Professional Law” system. Additionally, these inconsistencies raise questions as to whether a Rule of Law society can effectively operate without professional legal representation in the organ responsible for dispute resolution under the Rule of Law.

In any event, the time it takes to bring an average case to final resolution through appeal to the High Court has decreased. However, this change may prove to be purchased at too high a price if the cost of such time reduction is the opinion or belief that the judicial system is not prepared or willing to hear one litigant’s side of the story. To the extent that speed has been bought at the price of third person witness and party witness testimony, the price may be too high in Rule of Law terms. It is suggested that the Japanese judicial system, including its lawyers and professors, should explore this issue.

The Japanese Diet recently adopted legislation that will require both criminal and civil cases to be determined at the District Court level within a two-year time frame. While well intended, the legal community should carefully consider the Rule of Law implications for such legislation. First, placing a time limit on judicial activities raises issues of judicial independence. While many legal scholars hope that judges will act


209. Since Japanese judges are viewed by many as both “paternalistic” and protectors of the parties (whether or not represented by counsel), the consequences of judges acting as gatekeepers and denying parties the right to either tell their stories on the witness stand or to call witnesses may compound the potential damage done to the judicial system as a Rule of Law decision-making organ, as witness testimony is not permitted in a high percentage of cases. Tanabe, supra note 121, at 514, 520–22. See also Miki, supra note 85, at 5.

210. One purpose of U.S. lawyers, who assisted in the revision of the Japanese civil and criminal procedure systems, was to replace the concept of “trial by dossier” with an oral adversary system. This objective does not appear to have been achieved in criminal adjudication and, with the decline in witness testimony in civil cases, it would appear that the objective of the occupiers was not achieved in the civil procedure arena either. Hirano, supra note 200, at 129, 139.

211. Lower House Approves Speedy Trial Legislation, supra note 18. See Trial to be Expedited, supra note 18.
quickly and dispose of cases expeditiously, a judge should take as much time as conscience requires in reaching a determination. Additionally, other branches of government should not compel judges to ignore conscience considerations. Second, time limits raise constitutional questions — the issue of judicial independence, which Japan’s constitution guarantees, and the judicial branch’s management, which is placed in the judicial branch itself. Third, in order to reach the legislatively mandated time-limit, courts may further restrict the rights of parties to testify or call witnesses — potentially further eroding public confidence in the judiciary as a mechanism for obtaining relief. Finally, such time limit legislation appears entirely hortatory and provides no means of enforcement.\footnote{212}

While the legislation will place pressure on the judicial branch to quicken the pace of litigation, reality indicates that judges will continue to take the time necessary to fairly resolve cases — especially complicated ones. However, the judicial branch’s failure to conform to legislative fiat then creates its own legal paradox, as the court system itself will in a sense fail to follow the law and its mandates. Instead, legislation that significantly increases the pool of Japanese judges may better serve the Rule of Law objectives of the Judicial Reform Council, as opposed to limiting the time frame of judicial decisions.\footnote{213}

\footnote{212. The \textit{Japan Times} reports that the new two-year legislation makes it the clear “duty” of participants in the trial to conclude the case within two years. \textit{Trials to be Expedited, supra} note 18. Thus, the legislation itself appears to not be mandatory, but simply hortatory. Moreover, although the time limits apply to both criminal and civil cases, it is impossible to believe that a criminal case will be dismissed and an accused freed simply because the trial extends past the time limit. With respect to civil cases, the general rule is already that most cases take less than two years. Thus, it is not expected that the new two-year legislation will be applied to civil cases. The reality is that judges are already under great pressure to speed up the pace of litigation to the point that criteria such as “whether the judge has managed to bring about a court-mediated settlement in civil suits within a certain time frame” and “the number of cases they have handled” are considered when deciding whether to promote a judge or not. \textit{See Panel Seeks Transparent Career System for Judges, JAPAN TIMES ONLINE, Sept. 13, 2000, available at \url{http://www.japantimes.co.jp/cgi-bin/getarticle.pl5?nn20000913b2.htm}.}

\footnote{213. The number of judges in Japan (excluding Summary Court and Supreme Court judges) has risen from 2,121 in 1998 (when the New Code went into effect) to a current total of 2,341 (for fiscal 2003 through March 2004), increasing by 10%. \textit{See The Japanese Court System’s Statistics, supra} note 96}
2004] JAPAN'S NEW CIVIL PROCEDURE CODE 571

B. Production of Evidence

1. Inquiry Procedure

Interviewees were also questioned as to the new procedural devices for obtaining evidence and narrowing issues. The New Code’s “inquiry procedure” had been designed to mirror the “interrogatory” procedure of the U.S. Federal Rules of Civil Procedure. Unlike the Federal Rules however, the New Code provides neither judicial oversight of the inquiry process nor sanctions when a party fails to answer or responds inaccurately to questions. Moreover, the area of inquiry is more limited than in the U.S. By relying on counsels’ obligations to each other as professionals, the objective of the new procedure is to obtain information that could assist in narrowing issues and thus advance trials without damaging confidence in the system.

In the U.S., interrogatories serve a dual purpose. First, they are a means to clarifying the basis for the claims and defenses raised. Second, interrogatories act as a “first step” discovery device typically used at the outset of a case to compel the other (specifically the data provided by the Judicial Secretariat). Nonetheless, the fact remains that the number of judges available to try cases in Japan is quite small compared to other advanced countries. See Oda, supra note 1, at 403–04 (2d ed. 1999).

214. MINSÔHÔ, art. 163 (noting that a party may inquire on matters necessary for the proof of factual allegations from their opposing party). However, the New Code does not require that the served party actually answer such inquiries, nor does it necessitate that answers be truthful or made under oath. Kojima, supra note 15, at 702–03. Additionally, the New Code precludes inquiries that are not particularized, or which insult, embarrass, or attempt to cause undue expense to the other party and/or seek either an opinion or concern a privileged matter. MINSÔHÔ, art. 163.

215. FED. R. CIV. P. 33.

216. See U.S. for General Electric Supply Corp. v. W.E. O’Neil Const. Co., 1 F.R.D. 529 (D. Mass. 1941) (proper remedy for failure to answer interrogatories is a motion by default, not a motion to require answers to the interrogatories); Michigan Window Cleaning Co. v. Martino 173 F.2d 466 (6th Cir. 1949) (holding that if a party declines to answer interrogatories he may be precluded by the court from offering proof at trial).


218. See McElroy v. United Air Lines, Inc., 21 F.R.D. 100 (W.D.Mo. 1957) (stating that one principle purpose of interrogatories is to ascertain contentions of adverse party).
side to identify potential witnesses to important events and opponent documents that may contain or lead to evidence useful to the inquiring party.\footnote{219} As a clarifying mechanism, interrogatories have not been very helpful since responses to such inquiries are typically drafted by lawyers and signed by clients.\footnote{220} The “lawyering” of interrogatory responses provides insufficient information to clarify claims early in the process and leave open potential for modification later. But, as a first step discovery device, the interrogatory procedure has become a staple for litigators and proven itself very useful in the U.S.\footnote{221}

Some Japanese writers dealing with civil procedure argued that the inquiry process was a form of “discovery” new to the Japanese system;\footnote{222} thus, interview subjects were asked whether the inquiry procedure had been previously used by them or their opposing counsel to gather information about potential witnesses or documents. No \textit{bengoshi} interviewed had ever used the inquiry process for this purpose nor had it been used against them for this purpose. Quite naturally, no one interviewed found the inquiry process helpful in identifying witnesses or documents.\footnote{223}

The consistent theme of the responses was that the inquiry process was rarely, if ever, used, and even when used was not very helpful in narrowing issues or obtaining evidence.\footnote{224} Vari-

\footnote{219}{See Hercules Powder Co. v. Rohm & Haas Co., 3 F.R.D. 328 (D. Del. 1944) (stating that one purpose of interrogatories under Rule 33 is to ascertain facts and to procure evidence as to where pertinent evidence exists and can be obtained).}

\footnote{220}{See McCormick-Morgan, Inc. v. Teledyne Indus., Inc., 134 F.R.D. 275, 287 (N.D. Cal. 1991), rev’d in part, 765 F. Supp. 611 (N.D. Cal. 1991) (stating that interrogatories are not particularly useful because lawyers craft answers to interrogatories to reveal as little information as possible).}


\footnote{222}{See, e.g., Miki \textit{supra} note 85, at 6–7 (describing the inquiry process as a “method of obtaining evidence...basically modeled on the interrogatory of the United States”). \textit{See also} Taniguchi, \textit{supra} note 10, at 776–79; Kojima, \textit{supra} note 15, at 701, 702.}

\footnote{223}{Reflecting the author’s U.S. litigation experience, inquiry subjects were asked: “Has the procedure for inquiry resulted in the identification and production of documents detrimental to the position of the answering party and helpful to the inquiring party?”}

\footnote{224}{For example, an official of the Hiroshima Bar Association stated in his interview that the New Code’s inquiry procedure was not much used despite...}
ous explanations of this phenomenon were given, ranging from the view that the court’s use, as an inquiring body, was preferable over the informal inquiry procedure to the belief that neither side was likely to provide damaging answers, especially as there was no sanction for refusal to answer or refusal to answer “at this time.” Additionally, interview subjects were asked for their views on the conflict of ethical obligations inherent in a non-compulsory inquiry process, i.e., the conflict between the ethical duty to respond to opposing counsel and not to voluntarily damage a client’s position. No interview subjects were willing to state that they had no obligation to respond nor were they willing to admit that they might inaccurately respond rather than damage their client’s interests. Still, the general tenure of responses was that the obligation to the client outweighed the obligation to opposing counsel. Hence, some ra-

its usefulness in theory. Interview with Official (M), Hiroshima Bar Association, in Japan (on file with author). A lawyer in Kyoto stated that Japanese lawyers do not use this procedure even after the reform — for example, he had never used the procedure and opposing counsel had only once requested that he do so. Interview with lawyer (B) in Kyoto, Japan (on file with author). A lawyer in Kobe stated that while the inquiry procedure was initially utilized, attorneys’ stopped using it. Interview with lawyer (U) in Kobe, Japan (on file with author). A lawyer in Hiroshima stated that the procedure is not used very often. Interview with lawyer (W) in Hiroshima, Japan (on file with author). These interview responses simply serve as illustrations of the multitude of responses portraying the majority view that the New Code’s procedure was of little use and was accordingly used sparsely.

225. Typical was the response of a lawyer in Tokyo who noted that as there was no sanction for failing to respond as this lawyer did not use the procedure because he did not expect it would produce anything of value. Interview with lawyer (S) in Tokyo, Japan (on file with author).

226. Inquiry subjects were asked, “As the attorney for a party to whom an inquiry has been made, do you feel an obligation to provide an answer even if the answer is harmful to your client’s position? If the answer could be harmful to your client’s position do you feel an ethical obligation to: a) answer or b) refuse to answer the inquiry?”

227. Typical was the view of a lawyer in Hiroshima that by permitting a lawyer to make inquiry, the New Code implies that an ethical obligation to respond to the inquiry exists. See, e.g., Interview with lawyer (W) in Hiroshima, Japan (on file with author). However, this lawyer also noted that if the response were harmful to the client, the lawyer should find a way to prevent such harm. Id.

228. One lawyer responded that he had an obligation to respond to inquiries as an attorney, but that there was no ethical conflict because if the client tells
tionale for failing to respond would be employed when such response would damage a client’s position. On the other hand, where the answer would eventually be found in any event and disclosure at the time of response would not damage the client, responding attorneys appeared willing to voluntarily respond. Moreover, when circumstances make it impossible for opposing counsel to refuse to respond, inquiry may prove useful. For example, when an employee is injured due to an industrial accident, the employer is required to file a report with the Ministry of Labor concerning the accident. Inquiries such as whether a report was filed and requests for a description of the report and its contents cannot be ignored because it is general knowledge that filing the report was a requirement. In such a case, inquiry can assist in producing the report. However, where inquiry relates to internal documents or undocumented events, it appears that responding counsel need not and will not respond if to do so will adversely affect his or her client. In short, the process was not very well used and

229. The response of a lawyer in Kyoto was typical — he noted that a lawyer should not say something that would disadvantage his client. Interview with lawyer (B) in Kyoto, Japan (on file with author). Thus, if the answer would hurt his client, he would either reply in an unresponsive way or would postpone answering at all. As this lawyer noted, since there was no sanction for refusal to comply, non-response was preferable to hurting his client’s interest. Id.

230. See, e.g., Interview with lawyer (E), Saitama, Japan (on file with author) (explaining the voluntary production of evidence in regular cases).


232. A lawyer interviewed in Hokkaido described an experience where a worker was killed on the job. The worker’s family did not know the facts of the incident, but were concerned that the employer was at fault. Under Japanese Labor Law, the employer was required to make a report to the Ministry of Labor. See SUGENO, supra note 231, at 39, 284–88 (1992). The worker’s family sued, and the lawyer made inquiry as to the report filed with the Ministry. The company could not deny the existence of the report because of the Labor Law’s reporting requirement. After receiving the admission about the report, the lawyer requested that the court order the document produced and the report was produced. In the lawyer’s opinion, once the existence of the report was shown, the court was more willing to order its production than it would have been under the previous Code. Interview with lawyer (K) in Hokkaido, Japan (on file with author).
when used, was not very helpful. Furthermore, as a “discovery device,” the process was almost completely non-existent.

At this point in U.S. litigation practice, most lawyers recognize their client’s obligation to provide answers and evidence in response to opposing counsel’s discovery requests. The reasons for this recognition of an obligation to produce (or its patronage within the legal community) are not completely clear. The availability of court sanctions in the U.S. may play a role. However, this reason may not be absolute or even substantial. In addition to sanctions, the U.S. litigator has a reasonably clear idea of clients’ and their own ethical and legal obligations in discovery. To the extent that a question of loyalties may arise, the sanction mechanism (even if unused) indicates to the lawyer his and the client’s primary obligations. Moreover, in the U.S., the basic obligation to respond belongs to the client possessing the requested information — not the lawyer who is the conduit for transmission. The willingness of U.S. judges to sanction clients for failing to accurately respond defines the role of lawyers and clients as well as influencing clients’ willingness to respond in a timely and accurate manner.

233. Professor Koichi Miki reaches a similar conclusion. See generally Miki, supra note 85. Professor Miki notes that:

“A considerable number of people have pinned their hopes on [the inquiry procedure], although many others have doubted its effectiveness. Five years have passed since the New Code came into effect and it has become clear that the latter view was correct. The number of cases in which Party Inquiry is used has proven negligible.” Id. at 14.

234. See Goodman, The Somewhat Less Reluctant Litigant, supra note 15, at 789–90, 801 n.142. See also Wanderer v. Johnston, 910 F.2d 652 (9th Cir. 1990) (“severe” sanctions were imposed when defendants failed to appear at depositions and produce requested documents).

235. See FED. R. CIV. P. 37.


237. See FED. R. CIV. P. 33 for the interrogatory analogue to Japan’s inquiry process that requires all interrogatories be either answered or objected to. Counsel signs objections whereas the “person” making the answer signs answers. This discloses that answers are to be made by a party, while lawyers need to make the objections.

238. Lawyers are, of course, the major players in discovery responses and have ethical obligations regarding searches for answers to interrogatories and document production in the U.S. But, the interrogatory (for example) is di-
Unlike the U.S., Japan has a non-compulsory process regarding disclosure of information. One reason for the nature of this process is that the Japanese Bar objects to a compulsory process. However, a compulsory process may in fact be helpful to the Bar by providing an airtight answer to complaining clients who question why information must be disclosed to the other side. Furthermore, by lifting the ethical dilemma from the shoulders of lawyers, the compulsory process results in greater use of disclosure methods by both sides and more efficient disclosure of relevant answers.

It is the author’s view that the Japanese judiciary’s objections to a compulsory process may reflect its unwillingness to: (1) become involved in disputes that do not affect substantive decision-making; (2) make sanction decisions that might hurt a client when the lawyer may be at fault; and (3) exclude evidence when production is conducive to substantive justice whereas exclusion is not.

However, by making the process compulsory, the judge is relieved of the time-consuming task of dealing with preliminary evidentiary and issue inquiries, and is thus able to devote more time and energy to the substantive decision-making process. Placing the inquiry process at the early stage of a case — even prior to the first Preliminary Oral Hearing and surely before or during the new Preparatory Proceedings for Oral hearing — and making disclosure compulsory in certain areas will substantially advance the issue-determining process. Meanwhile, the present process appears to have no significant effect. Further, the existence of a “sanctions regime” does not mean that sanctions will be utilized on a frequent basis. The threat of sanctions, backed up by their infrequent use, exerts pressure on parties to comply.

Perhaps, the biggest obstacle to a sanctions regime is the “distrust” between bengoshi and the judiciary. There appears...
to be a gap in understanding and collegiality between Japanese bengoshi and Japanese judges that does not exist in the U.S. legal system. 243 Both history and present practice make the current Bar skeptical of a system that gives judges (as government officials in a government bureaucracy) power over individual lawyers. 244 Perhaps, a sanctions regime without U.S. remedies, such as authority to fine or otherwise sanction attorneys, will eventually arise in Japan. Japanese bengoshi appear to view the inquiry process as lawyer-to-lawyer, creating a lawyer response process in which the client is simply a minor player. 245 However, lawyers do not possess the first hand knowledge required to answer factual inquiries — only the client is in possession of such first-hand knowledge. Therefore, this objection to a sanctions regime may be overcome by clarifying that the duty to respond to inquiries lies with the party (i.e., the client) — assisted by the lawyer — and thus, failure to respond properly results in imposing sanctions on the client. 246 The July 2003 reform adopts a “pre-lawsuit filing” inquiry process for obtaining factual information. 247 Under the new scheme, a party contemplating litigation must send the prospective defendant a somewhat detailed letter, notifying him or her of the intent to file suit by a certain date and setting out the reasons for the suit; however, not all of the evidentiary materials required in a formal complaint must be disclosed. 248 Once such a letter is sent, the potential plaintiff may make inquiries similar to those made in the post-filing inquiry process. 249 There is even the possibility of receiving judicial assistance prior to filing a complaint in order to assist in the inquiry process. 249

243. Id.
245. See Interview with lawyer (A) in Nagoya, Japan & Interview with lawyer (G) in Rockville, Maryland (U.S.) (on file with author).
246. See Act to Amend Civil Procedure Act and Other Relevant Acts, 15 Heisei (2003) Statute No. 108, adding articles 132–2 to 132–9 (Japan) (dealing with the pre-litigation inquiry procedure). See also Interviews with lawyers (Q & T) from Japan (on file with author).
247. Interviews with lawyers (Q & T) from Japan (on file with author).
248. Id.
249. Such assistance may come through filing a form of motion. The motion practice would require the payment of a fee, but not as high a fee as the filing fee for a complaint. Id.
Inquiry prior to complaint is potentially very important in Japan as the formal complaint requires significant factual information to be accepted by the court. Unlike the U.S., Japan’s factual “discovery” cannot wait until after the complaint is filed. Inquiry as a potentially limited form of discovery is thus most important in the pre-filing stage, as it has the potential to provide a prospective plaintiff with the facts needed to file a formal complaint. Moreover, filing fees in Japan are high and the new inquiry process may aid in resolving cases without the need to file a formal complaint, thus saving the potential plaintiff some expenses. In turn, this early resolution may reduce the plaintiff’s settlement demand by the amount of the forgone filing fee.

Unfortunately, the pre-filing inquiry process suffers from the same lack of a sanctions regime (just as does the post-filing process). Thus, the expectation is that the pre-filing process will not have the positive effect that reformers envisioned. On the other hand, this process is a first step towards the discovery of facts that make filing a valid complaint possible. Finally, if a sanctions regime is later applied to such pre-filing inquiries, the reform may have real significance.

2. Document Production

When a proper request has been made for a document, the New Code permits the court to review the document in camera.

251. See id. at 789–90.
252. See id. at 791–92.
253. See GOODMAN, THE RULE OF LAW IN JAPAN, supra note 19, at 250 (discussing limitations on the court’s sanctioning powers where a third person fails to produce a requested document).
254. Documents must be produced in four situations: (1) where a party in possession of a document refers to that document during the litigation; (2) where the party seeking the document is entitled to demand delivery or examination of it; (3) where the document was created for the benefit of the party seeking it or was drawn up to evidence the legal relationship of the parties (such as a contract between the parties — a kind of mutual benefit document); and (4) a catch-all provision covering any other document that is not: (a) self-incriminating, (b) privileged or containing privileged material, or (c) a document created solely for the use of the person in possession of the document (a “self-use” document). MINSOHÔ, art. 220.
to determine whether it should be produced.\textsuperscript{255} In the U.S., an \textit{in camera} review permits the judicial officer to make a more informed decision about production while simultaneously protecting the fact-finder from exposure to inadmissible evidence, since the fact-finder is usually the jury, not the judge.\textsuperscript{256} However, in Japan, the judge is the fact-finder, and thus exposure to a contested document for \textit{in camera} review may potentially prejudice the producer of the documents by exposing an “inadmissible” document to the fact-finder.\textsuperscript{257} Both in the U.S. and Japan, professional judges often operate on the assumption that they can compartmentalize evidence so that an examined, inadmissible document will not play a role in decision-making.\textsuperscript{258} This fiction results in juries being warned not to consider the answer to a question that has been ruled inadmissible after response. Nonetheless, common sense tells trial lawyers that the damage is done when the evidence has been seen or heard because jurors are unlikely to completely forget what they have

\textsuperscript{255} Id. art. 223, para. 3. To obtain a document, a party must move for its production. Article 221 of the Code provides that the motion for production must contain: “(1) Indication of the document; (2) Gist of the document; (3) The holder of the document; and (4) The fact to be proven; (5) The ground for obligation for production of the document.” \textit{Id.} art. 221, para. 1. The New Code modifies the moving party’s obligation by loosening the duty to comply with the first two requirements when

\textit{[i]t is extremely difficult to clarify the matter mentioned in (1) or (2) of paragraph 1 of the preceding Article, at the time of the application it shall be sufficient to clarify, as a substitute for such matter, the matter which enables the holder of a document to distinguish the document under application.} \textit{Id.} at art. 222.

\textsuperscript{256} In the U.S., actions at common law seeking a recovery of twenty dollars or more entitle the parties to jury trial and “no fact tried by a jury, shall be otherwise re-examined in any court of the U.S., than according to the rules of the common law.” U.S. CONST. amend. VII.

\textsuperscript{257} See Goodman, \textit{The Somewhat Less Reluctant Litigant}, supra note 15, at 802 (stating that “the court that makes the in camera review is also the trier of fact because there is no jury.”); ODA, \textit{supra} note 1, at 73 (stating that “the Japanese court system does not accommodate either a jury system or a system of lay assessors.”).

\textsuperscript{258} Practicing lawyers know that in trying a case before a judge rather than a jury, the rules of evidence are liberalized by the court and many documents that are inadmissible at a jury trial will come into evidence. Furthermore, the court will note that the evidence will be given such weight as it deserves, including the possibility of no weight, if deemed appropriate.
heard or seen, and the same is likely true of judges. Accordingly, *in camera* review by the fact-finder creates problems.\(^{259}\) Regardless of the potential for improper exposure, all interview subjects indicated that they had never been involved in a case where the judge made an *in camera* review of a document.\(^{260}\) However, some individuals had heard stories of cases with *in camera* review.\(^{261}\) Like the inquiry procedure, this reform also appears not to have taken hold.\(^{262}\)

In general, respondents felt that the New Code made it procedurally easier to obtain the documents required to be produced.\(^{263}\) Respondents found that judges were more willing to "recommend" and "suggest" that parties voluntarily produce documents than had been the case pre-New Code.\(^{264}\) Additionally, respondents felt that parties were more likely to follow such suggestions than had been the case before the New Code. On the whole, respondents felt that the creation of the New Code led more documents to be produced than had ever oc-

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259. A judge interviewed outside Tokyo noted that judges do not at all like to use the *in camera* review process and will avoid doing so. Interview with High Court Judge (R) in Japan (on file with author). This judge noted that a problem exists with *in camera* review because even if the judge could divorce himself from using an improper document in his decision-making, the attorneys would object because the judge is the fact-finder. *Id.* Lawyers echoed this view. Typical was the response of a lawyer in Kobe that because judges find it difficult to forget what they have read, lawyers do not like the *in camera* review system. Interview with lawyer (U) in Kobe, Japan (on file with author).

260. A Hiroshima lawyer gave a typical response when he stated that he had never experienced a situation where a judge either made an *in camera* review or redacted a document for production. Interview with lawyer (M) in Hiroshima, Japan (on file with author). *But see* MÍNSOHÓ, art. 223, para. 1 (noting that redaction is permitted).

261. *See, e.g.*, Interview with *bengoshi* (C) in Sapporo, Japan (on file with author).

262. Although not specifically addressed in the questionnaire, discussion with interview subjects shows that the new “redacting” authority given to the court is also rarely, if ever, utilized.

263. For example, a lawyer in Tokyo noted that courts are reluctant to order a party to produce documents and may instead suggest production, but without sanction for failure to follow the suggestion. In any event, he did feel that while the procedure for requesting documents from the other side was easier under the New Code, actual production had not changed significantly. Interview with lawyer (S) in Tokyo, Japan (on file with author).

264. *See, e.g.*, Interview with lawyer (L) in Hiroshima, Japan (on file with author).
curred before. The view was also expressed that the government produced more documents under the New Code, especially after the 2001 Amendment covering government documents, since failure to do so would lead to unfavorable judicial decisions regarding the government’s position on document production. Nonetheless, most respondents did not feel that the new document provisions significantly aided plaintiffs. In other words, significant documents that were “against a party’s interest” were still not being produced and remained unavailable to plaintiffs.

The self-use exception to document production requirements appeared to be the primary reason for the New Code’s failure to significantly enhance the plaintiff’s ability to obtain damaging documents from the defendant.

Although the New Code contains a “catch-all” document production requirement (as well as the very narrow specific requirements for categories of documents that should be produced contained in the old Code), it also contains a list of “exceptions” to the production requirement. In addition to the type of traditional exceptions found in the U.S. system (attorney-client privileged materials, self-incriminating materials, etc.), the New Code legislatively adopted the “self-use” document exception that prevailed under the old Code. Under this exception, documents that are created solely for the use of the creator are not subject to production.

265. A lawyer in Kobe indicated that the government did not want the Supreme Court to take a case involving the question of production of self-use documents by the government and thus, the government often voluntarily produced such documents to avoid potential litigation about the issue. Interview with lawyer (U) in Kobe, Japan (on file with author).

266. A lawyer interviewed in Tokyo noted that if a defendant tries hard to hide a document’s existence, a plaintiff cannot find out that the defendant has the document. Interview with lawyer (D) in Tokyo, Japan (on file with author).


268. GOODMAN, THE RULE OF LAW IN JAPAN, supra note 19, at 249.

269. MINSOH Ō, art. 220, para. 4(d) (noting that self-use document production is part of the “catch-all” provision of Article 220 that permits production in several instances, including when: “(4)...the document does not come under any of the followings;...(d) [a] document to be offered only for the use of a holder of a document.”).

270. Documents produced for the benefit of the party seeking production (such as a receipt) and documents produced for the benefit of both parties
is to permit the free flow of ideas within the preparing entity without fear that the document will later become the object of public scrutiny.\textsuperscript{271} The exception can be quite broad in scope and is likely to include the traditional “smoking gun,” that is, the damaging documents that U.S. lawyers are always looking for in their discovery “fishing expeditions.”\textsuperscript{272} Indeed, most damaging documents maintained by a company defendant would likely be subject to the self-use exception. If given broad interpretation, the exception will likely swallow the “catch-all” nature of the New Code’s document production approach — in fact, this breadth may have been one purpose for legislating the self-use exception.

After the New Code’s adoption, the Supreme Court of Japan had at least two opportunities to discuss the self-use exception.\textsuperscript{273} In both cases, the Court broadly interpreted the exclusionary character of the exception, and thus limited the nature of the “catch-all” discovery provision.\textsuperscript{274} In the \textit{Fuji Bank} case, the Court held that the self-use exception prevented the plaintiff, the family of a deceased borrower, from obtaining the loan application files from the defendant, the lender.\textsuperscript{275} The plaintiff argued that the files would prove that the bank officials were aware of the deceased’s inability to make the loan payments, and therefore, the lender should never have made the loan in the first place.\textsuperscript{276} Accordingly, the plaintiff asserted that the lender was not entitled to recover payment of the loan from the

\begin{footnotesize}
\begin{enumerate}
\item[(such as a contract)] were required to be produced under the old Code and are still required to be produced under the New Code. Minsohō, arts. 220–23.
\item[271.] See Goodman, THE RULE OF LAW IN JAPAN, supra note 19, at 249–50 (discussing the rationale of the Supreme Court of Japan in the \textit{Fuji Bank} case (see infra note 273) “to require such documents to be produced would interfere with the frank discussion of views within the bank”).
\item[272.] See Goodman, THE RULE OF LAW IN JAPAN, supra note 19, at 248–50.
\item[274.] See Goodman, THE RULE OF LAW IN JAPAN, supra note 19, at 248–50.
\item[276.] Fuji Bank, Case No. 2 of 1999, at para. 1.1.
\end{enumerate}
\end{footnotesize}
deceased’s estate. The Supreme Court found that loan officials were entitled to the free flow of information and ideas from their subordinates and that to require the production of the file would inhibit that free flow. Since the documents in the file were prepared solely to assist the bank officials in deciding whether or not to make the loan, they were self-use documents and thus not subject to production.

A year later, in a derivative action against bank directors, the Supreme Court held that the self-use exception prevented the derivative plaintiffs from obtaining certain bank files on the grounds that the files were created for the self-use of the bank. As in the Fuji Bank case, the Court could have narrowly read the exception to permit discovery, holding that since this derivative action was for the benefit of the bank and the plaintiffs were standing in the bank’s shoes, the document was created for the benefit of the plaintiff and thus should be produced. The Court could have also held that since they were separate from the Bank, the exception did not apply to the Directors because the documents were not created for the Directors’ benefit, let alone for their sole benefit. However, the subject of this Article is not whether the Court should or should not have entered into a narrow interpretation of the exception; rather, the point is that the Court has rendered a broad interpretation of the self-use exception, thus limiting the scope of production by the lower courts.

277. See id.
278. Id. at para. 3.
280. Some scholars suggest that Fuji Bank is a broad reading of the exception and a narrow reading of the production obligation. See GOODMAN, THE RULE OF LAW IN JAPAN, supra note 19, at 249–50. The Court could have logically found that making a “good loan” was in the interest of both borrower and lender while rejecting a loan application where the hopeful borrower was unable to repay was also in the best interest of both parties. In such case, the application file could be viewed as having been prepared for the benefit of both parties and, thus, not subject to the self-use exception.
281. A High Court Judge interviewed outside Tokyo specifically referred to the determination of the Supreme Court and noted that this case is considered as the “basic case” for self-use documents and the lower courts must follow it. Interview with High Court Judge (R) in Japan (on file with author). This Judge also noted that production of self-use documents could damage privacy rights of the party in possession of the documents. Id.
Interview subjects clearly indicated that the Fuji Bank case and its limiting nature was well-known to both bengoshi and judges, and furthermore, both were adhering to Fuji Bank. Interview subjects were asked:

Q: Do you believe that the self-use document exception to production limits the ability of the plaintiff to obtain significant documentary evidence adverse to the interests of defendants? The answer was generally “yes.”

Q: Would you like to see an amendment to the Code restricting the definition of self-use documents so as to allow for greater production of self-use documents? As was to be expected, those respondents who substantively responded to this inquiry did so based on their practice preferences.

Thus, attorneys who represented both plaintiffs and respondents desired that the Code be amended and the self-use document exception narrowed. On the other hand, those who only represented respondents felt that the provision was acceptable

282. The response of a lawyer in Nagoya was typical. He noted that the self-use exception remains very broad and has not changed with adoption of the New Code. Further, this lawyer noted that, due to the near impossibility of proving the existence of a document and the ability of the defendant to avoid admitting that a document exists (while the plaintiff must specify facts about the content of the document), very little change was effected by the New Code in most cases. Interview with lawyer (A) in Nagoya, Japan (on file with author). This lawyer was of the view that change had been achieved in connection with medical malpractice cases where the existence of documents and the subject matter of their contents were more readily available. Id. A lawyer in Hokkaido responded that production of self-use documents would violate the privacy rights of the party in possession. Interview with lawyer (K) in Hokkaido, Japan (on file with author). A High Court Judge also made this argument for privacy rights. Interview with High Court Judge (R) in Japan (on file with author). Further, this rationale is used by the Supreme Court in its broad reading of the self-use exception in the Fuji Bank case. See Fuji Bank, Case No. 2 of 1999, at para. 3.

283. A lawyer in Nagoya who primarily represents corporate interests responded that, in his view, plaintiff's lawyers wanted the doctrine to change while defendant's lawyers were opposed to change. Interview with lawyer (A) in Nagoya, Japan (on file with author).
as is. Some attorneys felt the question was irrelevant since pressure from business interests rendered change impossible.\textsuperscript{284}

In general, the new document production provisions of the Code were viewed as simplifying the procedure in order to obtain documents, but failing to significantly open up the opposing party’s records. In other words, although more documents were being produced in response to the judges’ “requests,” plaintiffs still had great difficulty obtaining defendants’ documents, particularly if the documents were adverse to the defendants’ interests.

\textbf{C. Legislative Changes Limiting Damage Awards in Derivative Cases}

In the U.S., plaintiff's counsel in class action and derivative lawsuits typically receive contingent fee awards which are set by the court after the case is resolved.\textsuperscript{285} Where the size of such awards is tied to the monetary damages won (or computed as won), the amount of damages that can be obtained in such cases is a strong factor in determining whether such cases are brought.\textsuperscript{286} Counsel has a strong incentive to sue if there is the chance of a large recovery (i.e., large fee award) and less incentive if there is a small recovery. Thus, to the U.S. lawyer, the Tokyo District Court’s decision in the \textit{Daiwa Bank} case, where huge damages were awarded against the company officials (in favor of the company via the derivative plaintiffs), represented

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{284} Nonetheless, the question of change has been brought up in a legislative committee with responsibility for civil procedure matters. Discussion with Professor Miki in Tokyo (on file with author). Such discussion does not mean that change will be achieved or if it is, it will be in the near future.
\item \textsuperscript{285} \textbf{STEPHEN C. YEAZELL ET AL., CIVIL PROCEDURE 550 (3d ed. 1992).}
\item \textsuperscript{286} In some cases, plaintiffs actually receive no monetary recovery, but, nonetheless, a substantial monetary recovery is computed for fee-setting purposes. Thus, where a settlement involves the use of “coupons” to be distributed to plaintiffs so as to grant them a discount on future purchases, no money has actually changed hands but the damage award calculation for fee purposes may include the total value of the coupons, even if no receiving party ever uses a coupon for a future purchase. \textit{See generally} Christopher R. Leslie, \textit{A Market-Based Approach to Coupon Settlements in Antitrust and Consumer Class Action Litigation}, 49 UCLA L. REV. 991 (2002) (criticizing the use of coupon settlements in class action litigation); Geoffrey P. Miller & Lori S. Singer, \textit{Nonpecuniary Class Action Settlements}, 60 L. & CONTEMP. PROBS. 97 (1997).
\end{itemize}
\end{footnotesize}
the possibility that derivative suits would dramatically increase in Japan.\textsuperscript{287} The *Daiwa Bank* case represented an interesting example of lowered barriers leading to greater litigation, as the case was brought after the Commercial Code reduced the filing fee for derivative lawsuits.\textsuperscript{288}

Shortly after the lower court decision in *Daiwa Bank*, and while the case was pending appeal, the Japanese Diet amended the Commercial Code to limit the recovery against a director in a derivative lawsuit.\textsuperscript{289} Previously, the Diet amended the environmental laws to create administrative remedies. This charge occurred after the courts rendered favorable decisions for plaintiffs in the “Big Four” pollution cases.\textsuperscript{290} Some scholars suggest that this legislative response was designed to take pollution cases away from the judicial system and place pollution abatement responsibilities back in the hands of Japanese administrative government officials.\textsuperscript{291} Thus, the question was raised as to “whether this amendment [reducing damages against corporate officials in derivative cases] will stifle the prophylactic effect of

\begin{itemize}
  \item 288. For a discussion of the *Daiwa Bank* case and the question of whether it will lead to additional litigation, see Goodman, *The Somewhat Less Reluctant Litigant*, supra note 15, at 798.
  \item 289. For an English language synopsis of the amendment to the Japanese Commercial Code, see *Amendment to Limit Execs’ Liability*, JAPAN TIMES ONLINE, Nov. 30, 2001, available at http://www.japantimes.co.jp/cgi-bin/getarticle.pl?nb20011130q9.htm; *Revised Code Limits Liability of Executives*, JAPAN TIMES ONLINE, Dec. 6, 2001, available at http://www.japantimes.co.jp/cgi-bin/getarticle.plg?nb200011206a3.htm. Under the amendment to the Commercial Code referred to by the *Japan Times*, director liability may be capped at the total employment benefits received by the director for a certain number of years, depending on the responsibilities of the director and whether he/she is an independent director. \textit{Id}.
  \item 290. UPHAM, LAW AND SOCIAL POLICY IN POSTWAR JAPAN, supra note 70, at 35. The Big Four consist of Aoyama et al. v. Mitsui Kinzoku, Nagoya High Court, Aug. 9, 1972, 674 Hanji 25 (Japan); Ono et al. v. Showa Denko, Niigata District Court, Sept. 29, 1971, 22 Kakyu Minshu (Nos. 9–10) (Japan); Watanabe et al. v. Chisso, Kumamoto District Court, Aug. 9, 1972, 696 Hanji 15 (Japan); Shirone et al. v. Showa Yokaichi Sekiyu, Tsu District Court, July 24, 1972, 672 Hanji 30 (Japan) (on file with author).
  \item 291. \textit{See generally} UPHAM, LAW AND SOCIAL POLICY IN POSTWAR JAPAN, supra note 70.
\end{itemize}
derivative litigation in the future. Accordingly, interviewees were asked:

After the Daiwa Bank derivative lawsuit decision, the [Japanese] Diet enacted a law permitting the limitation of liability of Directors in derivative cases. What effect do you think such legislation has had on the willingness of persons to file derivative lawsuits? What do you think was the reason that the Diet passed such a limitation of liability provision?

Typically, interviewees believed that the purpose of the legislation was to make it easier for companies to obtain directors willing to serve. This rationale was, of course, used by the government in enacting the law. On the whole, bengoshi responded that they believed this to be the purpose of the law. Indeed, there is reason to believe that such limited liability may be necessary, especially as Japan’s corporate law moves from boards composed solely of insiders to those on which outside independent directors are expected to hold several positions. While enacting the limited liability provision the Japanese Diet was also shifting the corporate structure in Japan to a style more similar to the U.S., with greater reliance on outside directors. However, if outside directors were subjected to the same unlimited liability that was applied to the Daiwa Bank defendants, outsiders might refuse to serve. In fact, there is anecdotal evidence that in recent years U.S. Boards have experienced a substantial turnover of outside directors due to candidates’ concerns over potential liability.

292. GOODMAN, THE RULE OF LAW IN JAPAN, supra note 19, at 198.
293. Typical was the response of a lawyer in Tokyo who commented that in his opinion, the limit on damages would not affect the number of derivative type cases brought since the end result sought was not monetary damages but change in management actions. Interview with lawyer (S) in Tokyo, Japan (on file with author). Id. In addition, he felt that the reason for the monetary limitation was responsive to the need to obtain directors willing to serve as such.
295. “Corporate America is undergoing the largest turnover in corporate boards of directors in several years as a result of the enactment of the Sarbanes-Oxley Act, representatives of an industry group representing directors and several executive search firms told BNA in recent interviews.” BNA Corporate Law & Business, 34 Sec. Reg. & L. Rep. No. 47, Dec. 9, 2002, availa-
Surprisingly, most bengoshi believed that the limitation provisions had no effect on plaintiffs’ decisions to file derivative actions. Although the majority of bengoshi interviewed had never been involved in derivative litigation, those who expressed an opinion believed that derivative plaintiffs filed suit for non-monetary reasons. Since derivative suits were not viewed as “economically” motivated, the amount of the damage award was of relatively little consequence. Moreover, some subjects believed that Japanese lawyers who filed derivative suits were not paid based on the amount recovered in the case; thus, the damage amount was not relevant to a lawyer’s decision to file a derivative case. Again, respondents were of the view that factors other than economics lay behind the filing decision. To some extent, the responses were an echo of the cultural and societal arguments voiced by some scholars as to why Japanese citizens appear to be more reluctant to file lawsuits than U.S. citizens.

The statistical evidence available is too slim to make any conclusion as to whether the 2001 law has had any effect on litigation rates. While interesting, the decline in the number of de-
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derivative cases initiated in 2001 is inconclusive, especially as it mirrors the 1998 decline. The available data shows:

Derivative Cases Filed From 1996-2001 in the District and High Courts

<table>
<thead>
<tr>
<th>Year</th>
<th>District Court</th>
<th></th>
<th>High Court</th>
<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Newly Filed</td>
<td>Disposed</td>
<td>New Appeals</td>
<td>Disposed</td>
</tr>
<tr>
<td>1996</td>
<td>68</td>
<td>66</td>
<td>12</td>
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<td>1997</td>
<td>88</td>
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<td>9</td>
</tr>
<tr>
<td>1998</td>
<td>73</td>
<td>59</td>
<td>17</td>
<td>18</td>
</tr>
<tr>
<td>1999</td>
<td>93</td>
<td>77</td>
<td>15</td>
<td>11</td>
</tr>
<tr>
<td>2000</td>
<td>83</td>
<td>98</td>
<td>32</td>
<td>30</td>
</tr>
<tr>
<td>2001</td>
<td>68</td>
<td>80</td>
<td>28</td>
<td>25</td>
</tr>
</tbody>
</table>

Further study is required regarding derivative lawsuits, once data for 2002 and 2003 is available.

D. Representative Actions

Unlike U.S. law, Japanese civil procedure does not provide for class action suits. In Japan, each allegedly injured party must separately claim damages. However, Japanese law does recognize the “representative action.” In a representative action suit, numerous parties are named as plaintiffs.

299. In 2001, a great deal of publicity was given to the government’s bill to limit the liability of directors in derivative litigation, although the law did not get passed until December 2001, and did not become effective until May 2002. Corporate Government and Reform, supra note 294.

300. While interesting, it is noted that the drop in the number of derivative cases between 2000 and 2001 is exactly the same (15 cases) as the drop between 1997 and 1998. See Derivative Cases Filed From 1996-2001 Chart.

301. See The Japanese Court System’s Statistics, supra note 96. The data provided by the Secretariat differs slightly from data reported by Professor West for 1996–1999. See West, Why Shareholders Sue, supra note 71, at 356 (Table 1).


303. See id.


305. See id.
these plaintiffs, a small group is designated to represent the entire plaintiff group in the litigation. In this fashion, one case can try the issues and facts common to all claims made by the entire group of plaintiffs. Unlike the U.S. class action, however, all the plaintiffs must in fact be real plaintiffs who appear in the case, and the plaintiffs do not represent others similarly situated who did not join in the lawsuit.

The writers of the New Code of Civil Procedure were aware of the U.S. style class action and were aware of the existing opinion that Japanese law should permit class actions. The idea of permitting U.S. style class actions was rejected by the New Code, but the “representative action” was modified to permit parties to join the action after the complaint had already been filed. This joinder provision was seen as a step towards greater access to the court process, placing the New Code somewhere between the Old Code and the U.S. class action.

Bengoshi interviewees were also asked whether the new representative action provisions had significantly changed the role of litigation in Japan (as class actions have significantly changed the role of litigation in the U.S.). The response was that the new change had made virtually no difference in litigation. Respondents felt that while some new plaintiffs may have joined suits, the New Code brought about no great change. At the time the New Code was written, one issue raised was whether representative plaintiffs’ counsel should be allowed to “advertise” the pending suit and invite others to join the litigation. Interview subjects were asked:

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306. See id.
307. See id.
308. See id. at 782.
310. See Taniguchi, supra note 10, at 783.
311. For example, a lawyer interviewed in Kobe stated that he had not yet seen a representative action brought in the Kobe District Court. Interview with lawyer (U) in Kobe, Japan (on file with author).
312. Interview subjects were asked: “Have the provisions allowing for persons to join representative actions after the lawsuit has already been filed resulted in significant numbers of persons joining such suits after they have been filed?”
313. Kojima, supra note 15, at 719 n.208 (“Placing the burden on the plaintiffs to provide such notice would seem to undercut the potential effectiveness of this device.”).
Do you think [that] lawyers under [the] supervision of the court should be allowed to place notices in the newspapers advising persons of the filing of a representative suit and advising as to how persons may join such suits?

Responses varied greatly. Some bengoshi believed that they already had the right to place such advertisements without court approval. Some interviewees even felt that the court should have no say in what the bengoshi published, while others felt the court would want no role in this issue in order to avoid responsibility for the advertisement. Additionally, some bengoshi felt that such advertising would be bad for the Bar's public reputation, while others considered this issue as unimportant. Among the various rationales for this viewpoint was the notion that lawyers already had the ability to advertise the filing of such cases through newspaper interviews and other devices, and therefore newspaper advertising was neither significant nor important. Another factor may very well be the costs of such advertisements. Unlike in the U.S., where a lawyer's contingent fee may be greatly enhanced by the size of the plaintiff class and the value of the class claim, lawyer's fees in Japanese representative cases are not related to the number of plaintiffs represented, although the “success” portion of the fee may be related to the amount of damages recovered.

314. A bengoshi in Saitama noted that advertising was taking place in connection with representative suits but also noted that he had recently seen some advertisements and public relations (i.e., interviews with the press, announcements to lawyers groups) relating to consumer fraud cases. Interview with lawyer (E) in Saitama, Japan (on file with author).

315. See, e.g., Interview with lawyer (U) in Kobe, Japan (on file with author).

316. See, e.g., Interview with lawyer (V) in Hiroshima, Japan (on file with author); Interview with lawyer (W) in Hiroshima, Japan (on file with author). An interviewee bengoshi in Saitama noted that the image of U.S. lawyers in Japan was not good and that such advertising might create a similar image for Japanese bengoshi. Interview with lawyer (E) in Saitama, Japan (on file with author).

317. In Japan, it is customary for the Bar Association to prepare a chart of lawyers fees for cases. The chart encompasses the “up-front” portion of the fee, based on the recovery sought, and a “success” component, based on the success in the case and typically represents a percentage recovery. Such charts were regularly published at the front of address/note/memo books prepared by the Bar Association for its members. Recently such charts, such as official guides to fees, have been moderated because of anti-trust arguments.
lawyer placing an advertisement might not be able to recoup the cost of preparing and printing such advertisements. In sum, there did not appear to be great support among *bengoshi* for an advertising option paid for by the plaintiff group.

**E. Complicated Cases**

In Japan, cases in which two or more witnesses testify are viewed as complicated cases.\(^{318}\) In the Preparatory Proceeding for Oral Argument phase of a case, the judge will narrow the number of issues and witnesses required to try those issues to such a great extent that if two or more witnesses are needed to resolve the issues the case is, by definition, complicated.\(^{319}\) Us-

For an English language Japan Federation of Bar Associations retainer and success fees schedule, see Yamanouchi & Cohen, supra note 28, at 448. See also West, *Why Shareholders Sue*, supra note 71, at 365.

318. For example, when keeping statistical records, cases are categorized as those involving only one witness and those in which two or more witnesses appear. The number of cases where only one witness appears exceeds the total of all other cases where two or more witnesses appear. See, e.g., *Average Number of Months from Filing of Complaint to Disposition Chart*, supra Part III.A.1.

319. The “narrowing of issues” by Japanese judges represents a significant difference in the role of the court in the U.S. and Japanese systems. In Japan, the Judge can “narrow” issues by preventing a party from raising an issue for trial without rendering a decision or order as to the validity of the issue. Moreover, a judge can use his/her narrowing of issues authority to refuse to permit witness testimony. See *MINSHÔ*, arts. 165(1), 170(6) & 177. See also *id*. art. 181(1) (the court can decide whether evidence is required). Prior to the Second World War Japanese civil procedure was such that the trial judge had strong directive powers in the process of “fixing issues” and “proof taking.” Tanabe, supra note 121, at 507–08. For example, the court assumed the leadership and responsibility for both fixing and narrowing the issues, as the court would ‘clarify’ matters throughout the entire trial process. *Id*. Although in form this procedure was changed by the occupation to a more adversarial procedure, the reality was that the role of the judge changed little. *Id*. at 517–25. See also Kamiya, supra note 182, at 56. Kamiya explains:

After five decades, it appears that lawyers (and judges) still take it for granted that the presiding judge will be in control, not only during the trial...but also in case management....In other words, the adversarial structure of the proceedings has not denied courts and presiding judges the opportunity to be paternalistic, or even meddling in many aspects of the litigation.

*Id*. In the U.S., the court lacks such authority and as a consequence the parties are in control of the issues until the court makes a ruling that is a part of the record and thus part of the record on appeal, on the validity or invalidity
ing this methodology, the consolidated trial procedure is a useful method for dealing with testimony in complicated cases. Further, both interview responses and statistics show that this procedure is being used on an ever-growing basis. For purposes of this discussion, however, complicated cases are considered to be cases that involve complicated issues of fact — especially those involving facts typically outside the experience of the judge. Such cases usually need some form of expert advice. For example, medical malpractice cases require technical medical expertise, construction cases may require technical engineering expertise, and intellectual property cases may require technical expertise in any of a number of fields. In the U.S., on direct and cross-examination, expert witnesses typically present technical facts to either a judge or a jury, who usually lack such technical knowledge. Although U.S. judges have the right to appoint experts, they rarely do so. Additionally, when such experts are appointed, their opinions may be subjected to cross-examination and challenged by party witnesses. Although the rate of litigation has not increased with adoption of the New Code, there is evidence that the number of complicated cases has increased. This increase, combined with the need to further reduce the time necessary to resolve cases, is creating additional stress in the Japanese judicial system. For example, the number of medical malpractice cases brought in the District Court has risen consistently from the adoption of the New Code until today. The figures for medical malpractice cases show:

of an issue. See, e.g., Marcus, supra note 35. Thus, in the U.S., the court can only narrow the issues in a case by resolving the issues raised by the parties. See Tahirih V. Lee, Court-Appointed Experts and Judicial Reluctance: A Proposal to Amend Rule 706 of the Federal Rules of Evidence, 6 YALE L. & POL’Y REV. 480, 490–93 (1988).


Id.

Id.

See The Japanese Court System’s Statistics, supra note 96.
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Malpractice Cases

<table>
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<th>Year</th>
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<td>2000</td>
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<tr>
<td>2001</td>
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</tr>
</tbody>
</table>

Bengoshi and others interviewed noted this increase in complicated cases (in this sense of the term) and the need to handle such cases better than they are currently. Those interviewed agreed that the consolidated hearing system embodied in the New Code helped deal with the increase in complicated cases. Since these cases involved the use of several witnesses, they lend themselves to the consolidated hearing method. However, there was a general feeling that more needed to be done in order to move these cases along to judgment faster. As of 2001, statistical evidence showed that medical malpractice cases were resolved in an average of 32.7 months, whereas in 1999 (the year for which figures were used by the Judicial Reform Council) such cases were resolved in approximately 34.6 months at the District Court level.

The Judicial Reform Council recognized this problem in its report and made several recommendations to deal with these lengthy resolutions. Among the recommendations were using

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325. From a Rule of Law judicial system standpoint, the increase in medical malpractice cases proves interesting and bodes well for the legal system as a Rule of Law mechanism. It is not known why the number of malpractice cases is increasing, but it is suggested that factors outside the New Code are responsible. Particularly important may be the public’s greater knowledge of medical mistakes made by doctors and institutions such as hospitals, as well as the developing substantive law concerning patient’s rights in Japan. See Yutaka Tejima, Recent Developments in the Informed Consent Law in Japan (I), 36 KOBE U. L. REV. 45 (2002).
“expert commissioners to support judges,” improving the “court appointed expert witness system,” and strengthening the technical expertise of the legal profession. The judicial system has recognized the challenge presented by these new complicated cases and is attempting to find solutions. Since it is recognized that both judges and lawyers lack technical knowledge, one idea being considered is that the judicial system should hire its own experts to work along side judges, as part of the judicial system. Thus, physicians or engineers might be hired as judicial research assistants to provide technical advice to the judge. Such a system, mimicking the system in effect for intellectual property cases, is seen as having the advantage of accuracy, since the expert is assisting in the decision-making, rather than a layperson. Expert assistance also expedites the task of issue clarification. However, such a system may have Rule of Law ramifications.

If experts are hired as a part of the court bureaucracy to advise judges in camera, parties will not have the opportunity to challenge the expert opinion in front of the decision-maker. Such a system may be seen as taking the decision out of the public arena and placing it in a secret arena. Even if experts on the court payroll are required to present their findings in open court, by denying parties the opportunity to challenge the court expert (through cross examination and/or party hired experts), parties may feel that they are being denied a public and fair process. Indeed, a system that does not permit open challenge to the expert opinion may undercut the objective of accuracy being sought. Whatever the shortcomings, the ability to cross-examine an expert and to put on expert testimony in support of a party’s position does have the advantage of exposing the experts’ views to public scrutiny and allowing challenges


327. In discussing use of technical experts as “expert commissioners to support judges,” the Judicial Reform Council expressed concern that any such system could “assure[e] the transparency of procedures” and raised questions regarding whether expert commissioners “can be considered fair and neutral from the standpoint of both patient and doctor, and whether expert commissioners might exert some hidden influence on the process whereby judges form their decisions.” Id. These same concerns should apply to a new “expert employee” or “expert research assistant” system.
that the expert may not have considered. Such examination will aid the court in reaching a “correct” judgment.

Another alternative is for the court to create a list of “expert Commissioners.” These Commissioners would not be full time court employees. Instead, one such Commissioner would be called upon by the court, on a case-by-case basis, to sit with the judges hearing a case. The “expert Commissioner” would advise the judge as to the expert testimony heard in the case. In effect, the “expert Commissioner” would be a “super expert,” commenting on the validity of the opinions expressed in open court by witnesses. However, if the court received the views of the “expert Commissioner” in camera and without confrontation or possibility of contradiction, severe due process and Rule of Law questions could arise. Indeed, if taken as part of the court’s deliberations and not as evidence, the views of the “expert Commissioner” would not be available for review by an appellate court.

Of course, requiring court-appointed experts, hired experts, or expert Commissioners to give the parties copies of their opinions and subjecting them to cross-examination and/or opposing expert views takes time. Nonetheless, some scholars find that the increased fairness and perceptions of fairness among parties and the public, as well as greater accuracy, is worth the extra time.328 While today’s bengoshi are not sufficiently educated in medical or engineering matters to conduct a valuable cross-examination, the legal education system is changing and part of that change is allowing persons from faculties other than the law faculty to become bengoshi (and hence judges as well).329 This change may have the effect of opening the legal field up to persons with knowledge in these specialized fields. Further, one of the objectives of the new law school system is educating students on the practical aspects of lawyering.330 With an education based on the Socratic method and challenge to responses, tomorrow’s bengoshi may be better prepared for such cross-examination than may be the case today. In an ef-

328. Recommendations of the Judicial Reform Council, supra note 19, at ch. II, pt. 2. See also Lee, supra note 320, at 490–93.
330. Id.
Fort to bring more expertise in other fields to the legal and judicial practice, perhaps new law schools should exempt some limited number of licensed or otherwise accredited professionals in specific non-law fields from the entrance exam requirements or give such persons extra consideration. Such exemption might be particularly useful where medical doctors or construction engineers (two fields where complicated cases appear to be on the rise) are law school applicants.

If cross-examination is deemed unnecessary for a civil law non-adversary system, then expert opinion, including the views expressed by “expert Commissioners,” should, at a minimum, be made publicly available to the parties in advance of a decision. With this notice, parties can submit conflicting expert opinion or views to correct perceived errors in “expert Commissioner” advice. Additionally, this system would create a dialogue between experts and judges and might reveal areas of inquiry not considered by court-retained experts as witnesses or Commissioners. Giving the court the gatekeeper function of determining whether a party should be allowed to submit an expert to contradict a court employee expert is inadequate. A judge is unlikely to permit such a contradicting witness because to do so would both sanction a challenge to a colleague and take additional time in the trial. Moreover, once the court has determined that expert advice is important in the case, failure to allow the parties an opportunity to present their own expert witness would be inconsistent with the objective of the new reforms to better train lawyers so that they can better prepare and try cases. Further, denying a party’s request to present its

331. While retaining a “civil law” based substantive law system, the post-war procedure in Japan was modeled on the U.S. adversary system, and the New Code retains the adversarial form of examination and cross-examination of witnesses. ALFRED C. OPPLER, LAW REFORM IN OCCUPIED JAPAN 130–34 (1976). Under Rule 114 of the Japanese Rules of Civil Procedure, cross-examination is limited to matters brought out on direct examination or matters relevant thereto as well as credibility issues. MINJI SOSHI-O KISOKU, art. 114.

332. A Japanese judge’s role in determining whether a party in such circumstance can present a witness is not similar to the role of the U.S. judge under Daubert, since in the Japanese situation, through its actions in appointing an expert, the Court has impliedly decided that the expert advice sought meets the reliability and professional standards set in Daubert. For a discussion of Daubert, see supra note 187 and accompanying text.
own expert will likely lead to that party filing an appeal and urging the appeals court to hear its witness. Even in the likelihood that the appeals court refuses to hear the witness, the appeal itself will take time and will add to the costs of the litigation system.

The July 2003 reform adopts a form of the “expert Commissioner” system but does not adopt the full time expert employee system.333 Under the 2003 reform, the opinion of the expert Commissioner must be given in the presence of opposing counsel (or if given by phone, a record of the opinion must be made and given to counsel); counsel then has an absolute right to present an expert opinion of their own.334 The opinion of the expert Commissioner will be a part of the record in the case and thus will be available to a reviewing court.335 Since the court is compelled to hear an expert proffered by a party whose opinion differs from the expert Commissioner, the Commissioner’s opinion is not conclusive. Nonetheless, the court is likely to give greater weight to the opinion of the expert Commissioner than to that of an expert presented by a party. There is nothing inherently wrong with such a system because the expert Commissioner may be viewed by the court as neutral, while a witness proffered by a party may be viewed as somewhat less neutral.

F. Relations between the Bench and the Bar

One of the more interesting serendipitous perceptions arising from the interview process was the gap in thinking, understanding and respect between the Bench and the Bar. Among Japanese lawyers, the perception existed that judges were ei-


334. It remains to be seen whether Japanese judges will use their gatekeeper authority to limit such expert opinion to written opinion or whether they will permit the parties to present oral expert testimony. If limited to written opinion, it can reasonably be assumed that the opinion of the party expert will play little, if any, role in the determination of the case.

ther unwilling or lacked the time to make difficult decisions regarding the consideration evidence that could affect a case.\textsuperscript{336}

Yet, lawyers appeared to be unwilling or lacked the time to educate the court regarding the necessity of making decisions or allowing of certain evidence.\textsuperscript{337} Lawyers instead wanted judges to prod opposing counsel to produce or find evidence and issues to assist their client.\textsuperscript{338} They wanted judges to suggest settlements so that cases could be resolved, rather than lawyers being the vehicles for settlement talks.\textsuperscript{339} Judges, on the other hand, complained that lawyers were ill-prepared and unwilling to do the work needed to move the cases along swiftly.\textsuperscript{340} Judges felt the need to be paternalistic in their approach\textsuperscript{341} because so many parties were either not represented or were (in the judge’s view) inadequately represented.\textsuperscript{342}

In short, there appeared to be a significant divide between these legal professionals. This divide is mirrored in the discus-

\begin{itemize}
\item \textsuperscript{336} See, e.g., Interview with lawyer (E) in Saitama, Japan (on file with author).
\item \textsuperscript{337} Id.
\item \textsuperscript{338} A lawyer in Nagoya reasoned that the inquiry procedure was infrequently used because it was much better for the court to do the questioning than for counsel. Interview with lawyer (A) in Nagoya, Japan (on file with author).
\item \textsuperscript{339} See, e.g., Interview with lawyer (M) in Hiroshima, Japan (on file with author). A judge interviewed outside Tokyo expressed the view that settlement should be in the hands of the lawyers, but that lawyers were afraid to raise settlement discussions for fear it would expose weaknesses in their case. Interview with High Court Judge (R) in Japan (on file with author). As a result, lawyers want judges to raise settlement issues, remaining sensitive to the lawyers’ need for the court to initiate such discussion for fear of exposing individual case weaknesses. Id.
\item \textsuperscript{340} A judge interviewed outside Tokyo noted that due to problems with lawyer preparation, judges had to be actively involved in the cases. Interview with High Court Judge (R) in Japan (on file with author). Moreover, this judge was of the view that lawyers in general had confidence in the government, including the judicial branch, and thus wanted judges involved. Id.
\item \textsuperscript{341} Miki, supra note 85, at 5 (“Japanese judges tend to be paternalistic and support the weaker side....”).
\item \textsuperscript{342} Interview with High Court Judge (R) in Japan (on file with author). Lawyers are aware of this feeling by judges. As one lawyer noted, judges have a certain “arrogance” and look down on lawyers. Interview with lawyer (E) in Saitama, Japan (on file with author). See Kamiya, supra note 182, at 70 (noting that the paternalistic attitude of courts “may be justified by the fact that the Code allows litigation to be filed and conducted without legal counsel or representatives”).
\end{itemize}
sion regarding entrance requirements for new law schools that will become operational at the beginning of 2004. To begin with, issues arise regarding whether entrance exams for these new law schools should be prepared by the Ministry of Education (probably with some input by the Judicial Branch) or the Bar Associations. The likelihood is that two different entrance exams will be prepared and law schools will be allowed to choose one or the other and, perhaps in some cases both. Similarly, with the advent of the new law schools, what will be the role of the Judiciary’s Legal Training and Research Institute?

343. Although there is said to be a separation of powers in Japan, judges are regularly assigned to the executive branch to assist and work alongside administrative officials. Oda, supra note 1, at 395–98. This assistance can include the representation of the government in litigation as well as opining on the constitutionality of legislation throughout the legislative process. Id. The former creates the specter of a judge as counsel for a party, and the latter complicates the judicial function when an issue of constitutionality is raised in a case or controversy due to the likelihood that, in a highly administrative State such as Japan, their colleagues respect judges assigned to the executive branch. See Civil Procedure in Japan Revised, supra note 8, at § 3.02(4).

In the course of their long careers and as a step in their promotion, the judges are sometimes appointed to a non-judicial task inside or outside the judiciary….Outside the judiciary, the greatest number of judges are assigned to various positions in the Ministry of Justice, as legislative or administrative staff, or as government attorneys….Generally speaking a judge’s career path is regarded highly when it includes one or two of the above-mentioned special assignments.

Id. The fact that colleagues have approved of the court’s ability to challenge the constitutionality of laws places a burden on courts which might have questions concerning the constitutionality of certain laws. This burden certainly places the challenging party at a disadvantage.

344. In August of 2003, eighteen thousand persons took the exam for entrance to the New Law Schools administered by the Japanese Bar, i.e., the Japan Law Foundation. However, another entrance test was administered on August 31 by the National Center for University Entrance Exams. “It is up to each graduate school to decide which tests to consider in evaluating applicants, but many graduate schools are expected to refer to both….” 18,000 Take Exams for New Law Schools, JAPAN TIMES, Aug. 4, 2003 at http://www.japantimes.co/cgi-bin/getarticle.pl5?nn20030804a3.htm.

345. The likelihood is that the Institute will continue, although the time required for attendance will be shortened from eighteen months to one year and the reduction will be distributed among the various aspects of Institute study, namely the classroom, intern program and final class sessions to incorporate what has been experienced in the intern program. Discussions with
Should there be continuing legal education requirements and, if so, is it appropriate for the judges to lecture at these CLE courses? Would such lecture process be seen by the Bar as an attempt by the judicial branch to control the Bar?

Some Japanese lawyers and professors interviewed did not see this divide between bengoshi and judges. Others acknowledged the existence of such a divide, but contended that it was small, at least in comparison to the past divisions between the two branches of the profession. Nonetheless, comments by both the Bench and the Bar indicate that a significant divide exists. In part, this gulf is historical, based on the Bar’s desire to preserve its autonomy and viewing judicial involvement in Bar matters with concern. This concern is heightened by the

Judicial Secretariat and officials at the Institute in Tokyo Japan (on file with author).

346. See generally Interview with lawyer (A) in Nagoya, Japan & Interview with lawyer (I) in Osaka, Japan (on file with author) (noting that the personality of the judge primarily affects how bengoshi perceive the divide between bengoshi and judges). But see Tanabe, supra note 121, at 553.

347. See Tanabe, supra note 121, at 553. See, e.g., Interview with lawyer (T) from Japan (on file with author).

348. At one time, all judges were graduates of the Imperial Universities and accordingly were highly respected. Rabinowitz, supra note 8, at 70. At the same time, the predecessor of the bengoshi, the kujishi and later the daigennin were not required to be graduates of any school and many had no professional training or qualifications. Id. at 71. In the early period of modern Japanese law the reputation of daigennin was so bad “that a special term of opprobrium, sambyaku daigen, a term which it has been suggested might best be translated as ‘shyster’ or ‘pettifogger,’ gained currency.” Id. at 67. One purpose of the Lawyers Law of 1933 was to raise the qualifications for bengoshi “to the same level as those of judges and procurators.” Id. at 75. As recently as 1974, Professor Tanaka could write:

[I]t must be said that the legal profession as a group still has a long way to go in order to gain general social acceptance of the social status it claims and of the role it plays. This is as much a question of changing the way of thinking of the general public as it is a challenge to the legal profession to improve its standing by its own efforts.

Tanaka, supra note 28, at 265; see also TANAKA, THE JAPANESE LEGAL SYSTEM, supra note 8, at 550 (“Practicing attorneys were in a lower position socially as well.”). Thus, the view that being a bengoshi was an “honorable” profession is of relatively recent origin while the judge position was always viewed as a highly regarded public servant. In a country where the bureaucracy is highly respected, judges were (and remain) among the most highly regarded. Moreover, until the Post-war period the legal profession was under the control of the Ministry of Justice. The profession had long chaffed under government
fact that Japan’s Supreme Court is specifically given rule-making authority for all matters relating to attorneys. In part, the divide represents a different experience with and outlook toward the litigation process.

The Judicial Reform Council recommended that the Bar be more involved in judging and teaching. Thus, the new law schools are encouraged to use “adjunct professors” who are members of the litigating Bar, and the judicial branch is encouraged to hire practicing lawyers as judges. Although technically eligible to become judges after entering the practice of law, the reality is that “[j]udges are nearly always selected from...assistant judges with 10 or more years of experience, because public prosecutors, lawyers and law professors with 10 years experience normally are not available for appointment to a Judgeship.” These recommendations are likely to have muted success. Some law schools appear to have adopted a policy under which the “adjuncts” work full-time for a few years, thus giving up their active practices and financial rewards. This approach is unlikely to attract the “best” of the practicing Bar. Similarly, the salary discrepancy between successful practicing lawyers and judges of similar age and experience may prevent successful lawyers from seeking judicial positions.

regulation. The Post-war occupation did away with Ministerial control and made the Bar mostly self-governing. Rabinowitz, supra note 8, at 76–77, 80.

349. KENPO, art. 77 (“The Supreme Court is vested with the rule-making power under which it determines the rules of procedure and of practice, and of matters relating to attorneys, the internal discipline of the courts and the administration of judicial affairs.”).
350. See generally Recommendations of a Judicial Reform Council, supra note 19.
351. CIVIL PROCEDURE IN JAPAN REVISED, supra note 8, at § 3.02(2).
352. Id.
353. See TANAKA, THE JAPANESE LEGAL SYSTEM, supra note 8, at 552 (noting that practicing attorneys are reluctant to accept the decrease in income that inheres to entering the judiciary); Takahara, supra note 29.
354. Discussion with Professor Miki in Tokyo (on file with author).
355. The prospect for adjunct judges is better as new legislation permits judges to continue to remain in their judicial positions while teaching at law schools. Previously, judges who wanted to adjunct teach were required to take time off from their judicial positions, while under the new law such teaching is considered a judicial duty and can therefore be performed on “judicial time.” See Act to Dispatch Judges, Prosecutors to National Civil Service Employees to Law Schools, 15 Heisi (2003) Statute No. 40 (Japan).
Moreover, there are currently few practicing lawyers in Japan.\textsuperscript{356} Transferring some of these practicing lawyers to judicial positions will further reduce the number of lawyers available for the public. A more radical approach to Bar and Bench relations may have to be considered if the gulf between them is to be addressed.

In the U.S., the divide between the Bench and the Bar is not nearly as broad as appears to be the case in Japan.\textsuperscript{357} One explanation is that federal U.S. judges are typically appointed after a successful (and profitable) career in the private practice.\textsuperscript{358} In any event, even the thought of a District Court judge appointment without any litigation experience is bizarre. Many U.S. judges were leaders in Bar Associations before joining the Bench and many continue to be actively involved in Bar Association activities after appointment.\textsuperscript{359} The fact is that U.S.


\textsuperscript{357} In the U.S., the failure of Congress to raise the salaries of federal judges and bring them closer to the salaries of lawyers in major firms has created something of a gulf between the Bar and federal judges. The Need for Judicial Pay Reform, Statement of the American Bar Association President, submitted to The National Commission on the Public Service, available at http://www.abanet.org (last visited Nov. 16, 2003). The Bar responded by supporting the judicial branch’s efforts to get pay relief. Independence of the Judiciary: Judicial Compensation, 2002 A.B.A. Legis. & Gov’t Priorities, available at http://www.abanet.org/poladv/priorities/judcom.html (last visited Oct. 30, 2003), which states:

\begin{quote}
The ABA supports legislative action to increase judicial compensation and ensure regular cost-of-living increases for federal, state, and territorial judges and the administrative judiciary, and urges Congress to de-link Congressional pay from judicial pay. The ABA also recommends periodic, systematic review of the adequacy of federal judicial pay (along with the adequacy of pay for other top-level government officials) in order to provide our judges with adequate and fair compensation.
\end{quote}

\textit{Id.}

\textsuperscript{358} Marcus, \textit{supra} note 35, at 28 (“U.S. Judges, too, were distinctive. Rather than emerging from professional training directed toward service in the judiciary, they came usually from the practicing Bar, and also had limited formal education.”).

\textsuperscript{359} The Japanese Federation of Bar Associations is composed of local Bar Associations and “all individual lawyers...members of the bench or procuracy
judges are members of both the Bench and the Bar. Judges understand the challenges and frustrations of the private practice because they experienced them themselves. Furthermore, lawyers tend to be more understanding of the pressures placed on the Bench because there is open dialogue about these issues. Both the Bench and Bar participate in legal education activities as adjunct professors, while actively employed outside the academic world. In short, there is a commonality of experience and interests between U.S. lawyers and judges.

Meanwhile, Japanese judges are part of a career civil service system and are exposed to the practice of law during their tenure at the Legal Training and Research Institute. All trainees are required to intern in the field at law offices, prosecutor’s offices and judge’s chambers. Through these training internships, trainees are educated to respect, and at times defer, to the other branches of the legal profession. However, this exposure is only for a relatively short period at the beginning of a career and does not provide the in-depth exposure to the practice of law that comes from dealing with clients and client-related issues on a daily basis.

On the other hand, U.S. judges are not moved from location to location but are appointed to the circuit or district where they serve. As a consequence, U.S. judges have a close relationship with the communities where they live and work. That relation-

cannot be members of the Federation.” CIVIL PROCEDURE IN JAPAN REVISED, supra note 8, at § 205(2).
361. CIVIL PROCEDURE IN JAPAN REVISED, supra note 8, at § 3.02(4).
362. Id.
363. LEGAL TRAINING AND RESEARCH INSTITUTE OF JAPAN, supra note 76, at 7.
364. Id. at 11–12. The Legal Training and Research Institute notes that:

During the field training term, legal apprentices are assigned to the district courts, the district public prosecutors’ offices, and the local attorney’s associations throughout the country. The field training lasts twelve months and is subdivided into three-month rotational assignments at each of the civil trial, criminal trial, public prosecution, and private practice of law.

Id.
ship extends to others who have similar training, experience and backgrounds — in other words local lawyers. Unlike Japanese judges, U.S. judges do not live together in compounds created or funded by a judicial bureaucracy. 366 Judges may have friends among their colleagues, but they also have friends among their former colleagues at the Bar and among the general community.

Most significantly, U.S. judges are not career judges who start their professional life as judges and seek to prosper within the judicial bureaucracy. 367 They are not “inbred,” learning their craft from the judges who came before them. Instead, they bring new experiences and new ideas from outside the Bench to the courtroom. However, this discrepancy can lead to unfortunate consequences in individual cases; for example, judges may be unprepared to sit on the Bench, may not understand how to work within the judicial system, or may be appointed because their brother went to school with a U.S. Senator rather than because of their ability. 368 Whatever the shortcomings, the U.S. system does provide a commonality of experience between judges and lawyers, as well as, a greater understanding and appreciation of each other’s experiences. Additionally, the knowledge and experience that judges with previous litigation experience may have in representing and understanding client issues is important from the judicial standpoint.

Still, convincing bengoshi to give up their lucrative practices and lifestyles in communities where they have ties and are respected only to move into the bureaucratic world of the traveling Japanese judge may prove difficult. 369 However, something

367. Marcus, supra note 35, at 28 (“[U.S. judges] surely did not rise through a judicial bureaucracy.”).
368. See generally American Bar Association, supra note 111 (noting that the U.S. judiciary is becoming increasingly politicized, creating public doubt as to whether judges make decisions on matters of fact and law or based on political pressure and special interests).
369. CIVIL PROCEDURE IN JAPAN REVISED, supra note 8, at § 3.02(4).
short of such a dramatic change may prove useful.\footnote{370} Perhaps aspiring judges, who choose the judicial life when in school or at the Legal Training and Research Institute, may be required to spend five years in the active private practice before they can be appointed as judges in training. Such a requirement would assure that judges have some practical experience before ascending to the Bench.\footnote{371} This requirement would also make them active members of the Bar community before becoming judges and might help to bridge the gap between the Bench and Bar in Japan.\footnote{372} Additionally, practicing \textit{bengoshi} recruited for the

\footnote{370}{One \textit{bengoshi} interviewed stated that if she could change one thing about the civil justice system she would abolish the career judge system and require that all judges be appointed from among practicing lawyers. Interview with lawyer (E) from Saitama in Washington, D.C., U.S.A. (on file with author).}

\footnote{371}{In the past, the Japanese judicial system has opposed such a suggestion. \textit{See} Supreme Court Accepts Advisory Panel on Judges, \textit{Japan Times Online}, Feb. 20, 2001, \textit{available at} http://www.japantimes.co.jp/cgi-bin/getarticle.pl?nn20010220a3.htm (Supreme Court of Japan accepted a panel to assist on Judicial selection but rejected the Bar Associations suggestion that all new judges first “work as lawyers or prosecutors for five years to broaden their experience.”). However, in light of changing attitudes towards Judicial Reform, it may be well to rethink this opposition and take a more global attitude that encompasses both the staffing needs of the judiciary and the judiciary’s need for a broader base of experience in the corps of judges. \textit{See} Rabinowitz, ibid at 77 for a discussion of the Bar’s attempts, as early as 1956 — the date of the Rabinowitz article — to achieve professional “integration,” meaning “selection of members of the judiciary from the Bar rather than directly from among graduates of the Judicial Research and Training Institute.” \textit{Id.}}

\footnote{372}{Similarly, Japanese prosecutors tend to be career prosecutors who have never represented criminally accused clients. \textit{Legal Training and Research Institute of Japan}, ibid at 12–14 (“Upon successful completion of the final qualifying examination, a legal apprentice may choose to be an assistant judge, a public prosecutor, or a practicing attorney.”). Japanese defense lawyers, on the other hand, have rarely been prosecutors as such service entails also a career in civil service. As a consequence neither truly understands the position of the other. Whatever the shortcomings of the U.S. criminal law system, distance in experience between prosecuting attorneys and defense attorneys is not one of them. Generally, most U.S. prosecutors have spent at least some time as defense attorneys and most defense attorneys have worked as prosecutors. There exists a real revolving door between the prosecution and defense Bar. As a consequence, while the prosecutors and defense lawyers may sharply disagree on issues, they each understand the position of the other — having been the other and perhaps considering being the other in the future. Japan may wish to explore whether it is helpful to the criminal law
Bench can be exempted from the transfer requirements, under which judges are moved around the country on an average three-year cycle. Having established ties in a particular locality, these *bengoshi* may be given the option of remaining in that locality during their service as a judge. Apparently, the Japanese Supreme Court has already decided to exempt such lawyers from the travel rotation system. \(^{373}\) More problematic, though, is determining how to deal with the practice that a *bengoshi* judicial candidate has built up over the years. Not only must the financial value of that practice be resolved, but the goodwill created over the years must be up-kept and the clients losing a trusted counselor must be protected.

Another problem in carrying out the Reform Council’s recommendation that more *bengoshi* become judges relates to the pay scale of judges — not simply where to place previously successful *bengoshi* judges without judicial experience on the pay scale, but also how to ensure that such judges receive appropriate pay consideration in the future. \(^{374}\) The likelihood is that any bureaucracy — including a judicial bureaucracy — will look more favorably on experience within its ranks than on outside experience. However, if *bengoshi* are to be recruited as judges, they must be assured as to future pay and responsibility equal to those who are their contemporaries in age and total professional experience. At the same time, if paid on the basis of experience and age alone, unsuccessful *bengoshi* may seek judicial appointment as a good alternative to unsuccessful practice. Yet, these individuals are not the *bengoshi* that the Reform Council envisions as future judges. In this regard, the practicing Bar also has a screening responsibility.

Another issue is that regarding retirement. Judges (except for Supreme Court Justices and Summary Court Judges) must re-


tire at age sixty-five.  Thus, a career judge who serves forty years as a judge has a significant retirement benefit. But, for a bengoshi becoming a judge after twenty years of experience, the retirement benefits received at sixty-five will be substantially less. Moreover, such a “bengoshi-turned-judge” may not wish to attempt to re-start a law practice after retirement, having already created a practice once before. Thus, such a bengoshi may be at a substantial disadvantage in retirement. To recruit successful, middle-aged bengoshi, the retirement rules may require modification. Perhaps, the law should be modified to allow “bengoshi-turned-judge” personnel to work until a later age or even be given retirement credit for some, if not all, of their years of active bengoshi practice. In any event, if the goal is to recruit successful bengoshi, some mechanism must be found to ameliorate the economic disadvantage that face bengoshi who wish to become a judge.

Further, rather than providing government subsidized housing where young judges are clustered together, consideration might be given to providing newly appointed judges with a housing allowance that would enable and encourage them to live among the people whom they serve. This housing will give judges more access to the lives of the people whose cases they

375. The compulsory retirement age of lower court judges is sixty-five, except for Summary Court Judges, who retire at 70. CIVIL PROCEDURE IN JAPAN REVISED, supra note 8, at § 3.02(2).

376. Goodman, The Somewhat Less Reluctant Litigant, supra note 15, at 807. Without some accommodation regarding the economic disadvantage of moving from bengoshi to judge, the likelihood is that only unsuccessful bengoshi will elect to become judges — but this is not the quality of judge that the system should be attempting to recruit. Of course, bengoshi who are so committed to the legal reforms may sacrifice themselves for the legal system and elect to become judges. However, such bengoshi should not be compelled to make this personal sacrifice and it will be difficult to find large numbers of such committed bengoshi. For example, in 1992, only a handful of practicing bengoshi actually became judges. In 1992, the National Bar Federation introduced a system in which they make recommendations to the Supreme Court regarding lawyers seeking judgeships. Although thirty-seven lawyers have made the change to the bench since the system was introduced, enthusiasm for the opportunity has been minimal. The change usually involves accepting a lower salary, giving up established clients and often a transfer to courts in remote areas. Takahara, supra note 29.
decide and give the public greater access to judges as real people at an early stage in their professional life.\footnote{377}

IV. CONCLUSION

One objective of the New Code of Civil Procedure, and a goal of the Judicial Reform Council, was to strengthen the judicial system as a Rule of Law dispute resolution mechanism. A few steps towards this goal were making the system more readily accessible to the public and strengthening the mechanisms of decision-making, such as quickening the pace of resolution and expanding the discovery of evidence, so that the public would in fact utilize the legal system for dispute resolution.\footnote{378} To make the system more accessible, the New Code expanded the jurisdiction of the Summary Court and introduced a new one-day small claims dispute resolution mechanism.\footnote{379} The small claims jurisdiction of the court appears to have had the desired effect as the number of small claims cases has increased on an annual basis at a rate that far exceeds that of new case filings in the judicial system on the whole. With respect to increasing the use of the judicial system in general, the New Code does not appear to have achieved its desired goal. The fact of the matter is that when the new small claim cases are factored out of the system, the number of new cases filed has barely changed since the New Code’s adoption.\footnote{380}

While the general use of the judicial system has not increased (with the exception of the small claims cases mentioned above), the pace of litigation has quickened so that on average new cases filed in the District Court are resolved relatively

\footnote{377. See generally McKenna, supra note 366, at 140 (noting that judges are subject to transfer to different geographical locations and are provided with housing in the same area as other judges). More experienced judges, who have saved sufficient funds to purchase their own residence and who can contemplate transfers within a relatively close geographic area, already purchase their own residences and many live among the general public. \textit{Id.} However, in their early years these judges tend to live in small, old and very inexpensive housing complexes that the Judicial Secretariat provides to them. \textit{Id.}}

\footnote{378. \textit{Id.} at 135–37.}

\footnote{379. \textit{MINSHO}, art. 370 (concerning the principles of a one-day trial).}

\footnote{380. See Hayashi, \textit{supra} note 143 and accompanying text (the table demonstrates that when small claims cases factored out, the increase in new cases filed in District and Summary Courts was negligible).}
quickly.\textsuperscript{381} This increase may be due to the “legalized” procedures in the New Code or due to the fact that judges are permitting fewer witnesses to testify in open court than was the case in earlier years.\textsuperscript{382} One question to be considered is why the number of new cases filed has not increased significantly since the adoption of the New Code. Undoubtedly, many other factors not considered in this study also have an effect on the number of new cases filed, such as the comparatively small size of Japanese damage awards, the continued high cost of litigation, the difficulties of collecting on a judgment, the time lag for the new \textit{bengoshi} reforms and legal education systems to take effect, and cultural factors. But, some of the factors considered herein may also be relevant.

Although the time to resolve an average case has significantly declined since adoption of the New Code, the fact remains that high profile cases continue to take several years for resolution at the District Court level and appeals of such cases take years at the High Court level.\textsuperscript{383} Due to the previous slow pace of resolution, the Japanese legal system needs to overcome the public perception that the system operates at a “snail’s pace.” The fact that some high profile cases take many years for resolution only furthers that perception. Similarly, the perception of the public is influenced by news reports that focus not on the improvements made in the time required to resolve the average litigation, but rather on the time delays in cases of public interest, both civil and criminal.

In addition, the failure to make greater use of the judicial system to resolve legal issues may be related to the way in which the system operates. Thus, the present system’s focus on “narrowing,” rather than resolving, issues presented in a case may have an effect on the system’s use. In approximately 85% of cases in the present system, no witnesses are heard, and in cases where witnesses are heard, the number keeps declining.\textsuperscript{384} Cases are resolved based on written materials or a form of trial

\textsuperscript{381} See \textit{Average Number of Months from Filing of Complaint to Disposition – District Court Chart}, supra Part III.A.1.
\textsuperscript{382} See \textit{Trials to be Expedited}, supra note 18.
\textsuperscript{383} See \textit{Percentage of Judgment Cases Decided in One and Two Years Chart}, supra Part III.A.1.
\textsuperscript{384} See \textit{Witnesses at District Court (First Instance) Chart}, supra Part III.A.4.
by dossier. Additionally, in many cases, there may only be a question of law which can be decided without evidence (rather than factual issues), and in others, a party may default. Even considering the dismissal of these cases, the high percentage of cases without witnesses and the declining number of witnesses in cases with oral testimony are likely to result in appeals, primarily based on procedural justice for the appellant, rather than substantive issues. To be an adequate dispute resolution system, the judicial system must not only do justice but must be perceived by the legal community as doing justice. A system in which the litigating parties rarely have an opportunity to personally state their case in front of the decision-maker in the formal setting of a trial or Oral Hearing is likely to be looked at as “removed” from the parties and failing to provide a “day in court.” Issues exist as to whether the cost of efficiency — the accelerating trend of not hearing live testimony — is too high.

Just as a minority of high profile, slow moving cases leads to the incorrect perception that all cases proceed slowly (when in fact the average case in Japan moves rather quickly), so too the lack of witness testimony may present a “perception” problem. “Paternalistic” Japanese judges are concerned with providing “substantive justice.” Judges want to issue a substantively correct decision to ensure that the party that should win does in fact win. Such judges are more concerned with a correct decision than with the procedural niceties surrounding the process. U.S. judges, on the other hand, are more concerned with procedural niceties and less concerned with whether substantive justice is achieved, as demonstrated by the relatively few jury awards that are set aside by the trial court. Yet, the possibility exists that some Japanese citizens do not use the legal system because they feel that the system does not provide them with justice, while many U.S. citizens use the system because they feel they can attain justice. If such is the case, perception (as distinct from reality) may have an impact on the judicial system as a Rule of Law dispute resolution mechanism.

385. See Tanabe, supra note 121, at 520–22.
386. See, e.g., BMW of North America, Inc. v. Gore, 517 U.S. at 568 (noting that only when an award is “grossly excessive” in relation to the State’s legitimate punishment and deterrence interests does it violate due process).
Further, the New Code reforms aim to make trials more reliable, efficient, and speedy, through the new inquiry procedure, the expanded document production language of the New Code and the new tools available to judges dealing with document production requests (\textit{in camera} review and redacting). \footnote{387} However, these goals appear not to have been realized in practice. Thus, \textit{in camera} review and redaction are virtually never used and the new inquiry procedure is similarly moribund. The inquiry procedure is not used to discover evidence, nor does it appear to narrow the issues to be tried or speed up the judicial process. Whether the reason for the failure of the inquiry system lies in the system itself — i.e., the fact that there are no sanctions for failing to respond or responding accurately — or elsewhere is a matter that should be further studied. One clear conclusion is that lawyers are not using the system as the New Code intended and in this regard, the system is not achieving its objective.

Similarly, while leading to the greater production of documents through the use of court suggestions, new document procedures do not appear to lead to the greater production of significant documents, at least in cases between private parties. Whether the reason for this problem is the reluctance of courts to punish individuals for failing to respond, or the substantive rules surrounding production requirements (i.e., the self-use document exception), it appears that the New Code’s catch-all document provision has not had a significant effect on making truly relevant documents available. According to \textit{bengoshi} interviewed, the New Code’s “discovery” provisions do not make it easier for a righteous plaintiff to obtain judicial relief.

Although most \textit{bengoshi} interviewed were not prepared to suggest that litigation today be instituted because it may be resolved at any higher rate than in the past, in certain areas the pace of new filings has increased. These cases generally consist of more complicated cases, such as malpractice. Here, the reasons for increased filings may be related to factors other than the New Code and new judicial activism to speed up resolution of cases. In the malpractice field, the substantive law seems to be changing, placing a greater burden on doctors to be more open with their patients and to more closely consider their

\footnote{387. \textit{See} Ota, \textit{supra} note 9, at 568–70.}
patient’s wishes. Perhaps, more malpractice cases are instituted today due to the combination of this higher burden on doctors and greater public awareness of medical matters (through availability of information on the World Wide Web and otherwise). Complicated malpractice cases take longer to resolve than simple litigations. Thus, although methods to enhance the efficiency of such cases should be pursued, restricting a party’s ability to challenge the expert opinion of a court-employed expert may be counter-productive to obtaining a “correct” decision and to enhancing the public’s perception of the judicial system as a Rule of Law system wherein justice can be obtained.

Based on the fact that the greatest rise in new cases is in the area of complicated cases and the average case is disposed of quicker than in the past, the conclusion can be reached that on the whole, cases are actually disposed of at a faster rate than the average figures would show. On one hand, the figures are skewed because all cases, even default cases, require at least two months for resolution if for no other reason than to allow for an answer and to determine whether there has been a default. On the other, the figures are skewed because non-average cases are the more complicated cases. Accordingly, the new procedures of the New Code designed to speed up litigation appear to be working. It matters not whether the reason is the “Code” itself, the judges’ perceived new inclination to expedite litigation, or the “legitimization” of the pre-Code reforms by the New Code. Average cases are resolved quicker than before the New Code’s adoption, and “non-average” cases are also disposed of more quickly. The fact that this improvement has not led to greater litigant use of the judicial system should be further explored if the objective of strengthening the judicial system in Japan as a Rule of Law dispute resolution mechanism is to be realized.
APPENDIX A

INTERVIEW QUESTIONS

1. Have the preliminary procedure provisions speeded up the pace of litigation? Has the procedure resulted in significantly narrowing the issues to be tried?

2. Has the procedure allowing inquiries to be made of the other side resulted in significant discovery of facts not already known to the inquiring party?

3. As the attorney for a party to whom an inquiry has been made, do you feel an obligation to provide answers even if the answer is harmful to your client’s position? If the could be harmful to your client’s position, do you feel an ethical obligation to a) answer or b) refuse to answer the inquiry?

4. As a Professor of Civil Procedure Law do you believe that a lawyer who has been asked an inquiry has an obligation to provide an answer even if the answer is harmful to his client’s position? If the answer could be harmful to his client’s position do you feel a lawyer has an ethical obligation to a) answer or b) refuse to answer the inquiry?

5. Has the procedure for inquiry resulted in the identification and ultimate production of documents detrimental to the position of the answering party and helpful to the inquiring party?

6. Has the procedure for making inquiry of the other side resulted in significant changes in document production by one party to another? If so, how would you describe such changes?

7. Have the new document production provisions, such as the court’s in camera review, the redacting of documents so that portions of a document may be produced and portions not produced, the new “catch-all” provision of the document production section CCP220(iv) had a
significant effect resulting in the production of relevant documents not obtainable under the prior code?

8. Have the new document production provisions made it easier for a potential plaintiff to be successful in litigation?

9. Have the new document production provisions resulted in more and more important documents being produced by defendants in the aid of a plaintiff’s case?

10. Since the adoption of the new Code of Civil Procedure, have you observed any change in the Court’s attitude toward the production of self-use documents?

11. Have you observed any change in the Court’s attitude toward what the Court would consider to be a self-use document? If so, what change: a greater willingness to allow production; or less of a willingness to allow production?

12. Do you believe that the self-use document exception to production limits the ability of the plaintiff to obtain significant documentary evidence adverse to the interest of defendants?

13. Would you like to see an amendment of the Code restricting the definition of self-use documents so as to allow for greater production of self-use documents? Why?

14. What effect, if any, do you think liberalization of the self-use document exception so as to allow for production of self-use documents when the document is directly relevant to the issue of whether a party knew of should have known that its actions were improper, would have on litigation rates in Japan? Would such a change result in more litigation or would it have no meaningful effect on the number of cases that might be brought? As a litigating lawyer do you think such a change would result in your recommending that client’s sue in more cases than you recommend today? Can you think of any situations in which you recommend that a client NOT sue where you would have recommended that a client sue had there been no self-use exception to the document production rule?
15. After the Daiwa Bank derivative lawsuit decision the Diet enacted a law permitting the limitation of liability of Directors in derivative cases. What effect do you think such legislation has had on the willingness of persons to file derivative lawsuits? What do you think was the reason that the Diet passed such a limitation of liability provision?

16. Have the provisions allowing for persons to join representative actions after the lawsuit has already been filed resulted in significant numbers of persons joining such suits after they have been filed? Do you think lawyers under supervision of the Court should be allowed to place notices in the newspapers advising persons of the filing of a representative suit and advising as to how persons may join such suits? Why?

17. Has the New Code of Civil Procedure affected how the judge acts during litigation in the District Court? If so, in what way? For example, is the judge more or less active (or the same) in examining witnesses or proposing settlements?

18. Do you think more or less (or the same number of) cases are referred to conciliation under the new Code than were referred under the Old Code?

19. In view of the changes made by the New Code of Civil Procedure, are you more likely to recommend that clients file civil cases in the District Court than you were under the Old Code?

20. In view of the changes made by the New Code of Civil Procedure, are you more likely to recommend that clients file civil cases in the Summary Court than you were under the Old Code?
RULES OF ORIGIN: NAFTA’S HEART,
BUT FTAA’S HEARTBURN

Jorge Alberto Ramírez

INTRODUCTION

The North American Free Trade Agreement (“NAFTA”) went into effect on January 1, 1994. Yet, nine years after its passage, questions remain about its impact on the economies and environment of the United States (“U.S.”), Canada and Mexico. Although economists can make certain assumptions

2. Altieri explains that [m]easuring the total benefit from eight years of NAFTA is not easy. In the United States, the [United States Trade Representative, known as the] USTR suggests that NAFTA has increased household income by $1,300 to $2,000 annually, and that since NAFTA was signed, U.S. manufacturing has added over 400,000 jobs. Nonetheless, the USTR has failed to provide documentation pursuant to a Freedom of Information Act request for substantiation of the USTR figure. Public Citizen estimates NAFTA has caused the loss of 1.7 million U.S. manufacturing jobs and a surging $450 billion U.S. trade deficit. Global Exchange says more than 765,000 U.S. jobs have disappeared as a result of NAFTA. When these laid off workers find new jobs, they earn 23 percent less on average than at their previous employment. In Mexico, manufacturing wages fell 21 percent from 1995 to 1999, and have only started to recover. The percentage of Mexicans living in poverty has also grown since NAFTA went into effect.


while U.S. companies have benefited from free trade, most workers feel left out in sharing those gains, ... workers’ wages for the past several years have remained stagnant and many... of the new jobs cre-
based on NAFTA’s short-term results, it is not yet fully implemented in many respects. Despite this fact, the thirty-four countries of the Western Hemisphere (“Partner Nations”) continue to pursue a Free Trade Area of the Americas (“FTAA”), which would be a free trade area like NAFTA, but which would extend beyond Mexico to encompass all of Central and South America. The decision to extend North America’s blanket of free trade beyond Mexico’s southern border solidified only eleven months after NAFTA’s implementation. Discussion of an FTAA began at the First Summit of the Americas held in

Michael C. McClintock, *Sunrise Mexico; Sunset NAFTA-Centric FTAA—What Next and Why?,* 7 *SW. J.L. & TRADE AM.* 1, 77 (2000) (internal citation and quotation marks omitted). Furthermore, Gilmore states that while [it] is obvious from the increases in Mexican trade they have received a substantial benefit from NAFTA, it is difficult to quantify what benefits NAFTA has bestowed on the United States based on the statistics. While it is true that exports to Mexico have increased substantially, since they are now the third largest trading partner of the United States, they only account for a small share of total U.S. exports.

Gilmore, supra note 1, at 395. “NAFTA has created job gains and losses, but genuine disagreement exists as to whether NAFTA has created or lost more jobs.” McClintock, supra note 2, at 24.

3. Transition periods for tariff reductions will continue to run until January 2008 for certain sensitive products. North American Free Trade Agreement, Dec. 8–17, 1992, Can.-Mex.-U.S., 107 Stat. 2057, 32 I.L.M. 289, Annex 302.2 [hereinafter NAFTA]. In addition, emergency relief in the form of suspension of tariff reductions called for by NAFTA may be invoked under Chapter 8 of NAFTA until that time. Finally, obstacles to trade in service industries such as trucking have not been fully implemented and have recently been hampered by at least one decision in the U.S. Federal Courts. See Public Citizen v. U.S. Dep’t of Transp., 316 F.3d 1002 (9th Cir. 2003) (holding that the Department of Transportation’s promulgation of three regulations without prior environmental analysis violated the Clean Air Act and state law but fulfilled the NAFTA obligations. The case was remanded to the Department for proper analysis.). See also The American Society of International Law, *Contemporary Practice of the United States Relating to International Law: U.S.-Mexico Dispute on Cross-border Trucking,* 97 *AM. J. INT’L L.* 179, 194 (Sean D. Murphy ed., 2003) (providing a brief overview of the NAFTA trucking dispute and the 9th Circuit opinion dealing with it).


5. Id. at 1.
Miami in December 1994. At this first meeting, the thirty-four democracies of the Western Hemisphere agreed to pursue a free trade area that would encompass all of the Americas by December 2005. Since 1994, the Partner Nations have negotiated intensely, and have resolved many potential problems. Still, significant problems remain.

As with the negotiation and implementation of NAFTA, the ultimate success of any FTAA will hinge on developing workable rules of origin, which play a critical role for any free trade area agreement. The concept of a free trade area (“FTA”) is

6. See generally id. at 1–4 (describing events that led to the Miami Summit).
7. Cuba, because of its Communist form of government, was the only country of the Western Hemisphere prohibited from participating in the Miami Summit. Christopher M. Bruner, *Hemispheric Integration and the Politics of Regionalism: The Free Trade Area of the Americas (FTAA)*, 33 U. MIAMI INTER-AM. L. REV. 1, 11 (2002) (describing the “democracy clause” contained in a declaration issued by the thirty-four participants at the Third Summit of the Americas, April 20-22, 2001).
9. See SCHOTT, supra note 4, at 13; Gilmore, supra note 1 (describing the work still needed to move FTAA negotiations forward).
10. SCHOTT, supra note 4, at 87 (“A key aspect of the market access negotiations will be the development of rules of origin (i.e., the criteria for determining eligibility for FTAA preferences).”).

Historically, governments have adopted rules of origin for a wide range of purposes, including qualification for duty-free treatment, charges against quotas, levying of dumping and countervailing duties, embargoes, and labeling and marking. As the hemisphere moves toward trade integration, the threshold question for all goods crossing borders will be, “Does this qualify as a product of a hemispheric country or countries?” Rules of origin are important to importers because they will dictate illegibility for Free Trade Area of the Americas (FTAA) treatment. They are also important to producers because they will dictate where businesses must produce and where they must source their materials and components in order to maximize the benefits of free trade.
very simple. An FTA begins when a group of neighboring nations decides that it would be more advantageous to trade among themselves than it would be to trade with nations in other parts of the world. 12 Aside from the economic advantages associated with restricting trade to individuals living in closer proximity, there exists the additional benefit of helping neighbors to grow their own economies — neighbors who likely will become consumers for one’s own products. 13 To encourage trade and its accompanying economic benefits among members of the FTA, the member nations agree to grant each other special trading privileges or benefits that they deny to imports from non-member countries. 14 Chief among these benefits are lower or non-existent tariffs on goods imported from member nations. 15 However, for partner nations to implement such favorable trade benefits successfully, each must have a set of procedures which allow their customs agents to determine whether or not the products being imported originated in a partner nation. Without these procedures, known as the rules of origin, any FTA would fail because the partner nations would have no way to favor products from partner nations over those from non-partner nations. Thus, the rules of origin provide the critical link that makes any FTA viable.

Id. As discussed in Part III infra, the FTAA’s success will also depend on its rules of origin being more understandable and more user-friendly than NAFTA’s rules.

12. SCHOTT, supra note 4, at 5.
13. “[T]he FTAA would strengthen each country’s interest in the economic health and political stability of the other members. This is important because problems in one country often spill over to neighbors and trading partners.” SCHOTT, supra note 4, at 92. “NAFTA highlighted to US policymakers the great opportunities that can be created by closer trade ties with neighboring countries.” Id. at 9.
14. Id. at 84–85.
15. Id. at 86.
NAFTA’s rules of origin are the most complex ever devised, but they have helped to police NAFTA’s implementation and have contributed to Mexico and Canada becoming the U.S.’ largest trading partners. The thirty-four Western Hemisphere democracies have used NAFTA as their model in negotiating many provisions as they pursue an FTAA. Although the com-


17. McClintock states that Canada is the largest U.S. trading partner exchanging goods and services worth $1 billion daily. In 1998, the U.S. bilateral trade with Mexico reached $174 billion, displacing Japan as the United States’ second largest trading partner. 32% of the United States’ overall exports go to, and 29% of its total imports come from, Canada and Mexico.


18. “[T]he NAFTA model is also widely viewed as the likely blueprint for the [rules of origin] of the Free Trade Area of the Americas (FTAA).” Antoni Estevadeordal & Kati Suominen, Paper, Rules of Origin: A World Map, (Preliminary draft presented at the seminar “Regional Trade Agreements in Comparative Perspective: Latin America and the Caribbean and Asia-Pacific”)
plex rules of origin have served NAFTA well, they cannot serve as models for the rules of origin to be developed for the FTAA because the existing complexity would become exponentially greater, and thus, bring trade to a halt. Using NAFTA-like rules of origin would doom the FTAA even before it leaves the negotiating table. Therefore, negotiators must either develop simpler rules or develop an alternative regional trade agreement model if they are ever to establish a Hemispheric–wide agreement.

Part I of this Article provides a brief overview of international trade, including the history, culture and diplomatic relationships among the three NAFTA partners, and provides the background and understanding (so important in international law) for interpreting and implementing NAFTA’s provisions. This historical overview illustrates the complexities involved in negotiating trade agreements when only three nations are involved, and discusses the increasing complexity when that number grows by a factor of ten.

Part II focuses on the NAFTA rules of origin. It provides specific examples that demonstrate their importance to a free trade area, their operation and how special interests have helped fashion them. This Part also illustrates how the NAFTA rules of origin work, and sets the foundation for the argument that they cannot serve as the model for a future FTAA. Part III identifies the obstacles that FTAA negotiators will face if they try to construct their own rules of origin. The Article concludes that the success of any agreement ultimately will rest upon the ability of nations to put aside individual political interests and economic anomalies in favor of hemispheric interests and truly free trade.

(Apr. 2003), at 11 (internal citations omitted), available at http://www.iadb.org/intal/foros/LAestevadeordal_&_suominen_paper.pdf. “[D]espite the many drawbacks of the NAFTA regime, it likely will be adopted for use in the FTAA.” Pawlak, supra note 16, at 343. “[T]he United States favored the creation of the FTAA through NAFTA expansion on a bilateral basis, which would give the United States substantial negotiating leverage over other nations in the hemisphere.” Bruner, supra note 7, at 39.

I. HISTORY, CULTURE AND INTERNATIONAL RELATIONS AMONG NAFTA'S PARTNER NATIONS

Trade is as old as civilization itself. The need to trade is a natural outgrowth of a world whose natural resources are unevenly distributed around the globe.\(^{20}\) Areas of the world blessed with certain natural wealth may at the same time suffer from the absence of other important resources.\(^{21}\) Civilizations that have made certain technological advances may lack the requisite natural resources to take full advantage of that technology and vice versa.\(^{22}\) The theory of absolute advantage helps to explain why it is economically efficient for nations to trade with each other.\(^{23}\) The theory holds that a country possessing a natural advantage for producing a particular type of good would make the best use of its resources and time if it concentrates on producing that one product, and uses that product in trade to obtain those products for which its production processes are less efficient.\(^{24}\) "What if a country has no absolute advantage over any of its potential trading partners with respect to any products or services?"\(^{25}\) The Nineteenth Century economist David Ricardo answered this question in his 1817 book entitled “The Principles of Political Economy.”\(^{26}\) Ricardo developed the theory of comparative advantage, a revolutionary way of thinking about international trade, which holds that a country should focus its resources on producing and exporting those goods which it can produce most efficiently even if it does not have an absolute advantage over its trading partner,\(^{27}\) be-

\(^{21}\) See id.
\(^{22}\) See id.
\(^{23}\) See id. (describing Adam Smith’s theory of absolute advantage).
\(^{24}\) See id.
\(^{25}\) Id. at 3.
\(^{26}\) Id.
\(^{27}\) As Trebilcock and Howse explain,

[s]uppose a lawyer is not only more efficient in the provision of legal services than her secretary, but is also a more efficient secretary. It takes her secretary twice as long to type a document as the lawyer could type it herself. Suppose, more specifically, that it takes the lawyer’s secretary two hours to type a document that the lawyer could type in one hour, and that the secretary’s hourly wage is $20, and that the lawyer’s hourly rate to clients is $200. It will pay the
cause international trade remains mutually advantageous even if one partner does not have an absolute advantage over another.\textsuperscript{28} By a series of arithmetic examples, Ricardo demonstrated that nations are most efficient when they specialize in the production and export of goods in which they have the greatest comparative advantage, and import those goods for which they have the greatest comparative disadvantage.\textsuperscript{29} Ricardo was the first in a line of theorists who held that “the underlying assumption of orthodox international trade theory is that factors of production, labor and capital, are relatively immobile.”\textsuperscript{30} As industrialists quickly learned, however, factors such as lower wages, lower transportation costs and fewer regulatory burdens could justify “direct foreign investment,” a decision to build production facilities in a foreign country.\textsuperscript{31} As a result, direct foreign investment became a viable alternative to trade alone.\textsuperscript{32} Unlike the theory of foreign trade, the theory of direct foreign investment recognizes the mobility of the factors of production, and recognizes that manufacturers may transfer production facilities across international borders to take advantage of cost-saving circumstances not present in their home countries.\textsuperscript{33} The three NAFTA countries experienced this natu-

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Id. at 4.  
28. Id. at 3.  
29. Id. at 4.  
31. Id. at 10 (noting that these cost advantages have been defined as “location advantages”).  
32. Id.  
33. McClintock explains that American transnationals have looked to the Western Hemisphere for investment opportunities. Their first choice has been Mexico where the cost of doing business is two-thirds less than in the United States...the reason increasing numbers of U.S. companies are choosing Mexico to enhance their competitiveness is because “NAFTA made it cost less.”
ral evolution from trade to direct foreign investment in their developing relationship.\textsuperscript{34}

From the time of their common origins in the British Empire, Canada and the United States have understood the importance of maintaining a close trading relationship with its geographic neighbors.\textsuperscript{35} Territorial proximity and the need for peaceful relations were not the only catalysts for trade between the two North American neighbors. Their common heritage, language and culture also contributed to the growth in trade and a peace-

\begin{quote}
McClintock, \textit{supra} note 2, at 77–78. In examining the amount of direct foreign investment in another country, an investor must look at all potential costs. A country such as Mexico may enjoy lower costs among a certain group of resources, but those lower costs may not be reason enough to move a plant to Mexico because these cost savings may be off-set by higher costs in other areas, such as transportation or energy costs due to the lack of an efficient infrastructure. \textit{Id.}


35. \textit{See generally FOLSOM & FOLSOM, supra} note 34, at 60–62 (describing trade between the two countries as an alternative to annexation of Canada following the American Revolution); \textit{Robert Craig Brown, CANADA’S NATIONAL POLICY 1883-1900: A STUDY IN CANADIAN-AMERICAN RELATIONS} 8–10 (1964) (noting that a “desire to establish a wide measure of reciprocal trade with the United States has been a persistent theme in Canadian history” supported by both liberals and conservatives with the only difference between them being “one of degree, not of kind”).
\end{quote}
ful coexistence. Since at least the time of the American Revolution, politicians on either side of the border have worked to establish a solid foundation for trade — a foundation upon which the two sides could mutually benefit. Some of the first trading treaties included the Elgin-Marcy Reciprocity Treaty, which focused on natural resources and tariffs, which were key sources of governmental revenue. Eventually, Americans and

36. See generally Folsom & Folsom, supra note 34, at ch. 3 (describing international business relations prior to NAFTA); B.U. Ratchford, Introductory Statement, in THE AMERICAN ECONOMIC IMPACT ON CANADA vii (Duke University Press 1959) (explaining that the “long tradition of friendly relations and good will between the two countries” was due to “a common background and...political philosophy” as well as similarities between language, culture and economic institutions). See also Carol Wise, NAFTA, Mexico, and the Western Hemisphere, in THE POST-NAFTA POLITICAL ECONOMY: MEXICO AND THE WESTERN HEMISPHERE 8 (Carol Wise ed., 1998) (describing the Canadian Free Trade Agreement as “an evolutionary phenomenon” because of the “highly homogeneous nature of the two countries, including similar factor endowments and levels of development, and the dominant role that each country played in the other’s trade and investment portfolio”).

37. Folsom & Folsom, supra note 34, at 60. See also Thompson & Randall, supra note 34, at 16–17 (noting that “the border was wide open to commerce, and transborder travel” until the War of 1812). See also id. at 59 (describing the late Nineteenth Century “Commercial Union movement,” which promoted “the establishment of a common market between the United States and Canada”).

The idea of a Commercial Union with the United States was not new. Making the North American continent an economic unit had been much more the direct concern of the Montreal merchants in 1849 than political unity. And, of course, economic cooperation between the two North American nations was and is a continuing feature of Canadian history. The real question was one of degree -- how far should cooperation go?

BROWN, supra note 35, at 127.

From the winning of independence in 1783...American trade goals with respect to the Canadas and the other British colonies were clear and unchanging....American policymakers looked forward to the dismantling of the exclusive imperial trading system -- which would give American merchants access to Canada and the other British North American colonies.


Canadians began to believe that a united Canada and United States would provide the most profitable relation for the two countries. However, because Canadian politicians did not believe that annexation by the United States was in their best interest, they agreed, instead, to broad-based trade agreements. These agreements suppressed talk of annexation, and, except for the War of 1812, Canada and the United States have been blessed with a peaceful co-existence.

Relations between the United States and Mexico, on the other hand, were not only rocky but outright hostile for much of the Nineteenth Century. The history of United States intervention in Mexico and other parts of Latin America made Mexico much more cautious about opening any doors to the United States. This differing history of diplomatic relations has affected the way in which Canada and Mexico deal with the United States, and therefore also has affected the politics of

The evolution of a U.S.-Canada trade relationship can be traced back to 1854 with the signing of the Elgin-Marcy Reciprocity Treaty. The treaty, intended to foster limited free trade between the countries, proved highly beneficial for Canada but was abandoned by the United States due to economic and ideological conflicts. The dissolution of this agreement was a unifying force in Canada and led to the formation of the Confederation in 1867. Subsequent efforts to formulate similar agreements in 1869, 1871 and 1874 fell victim to protectionist U.S. trade policies which had been implemented during the interim period. Rebuffed in their efforts to open trade, the Canadians, led by Prime Minister John MacDonald, adopted the National Policy of 1879. The policy’s purpose was twofold: (1) to protect Canadian manufacturing concerns through high tariffs and (2) to pressure the United States into negotiating another trade agreement. While the latter goal was never realized, the former was achieved all too well.

Id. (internal citations omitted).

39. FOLSOM & FOLSOM, supra note 34, at 60.
40. Id. at 59–62; STEWART, supra note 37, at 49 (describing how the Governor General of Canada, Lord Elgin, staved off calls for annexation by “negotiating access to the American market”).
41. See id. at 30 (discussing the relationship between the U.S. and Canada).
42. “According to historian Stanley R. Ross, Mexicans perceive their relationship with the United States as one shaped by ‘armed conflict, military invasion, and economic and cultural penetration.’” ROBERT T. MORAN & JEFFREY ABBOT, NAFTA: MANAGING THE CULTURAL DIFFERENCES 30 (1994) (internal citation omitted).
43. Id.
trade and trade relations. As the United States pursues an FTAA, other Latin American countries exhibit the same level of distrust first voiced by Mexico.

Distrust of U.S. foreign policy began almost immediately after Mexico gained its independence from Spain. In 1822, President James Monroe recognized the existence of a Mexican empire, but thereafter failed to appoint an ambassador to pursue closer relations. Monroe eventually appointed Joel Poinsett in 1825 as minister plenipotentiary, but Poinsett’s meddling in Mexican domestic politics eventually led to his recall in 1829. Poinsett returned to the United States having failed to establish a treaty of friendship and commerce with Mexico.

After Texas gained its independence from Mexico in 1836, it was only a matter of time before the United States annexed Texas (in 1845) and set its sights on California and other parts of the Southwest. Skirmishes along the Rio Grande River, recognized by the United States as the international boundary, but disputed as such by Mexico, provided U.S. President Polk and Congress the excuse they needed to declare war on Mexico. The Mexican-American War (or the “War of Northern Aggression” as Mexicans refer to it) finally ended in 1848 with the signing of the Treaty of Guadalupe Hidalgo. However, during the intervening period, Mexico lost half of its North American territories. The loss of such a large portion of its sovereign territory to the United States and the economic damage caused by years of war left the Mexican government with few resources in its treasury. It also planted a seed of suspicion within the

44. See id. at 30–31 (describing the history of diplomatic relations).
45. McClintock, supra note 2, at 10–11.
47. Id. at 346.
48. Id.
49. Id. at 346–47.
50. Id. at 354–59.
52. Vasquez, supra note 46, at 356.
hearts of the Mexican people regarding the future intentions that the United States might have toward their territory.  

Throughout most of the Twentieth Century, it was primarily the U.S. economy and not the needs of Mexico that dictated trade relations between Mexico and the United States. As a result, the United States relaxed its immigration laws during periods when it required cheap labor, but immediately tightened them when American economic policy called for it. Such policies only increased Mexico’s distrust of American economic policy and American industrial expansion into Mexico. These nationalistic pressures in Mexico, in part, led to its expropriation of foreign-owned oil and gas industries in Mexico during the administration of Mexican President Lázaro Cárdenas in 1938. The expropriations reduced foreign investment in Mexico, a trend that continued through the 1970s. Oil exports funded Mexico’s economy during this period, but the precipitous fall in oil prices during the late 1970s and early 1980s led to Mexico’s economic decline. Faced with a declining balance of trade, Mexico realized that it needed to relax its foreign trade investment laws, which had banned foreign investors and allowed inefficient industries to survive. The liberalization of

55. See, e.g., Victoria Lehrfeld, Patterns of Migration: The Revolving Door from Western Mexico to California and Back Again, 8 LA RAZA L.J. 209, 217–19 (1995) (discussing the effects of the economic climate of the U.S. in the Twentieth Century on the migration of Mexican nationals).
56. Id. at 209 (describing the pattern and attitudes of the U.S. regarding immigration from Mexico).
57. Mexico was not the only American neighbor to question such policies. Canada was also suspicious of initial overtures made by the U.S. calling for greater North American integration. “At the time, neither Canada nor Mexico responded with any enthusiasm, citing historical concerns about heavy U.S. influence over both countries, and a fear of being swallowed up by powerful U.S. competitors.” Wise, supra note 36, at 7.
58. FUENTES, supra note 53, at 179.
60. Id. at 299.
61. Wise explains that
Mexico’s foreign investment laws reached its zenith in 1990 when Mexican President Carlos Salinas asked U.S. President George H. W. Bush to consider establishing a free trade agreement with Mexico similar to the 1989 trade agreement between Canada and the United States. The United States was only too happy to oblige Mexico’s request. Many viewed NAFTA as a response to a growing sense that the United States was losing its global trade preeminence. By the mid-1980s the European Union (“EU”) began to strengthen and the General Agreements on Tariffs and Trade (“GATT”) stalled. The United States was concerned that the EU would as the competition to attract foreign capital became more fierce in the new post-Cold War context, President [Carlos] Salinas grew more willing to tread where his predecessor had feared to go: despite decades of diplomatic acrimony and mutual suspicion between Mexico and the United States, Salinas buried the hatchet and aggressively pursued an FTA with the Bush administration. Wise, supra note 36, at 11.

Id. at 7–8.

Id. at 9 (discussing the U.S. policy of embracing deals such as the Canada-United States Free Trade Agreement, which “offered more immediate prospects for guaranteed market access”).

This fear continues to drive the United States’ pursuit of the FTAA:

[T]he United States is a party to only two of the more than 130 free trade agreements in the world; the United States belongs to only one of the 30 free trade agreements in the Western Hemisphere. When multiplied across products and countries, the cost to America’s strength...of falling behind on trade soars exponentially.


Another example of how the United States counters EU influence is the 2002 agreement with Chile. Although discussions with Chile about an agreement began in 1990 under the first Bush administration, it was not until Chile reached an agreement with the European Union in early 2002 that the United States finally signed a trade agreement.

Altieri, supra note 2, at 869.

The United States had long been involved in discussions to expand the General Agreement on Tariffs and Trade (“GATT”) into a more comprehensive World Trade Organization. However, negotiations stalled, and the United States was eager to embark upon bilateral trade agreements in the hopes of igniting interest in the stagnating Uruguay Rounds of the GATT. THOMAS O. BAYARD & KIMBERLY ANN ELLIOTT, RECIPROCITY AND RETALIATION IN U.S. TRADE POLICY 16–17 (1994); Eugenio Diaz-Bonilla et al., Regional Agreements
come to dominate the world economic market, and it was determined to create an equally strong economic force in the Americas in order to compete globally. Although the United States was interested in maintaining its global trade status, it also wanted to create economic and political stability in its neighbor to the south. Through much of the Twentieth Century, Mexico’s economy was mixed, consisting of many state-owned corporations and possessing many characteristics of a

and the World Trade Organization Negotiations, 85 AM. J. AGRIC. ECON. 3, 679 (2003). The planned trade agreements with Canada and Mexico had their desired effect, and the Uruguay rounds were underway by September 1986, only three months after the U.S. and Canada had begun negotiations to establish the Canadian Free Trade Agreement. See RALPH H. FOLSOM ET AL., NAFTA, A PROBLEM-ORIENTED COURSE BOOK 37 (2000). As a result, negotiations for both NAFTA and the WTO were conducted almost contemporaneously; and not coincidently, the two agreements share many commonalities. Id. at 38.

66. See generally Wise, supra note 36, at 9 (describing how “the declining competitiveness of U.S. goods in foreign markets” and the “slowness with which the GATT’s Uruguay Round negotiations moved forward in the late 1980s” forced the U.S. to focus more upon bilateral trade agreements like NAFTA). Global competition continues, at least in part, to drive U.S. trade policy.

The main objective for which Bush sought TPA [Trade Promotion Authority] was creation of an FTAA. As with NAFTA, one of the selling points of the FTAA is that it will help the United States preserve its access to neighboring countries’ markets, while keeping the Europeans and Japanese out. It thus locked Canada and Mexico into America’s net and out of the reach of the Europeans. In that way, NAFTA has served American interests by creating a regional block that, if united, could become powerful enough to take on competition, primarily from the EU.

Altieri, supra note 2, at 866 (internal citations omitted); McClintock, supra note 2, at 44 (“NAFTA was the response to the emergence of the EU and Japan as well as Asia as world trade rivals”). For a detailed explanation of Trade Promotion Authority see infra notes 79–89 and accompanying text.

67. “US officials argued that NAFTA could yield important benefits not only for economic growth but also for a range of political objectives, including promoting democracy in Mexico and contributing to a long-term solution to immigration problems.” SCHOTT, supra note 4, at 9. U.S. trade policies continue to pursue goals beyond economic growth. “Free trade agreements can help establish the basic building blocks for sustainable development, including private property rights, competition [and] the rule of law….Most importantly, free trade is about freedom and open societies. These values are at the heart of America’s larger reform and development agenda.” Zoellick, supra note 64, at 6.
state-planned economy. The United States wanted to reshape the Mexican economy in its own image, and believed that NAFTA could transform Mexico's economy into a free-market economy.

In order to transform economic relations between Mexico and the United States, NAFTA had to address a variety of issues which hampered trade, including high tariffs and the web of restrictive investment laws that stifled foreign direct investment in Mexico. These issues were appropriately addressed, and Congress passed NAFTA in 1993, entering into force on January 1, 1994. At least early on, Mexico gained the most from NAFTA, and within three years it had become the second largest export market for goods from the United States. Between 1993 and 2001, the amount of trade generated among the three countries increased by 109% from $297 billion to $622 billion. However, environmentalists and labor unions have highlighted some of the problems NAFTA created. For instance, environmentalists determined that increased industrialization along the U.S.-Mexican border will cause further environmental damage, air pollution, water pollution and hazardous waste problems. As previously noted, however, it is difficult to

70. Gantz, supra note 16, at 387.
71. See id. at 391.
73. See generally NAFTA, supra note 3, at 107 Stat. 2057, 32 I.LM. 289.
74. In so doing, it overtook Japan, which had previously held this second place position. Gilmore, supra note 1, at 394.

The increased trade and industrial development created by NAFTA, however, will have serious detrimental ecological and environmental
predict whether NAFTA's eventual impact will be a net positive or negative.\(^{77}\)

NAFTA's success has encouraged President George W. Bush to pursue aggressively expanded trade agreements with other nations around the world.\(^{78}\) As did his father, the current President believes that fast track authority is vital to the success of future trade treaties.\(^{79}\) Fast track authority authorizes the United States executive branch to submit fully negotiated treaties to Congress for approval without opportunity for congressional amendment.\(^{80}\)

President Bush pursued fast track approval, which he called “Trade Promotion Authority,”\(^{81}\) and which was passed in the House by a very thin margin in July of 2002 by a vote of 215-212, and in the Senate the following month by a vote of 64-34.\(^{82}\) Bush wasted no time in using the new Trade Promotion Authority by signing a free trade agreement with Chile on December 30, 2002.

Effects. For example, along the 2000 mile border shared by the United States and Mexico, there is a history of ecological damage from past intensification of industrial operations. This gives environmentalists good reason to be concerned about NAFTA, for the agreement may also lead to an increase in industrial operations, thus causing further environmental damage. Intensified industrial operations could worsen air and water pollution and intensify the hazardous waste disposal problem. Opponents of NAFTA also fear that some American companies will use Mexico as a pollution haven, and that free trade will lead to challenges to United States health and environmental laws as unfair trade barriers.

\(\text{Id.}^{77}\) For further analysis on this issue, see supra notes 1–2 and accompanying text.


\(79.\ \text{Agence France Presse, Bush to Push Congress to Grant Him Special WTO Negotiating Powers, July 2, 2001, available at http://www.commondreams.org/headlines01/0702-01.htm.}\)

\(80.\ \text{See McClintock, supra note 2, at 11–20 (explaining the history and evolution of the fast-track procedure).}\)

\(81.\ \text{“Bush was recently granted Trade Promotion Authority (“TPA”) or ‘fast track.’ With TPA, presidents can negotiate trade deals that Congress must then ratify or reject, but which they cannot amend. TPA makes enacting trade agreements much easier.” Altieri, supra note 2, at 847.}\)

11, 2002,\textsuperscript{83} another with Singapore in January of 2003\textsuperscript{84} and a third with four Central American nations in December of 2003.\textsuperscript{85} Congress approved the first two of these trade pacts during the summer of 2003,\textsuperscript{86} but the Central American Free Trade Agreement may not be voted on until after the November 2004 elections.\textsuperscript{87} President Bush views these agreements as only the first of many bilateral trade agreements that his Administration will complete over the next several years.\textsuperscript{88} More importantly, how-

\textsuperscript{86} Josette Sheeran Shiner, \textit{Free Trade Rewards Workers}, \textit{WASH. POST}, Aug. 13, 2003, at A27. The Chile and Singapore free-trade pacts join those already in place with Canada and Mexico (NAFTA), as well as two others with Israel and Jordan. The Bush administration is also currently negotiating additional free-trade agreements with Morocco, Australia, and the South African Customs Union; and it has announced plans for a similar agreement with Bahrain. \textit{DOREEN HEMLOCK INT’L}, \textit{Dominican Republic Gets in Line for Free-Trade Pact}, \textit{SUN-SENTINEL} (Ft. Lauderdale, Fla.), Aug. 18, 2003, at 10 [hereinafter \textit{Dominican Republic Gets in Line for Free-Trade Pact}].
\textsuperscript{87} Courreges, \textit{supra} note 85 (suggesting that the CAFTA may have a difficult time being approved because of lobbying by the sugar industry, which stands to lose economically as a result of lower sugar prices resulting from the tariff-free importation of Central American sugar).
\textsuperscript{88} See \textit{Dominican Republic Gets in Line for Free-Trade Pact}, \textit{supra} note 86, at 10. The Bush administration is currently negotiating or contemplating additional negotiations for free-trade agreements with the Dominican Republic, Australia, Morocco, Panama, Bahrain, Thailand, Colombia, Peru, Bolivia, Ecuador and the five Southern Africa Customs Union countries, which include Botswana, Lesotho, Namibia, South Africa and Swaziland. \textit{Trade Scene: No Bore in 2004}, \textit{supra} note 85.
ever, President Bush sees Trade Promotion Authority as an essential tool he will use to pass an FTAA.  

Politicians and citizens of the Americas alike fervently debate the relative benefits of an FTAA.  The Bush Administration not only believes that the U.S. economy would benefit from increased free trade, but also argues that the FTAA will provide a cure for ailing Latin American economies.  The political benefits of such an agreement have not been overlooked. As with NAFTA, many political analysts believe that the U.S.’ greatest return from a successful FTAA would be the political stability achieved from the exportation of democracy and free market philosophy to Latin America.  

89. See Lochhead, supra note 82, at A1.  
90. “Domestic political support for deeper integration also remains uncertain. This is no less true for the United States than it is for other countries in the hemisphere.” Stephan Haggard, The Political Economy of Regionalism in the Western Hemisphere, in THE POST-NAFTA POLITICAL ECONOMY: MEXICO AND THE WESTERN HEMISPHERE 302, 304–05 (Carol Wise ed., 1998).  
91. “US officials argued that NAFTA could yield important benefits not only for economic growth but also for a range of political objectives, including promoting democracy in Mexico and contributing to a long-term solution to immigration problems.” SCHOTT, supra note 4, at 9. U.S. trade policies continue to pursue goals beyond economic growth. “Free trade agreements can help establish the basic building blocks for sustainable development, including private property rights, competition [and] the rule of law. Most importantly, free trade is about freedom and open societies. These values are at the heart of America’s larger reform and development agenda.” Zoellick, supra note 64, at 6.  
92. At least one Congressman has argued that stability and democracy has spread throughout Latin America because of liberalization of trade and integration of economies. “We can’t take this for granted. We cannot assume it will always be this way. The trend towards open markets and democratic rule may not continue...economic stagnation breeds political instability, and instability breeds mass emigration, civil unrest, military conflict, and poverty.” Rep. Jim Kolbe, The NAFTA and the Expansion of Free Trade: Current Issues and Future Prospects “A View from Capitol Hill,” 14 ARIZ. J. INT’L & COMP. L. 291, 293 (1997). President Clinton’s U.S. Trade Representative, Ambassador Charlene Barshefsky, made a similar argument in 1999 while defending pursuit of a Free Trade Area of the Americas stating, “[t]rade integration has both benefited from and strengthened peace, freedom, democracy and the rule of law throughout the hemisphere. And the Free Trade Area of the Americas will improve, strengthen, and transcend all of this.” Charlene Barshefsky, Keynote Address, 30 LAW & POL’Y INT’L BUS. 1, 5 (1999).  

There are a number of very important trade agreements that are being negotiated right now. The World Trade Organization has
More than a few Latin American leaders are unconvinced that the FTAA would provide them with the economic or political panacea that the Bush Administration continues to pursue.  Perhaps the most important single skeptic of the FTAA is Brazilian President Luiz Inácio Lula da Silva because Brazil, along with the United States and Canada, is co-Chair of the FTAA negotiations which are scheduled for completion by January 2005.  Also, as the largest of the Latin American countries, Brazil sees itself as the major U.S. competitor in the Western Hemisphere.  The Workers’ Party of Brazil and Lula, its launched a new round.  The Free Trade Area of the Americas is being negotiated.  So the presidents made it clear that through trade, we can not only open up markets to our workers and our businesses all across America, but we also will be trading the values that we cherish: democracy and freedom.  And so I’m up here encouraging the Senate, asking for the vote.

Sec. of Commerce Don Evans, Press Conference at the Capitol (Apr. 30, 2002).

93. “More and more Latin American countries are wary of [the NAFTA] approach.” McClintock, supra note 2, at 11.

[President] Bush [faces]...opposition [from] what amounts to a “new left” in South America, led by President Néstor Kirchner of Argentina and President Luiz Inácio Lula da Silva of Brazil.  Those leaders...see the world...through their nations’ own wrenching experiences with the free market.  Brazil has urged other countries to refuse to ratify a...declaration [on] free trade unless Mr. Bush addresses the United States’ $20 billion in annual farm subsidies.


Governments, often lacking credibility among their people, are finding it easier to row with the tide.  Argentina, a staunch U.S. ally in the 1990’s, nowadays defends warmer relations with Cuban dictator Fidel Castro and Venezuela’s populist leftist Hugo Chavez as a result of popular disillusionment with the IMF and Washington.


94. “Clouds over Quito,” ECONOMIST, Nov. 2–8, 2002, at 41 [hereinafter Clouds over Quito].  “Brazil, the largest country and economy in South America, has consistently rejected NAFTA.” McClintock, supra note 2, at 10.

95. Bruner explains that

Brazil itself feels that it has global competitive potential and finds the United States an “overbearing” presence in the hemisphere.  Brazil genuinely “views itself and in many ways is the premier country of South America and a competitor of the United States,” and as such believes in its own potential to achieve some measure of hegemony in South America.
leader, have both been skeptical of the FTAA for some time.\textsuperscript{96} “The party manifesto says that the FTAA, as currently being discussed, is not a free-trade agreement but a process of ‘economic annexation’ of Latin America by the United States.”\textsuperscript{97} Similarly, Venezuelan President Hugo \textsc{ Chavez}, distancing himself from some other Andean leaders, also criticized the proposed FTAA as a “hasty fix” for the impoverished Andean region.\textsuperscript{98} Slow economic growth and civil unrest in the Andean region have slowed the progress of reforms that are essential to forming the foundation of any successful FTAA in the Western Hemisphere.\textsuperscript{99} “Related to these problems, the revival of petty nationalism threatens to undercut the political comity required to maintain the cohesion of their integration initiatives and to work together to conclude the FTAA pact.”\textsuperscript{100} The seed of dis-

\begin{quote}
Bruner, supra note 7, at 29 (internal citations omitted). Additionally, Schott explains that

\begin{quote}
[T\]he willingness of the trading powers of North and South America to engage in broad-based liberalization of their own trade barriers will determine the fate of the entire [FTAA] venture. Bridging the gap between the US and Brazilian positions thus will be key to the successful end game of the negotiations.

Schott, supra note 4, at 114; “The United States, Brazil, and Mexico together account for more than 85 percent of Western Hemisphere GDP and two-thirds of its population.” \textit{Id.} at 2.

96. Clouds over Quito, supra note 94, at 41.
97. \textit{Id.} at 41. \textit{See also} Altieri, supra note 2, at 872 (describing da Silva’s anti-FTAA stance).
98. Alexandra Olson, \textsc{Chavez Opens Andean Summit}, \textsc{The News} (Mexico City), June 24, 2001, at 10. \textsc{Chavez} continues to accuse the United States of unwanted intervention in Latin America.

In a Sept. 7 radio monologue, the president charged the Bush administration with trying to interfere in Venezuela as previous U.S. administrations did against socialist governments in Chile in 1973 and in Nicaragua in the 1980s. “I say to the United States that the day must come when that interventionist obsession must end,” Mr. \textsc{Chavez} said.

Marc Lifsher, \textsc{Venezuela’s \textsc{Chavez Ratchets Up Anti-U.S. Rhetoric}}, \textsc{Wall St. J.}, Sept. 23, 2003, at A22. \textsc{Chavez} has gone on to refer to the FTAA as a form of “economic colonialism” that is meant to “hand our countries over to multinationals.” BBC Worldwide Monitoring, \textsc{Venezuela: \textsc{Chavez Criticizes Central Bank, FTAA, Chile}, in “Hello President,” Dec. 31, 2003}.

99. \textit{See} Schott, supra note 4, at 105.
100. \textit{Id.}
trust planted by United States interventionist policies in Mexico and Latin America during the early Nineteenth Century has germinated and its roots continue to grow and expand throughout Latin America. These obstacles of history, culture and

“If you talk to average people about the Free Trade Area of the Americas or even the gas export law, they really don’t know much about them,” said Eduardo Gamarra, a Bolivian scholar who is director of the Center for Latin American and Caribbean Studies at Florida International University in Miami. “But Evo Morales [leader of the Bolivian coca growers federation and 2002 Bolivian presidential candidate] and others have shrewdly used those ideas as a flag which plays on their deepest fears, the loss of identity and the giving away of what they consider to be their national patrimony.”

Larry Rohter, *Bolivia’s Poor Proclaim Abiding Distrust of Globalization*, N.Y. Times, Oct. 17, 2003, at A3. At a recent regional anti-globalization forum in Argentina, Mr. Morales maintained that the United States and multinational companies have “a plan to exterminate the Indian” in order to seize control of the riches of Bolivia and neighboring countries. *Id.*

Luhnow, de Córdoba and Marc Lifsher explain that mayhem in the streets of several Latin American cities, including a virtual siege of Bolivia’s pro-U.S. president by angry protesters, shows that the region’s disaffected are increasingly making their voices heard. Like the so-called Arab street in the Middle East, public protest in this impoverished region is growing more violent and anti-American, and is starting to limit policy choices for regional leaders.

Luhnow, et al., *supra* note 93, at A21. “Brazil is fundamentally uncomfortable with U.S. hegemony in the Western Hemisphere. It has been argued that, because of the excessive focus on the relationship between the dominant bipolar system and regions as subordinated systems during the Cold War, the role of middle powers like Brazil has been under theorized.” Bruner, *supra* note 7, at 28 (internal citations and quotation marks omitted). “The United States, which has often viewed most nations of Latin America as reliable and docile allies, is increasingly facing resentment over security and trade policies that some of them view as inimical to their interests.” Marquis, *supra* note 85, at 8A (internal citations omitted).

Across South America, labor unions, student and civic groups and a new wave of leaders — Hugo Chavez in Venezuela, Luiz Inacio Lula da Silva in Brazil, and Nestor Kirchner in Argentina — are expressing similar doubts about who actually benefits from a free flow of international trade and investment.

…

“Globalization is just another name for submission and domination,” Nicanor Apaza, 46, an unemployed miner, said…”We’ve had to live
language are not unusual when it comes to international trade. However, the Partner Nations must recognize and address these obstacles before they can move on to develop a workable structure for an agreement that will form the FTAA.\footnote{102}

II. NAFTA AND ITS RULES OF ORIGIN

A. Legal Authority for NAFTA

NAFTA is often referred to as a treaty. However, it did not enter the U.S. legal lexicon through the Article II treaty-making power extended to the President and Congress under the Constitution, which requires senatorial “Advice and Consent.”\footnote{103} Rather, it became a part of U.S. law as a result of a Congres-
sional-Executive Agreement. Since the founding of the nation, Presidents have made approximately sixteen hundred treaties under the Article II treaty-making power. But Presidents also have made countless other foreign compacts without Senate approval. Some of these more recent agreements were in the form of a Congressional-Executive Agreement in which Congress either grants the President advance authority to make agreements or ratifies the President’s action by a joint resolution of Congress.

It is now widely accepted that the Congressional-Executive agreement is available for wide use, even general use, and is a complete alternative to a treaty: the President can seek approval of any agreement by joint resolution of both houses of Congress rather than by two-thirds of the Senate. Like a treaty, such an agreement is the law of the land.

As previously discussed, Trade Promotion Authority grants the President power to negotiate trade treaties and present them to both houses of Congress for a simple majority vote. By using this method of approval, the President avoids the requisite approval of two-thirds of the Senate dictated by Article II of the Constitution. Although “[t]he Constitution does not expressly confer authority to make international agreements other than treaties,...such agreements, varying widely in formality and in importance, have been common from our early history.” For this reason, the U.S. Court of Appeals for the Eleventh Circuit refused to find NAFTA unconstitutional de-

104. See McClintock, supra note 2, at 11–13 (explaining the history of the congressional-executive agreement).
106. Id. at 215.
107. Id. at 215–18.
108. McClintock, supra note 2, at 33 (the author goes on to explain the Constitutional history of the Congressional-Executive agreement).
111. HENKIN, supra note 105, at 215–18 (internal citations omitted). See also Restatement (Third) of Foreign Relations of the United States, Section 303 (2) (“The President, with the authorization or approval of Congress, may make an international agreement dealing with any matter that falls within the powers of Congress and of the President under the Constitution.”).
spite the fact that it had not been promulgated through the treaty-making Clause.\textsuperscript{112}

NAFTA consists of twenty-two chapters that cover everything from Objectives in Chapter One\textsuperscript{113} to Exceptions and Final Provisions in Chapters Twenty-One and Twenty-Two.\textsuperscript{114} In addition, the agreement includes environmental and labor-side agreements as well as various annexes and rules of procedure.\textsuperscript{115} However, Chapter Four, which lays out the rules of origin, is the heart of NAFTA.\textsuperscript{116}

\textbf{B. Rules of Origin – The Heart of NAFTA}

Any study of a free trade agreement must begin with an understanding of the rules of origin and why they are so important to the heart of the Agreement.\textsuperscript{117} A free trade agreement is an agreement whereby two or more nations agree to reduce tariffs and other barriers to trade so that goods may cross the international borders free of any barriers to trade, hence the name free trade.\textsuperscript{118} In order for an FTA to operate effectively, the partner nations must devise a method by which customs inspectors at each border crossing can determine the origin of the goods being transported.\textsuperscript{119} Unless customs agents are able to distinguish between goods entitled to receive free trade benefits (those goods originating within the free trade area) and goods not so entitled, there is a danger that a partner nation will accept imported goods from outside the trade area without being paid the appropriate tariff.\textsuperscript{120} Any FTA would collapse if it failed to pro-

\footnotesize
\begin{itemize}
  \item \textsuperscript{112}  Made in the USA Found. v. U.S., 242 F.3d 1300 (11th Cir. 2001). \textit{See also} McClintock, supra note 2, at 34–35 (outlining the arguments presented to the Eleventh Circuit).
  \item \textsuperscript{113}  NAFTA, supra note 3, 107 Stat. 2061–2122, 32 I.L.M. 289, 297–93 (containing chs. 1–9).
  \item \textsuperscript{115}  See NAFTA, supra note 3, 107 Stat. 2163–65, 32 I.L.M. 605.
  \item \textsuperscript{116}  NAFTA, supra note 3, 107 Stat. 2069–86, 32 I.L.M. 349–58.
  \item \textsuperscript{117}  For the NAFTA Rules of Origin, see NAFTA, supra note 3, 107 Stat. 2069–86, 32 I.L.M. 349–58.
  \item \textsuperscript{118}  Schott, supra note 4, at 84.
  \item \textsuperscript{119}  See Pawlak, supra note 16, at 326–27.
  \item \textsuperscript{120}  See id. This sort of situation is referred to as the creation of an “export platform.” \textit{See} Gantz, supra note 16, at 383 (describing fears that the NAFTA
vide for some kind of procedure, like the rules of origin, for identifying and preventing non-member goods from taking advantage of trade benefits meant solely for member nations. 121

The rules of origin outlined in Chapter Four of NAFTA insure that only those goods originating within North America benefit from free trade. 122 Specifically, Article 401 defines when a good is “originating” and thereby entitled to the benefits conferred by NAFTA. 123 The definitions covered by Article 401 range from the very simple to the complex. 124 “In the simplest definition, originating materials are those that are wholly obtained in the territory of a party and include minerals extracted, goods harvested, and animals born and raised in a NAFTA country’s territory.” 125 Goods containing non-originating materials (parts or inputs that originate from outside the NAFTA member states), still may enjoy free trade benefits if “each of the non-originating materials used in the production of the good undergoes a change in tariff classification set out in Annex 401 as a result of production occurring entirely in the territory of one or more of the Parties.” 126 A “change in tariff classification” occurs when a non-originating material is transformed by a North American manufacturing process into another product. 127 For instance, vanilla beans (non-originating material) imported from Madagascar might be transformed by U.S. labor and manufacturing resources into “pure vanilla extract.” 128 This doctrine of substantial transformation “has deep roots in the jurisprudence of

122. See, e.g., id. at 61–62.
123. NAFTA, supra note 3, ch. 4, art. 401(b), 107 Stat. 2069, 32 I.L.M. 349.
126. NAFTA, supra note 3, ch. 4, art. 401(b), 107 Stat. 2069, 32 I.L.M. 349.
127. Id. ch. 4, art. 401 (b), 107 Stat. 2070, 32 I.L.M. 349. See also Einstein, supra note 121, at 62 (“[N]on-originating materials that…undergo a defined change in tariff classification…as a result of production occurring within the territory of one or more of the parties, are generally considered as originating.”).
128. See NAFTA, supra note 3, Annex 401, 32 I.L.M. 397. See also Einstein, supra note 121, at 62.
the Supreme Court," and was adopted as a statutory rule of origin in the Trade Agreements Act of 1979. The substantial transformation test proved to be inexact because its application relied on subjective evaluations, the outcomes of which depended on whether the final product of the U.S. manufacturing process had a new name, character or use. NAFTA replaced the substantial transformation test with a more precise method of evaluating the degree of transformation by utilizing the Harmonized Tariff Schedule (“HTS”) classification system. The HTS numerically “identifies items along a progression from raw materials to finished products,” providing customs officials with a tool to precisely measure degrees of transformation. By employing the HTS numerical classification system, NAFTA can specify a precise transformation (“change in tariff classification”) that must be achieved in order for a non-originating material to be transformed into an originating material or product. This, in turn, allows customs officials to apply appropriate trade preferences or restrictions.

129. RALPH H. FOLSOM ET AL., INTERNATIONAL BUSINESS TRANSACTIONS 292 (2d ed. 2001) (citing Anheuser-Busch Brewing Ass’n v. United States, 207 U.S. 556 (1908)).
130. Id.

For decades, most of the countries in the world, except the United States and Canada, classified imports according to the Brussels Tariff Nomenclature (BTN), which identifies items along a progression from raw materials to finished products. The United States had its own system of classification set out in the Tariff Schedule of the United States (TSUS). However, beginning in 1982, the United States initiated steps to convert the TSUS into a Harmonized Commodity, Description and Coding System (HS) of classification, in common with the classification system used by most other countries and developed by the Customs Cooperation Council in Brussels. The United States adopted the Harmonized System as the Harmonized Tariff Schedule (HTS) for classification of all imports by enactment of the Omnibus Trade and Competitiveness Act of 1988, with an effective date of Jan. 1, 1989. Many nations have adopted HS and use it for U.S. exports.

Id. at 291.
133. Id. at 290–91.
134. See generally NAFTA, supra note 3, Annex 401, 32 I.L.M. 397.
page “Annex 401” establishes the degree of transformation required for a non-originating material to convert into an originating material.\textsuperscript{135} The transformation occurs when the non-originating material is transformed to such a degree that its HTS classification number shifts to a different classification level as outlined in Annex 401.\textsuperscript{136} Goods that undergo this “tariff shift” receive free trade benefits under NAFTA because the additional North American labor and resources used to transform the non-originating material are deemed to have contributed sufficiently to the North American economy to grant the status of “originating good” upon the resulting product.\textsuperscript{137} “In order to be considered as originating, goods containing non-originating materials that do not undergo a sufficient change of tariff classification, and even many that do but with a further qualification defined in Annex 401, must fulfill the regional value content requirement of Article 402 of NAFTA.”\textsuperscript{138}

Under Annex 401 as well as under Article 401(d), certain products may achieve originating status even if they do not meet a required tariff shift so long as the product contains a minimum percentage of labor, materials or overhead (known as “inputs”) from North America.\textsuperscript{139} The percentage of a product’s North American input is referred to as a product’s regional value content.\textsuperscript{140} Granting originating status to a good with something less than 100% regional value content is justified because a good can make a substantial contribution to the North American economy even if 100% of the inputs do not originate in North America.\textsuperscript{141} Annex 401 also may require that this “regional value content” be met in addition to a specified

\textsuperscript{135} See id. Annex 401, 32 I.L.M. 397.

\textsuperscript{136} See Einstein, supra note 121, at 62.

\textsuperscript{137} NAFTA, supra note 3, ch. 4, art. 401(b), 107 Stat. 2069, 32 I.L.M. 349. See also Einstein, supra note 121, at 62 (“Inputs from outside the NAFTA, called non-originating materials, that are incorporated into a good and undergo defined change of tariff classification, as described in Annex 401, as a result of production occurring within the territory of one or more of the parties, are generally considered as originating.”).

\textsuperscript{138} Einstein, supra note 121, at 62–63.

\textsuperscript{139} Id. at 62.

\textsuperscript{140} Id. at 62–63 (citing NAFTA ch. 4, art. 402(3), 107 Stat. 2070, 32 I.L.M 349).

\textsuperscript{141} Id. at 63 (citing NAFTA, ch. 4, arts. 401(c), 107 Stat. 2069, 32 I.L.M. 349 & 402(4), 107 Stat. 2070, 32 I.L.M. 350).
tariff shift for certain goods. Article 402 provides for two methods of calculating the regional value content: the “transaction value method” and the “net cost method.”

The first step in calculating the regional value content is determining either the product’s transaction value or its net cost, depending on the method to be used. Once the transaction value or the net cost is determined, the formula for determining the regional value content is a simple matter of arithmetic. The regional value content (“RVC”) of a good using the transaction value method is calculated by applying the following formula: 

\[ RVC = \left(\frac{TV-VNM}{TV}\right) \times 100\% \]

where TV is the transaction value of the good and VNM is the value of the non-originating material used in the production of the good. The result from this formula reflects the percentage of the transaction value of the good that contains originating material. If originating material accounts for 60% or more of the transaction value, then the good is deemed originating.

The regional value content of a good using the net cost method is calculated by using a similar formula: 

\[ RVC = \left(\frac{NC-VNM}{NC}\right) \times 100\% \]

A good shall originate in the territory of a Party...provided that the regional value content of the good, determined in accordance with Article 402, is not less than 60 percent where the transaction value method is used, or is not less than 50 percent where the net cost method is used, and that the good satisfies all other applicable requirements of this Chapter.

Id.
VNM/NC) x 100, where NC is the net cost of the good and VNM is the value of non-originating materials used in the production of the good. The result of this formula reflects the percentage of the net cost of the good that contains originating material. If originating material accounts for 50% or more of the net cost, then the good will qualify for the benefits granted to originating goods.

The general rule provides that the exporter or producer of a good may choose either the transaction value method or the net cost method to determine the regional value content. Generally, the transaction value is easier to calculate than the net cost method because the latter method requires a cost accounting of every resource and component (whether originating or not) that goes into manufacturing a particular product. In certain cases, the producer or manufacturer is prohibited from using the more facile transaction value method in determining regional value content. Article 402(5) lists those situations that demand use of the net cost method. Among others, these situations include: certain cases where the good is sold by a producer to a related person, where the good is a motor vehicle.

152. Id. Since VNM (value of non-originating material) is subtracted from NC, only originating material is left as a percentage of NC. See id.
153. NAFTA, supra note 3, ch. 4, art. 401(d), 107 Stat. 2069, 32 I.L.M. 349.
155. As noted in supra note 144, the transaction value is defined as “the price actually paid or payable for a good or material.” NAFTA, supra note 3, ch. 4, art. 415, 107 Stat. 2081, 32 I.L.M. 354–57.
156. NAFTA, supra note 3, ch. 4, art. 402(3), 107 Stat. 2070, 32 I.L.M. 349 (providing the net cost method equation as RVC = [(NC-VNM) / NC] x 100, with NC representing the net cost of the goods).
158. Id.
159. “Related person” is defined in Ch. 4, art. 415 as a person related to another person on the basis that: a) they are officers or directors of one another’s businesses; b) they are legally recognized partners in business; c) they are employer and employee; d) any person directly or indirectly owns, controls or holds 25 percent or more of the outstanding voting stock or shares of each of them; e) one of them directly or indirectly controls the other; f) both of them are directly or indirectly controlled by a third person; or g) they are members of the same family (members of the same family are natural
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cle and where “the exporter or producer wishes to accumulate the regional value content of the good in accordance with Article 404.”

NAFTA prohibits use of the transaction value when related persons are involved “…and the volume..exceeds eighty-five percent of the producer’s total sales” during a given period to prevent producers from manipulating intra-company prices to generate a false transaction value, which could lead to granting a particular product originating status when it might not otherwise be so entitled. In this sense, NAFTA’s prohibition of the transaction value method is no different than the common practice of many countries that monitor and regulate transfer pricing between subsidiaries of a multinational corporation.

Transfer pricing, the act of selling to a related person for a higher or lower amount than one would sell in an arms-length transaction for the purpose of manipulating profits and, therefore, tax consequences in a particular jurisdiction, also can be used to make a product appear to be originating even though it would not be so designated in a normal arms-length transaction.

NAFTA’s rules of origin also include specific exceptions or protections for important industries and products. For example, its rules require that automobile manufacturers use the more onerous net cost method rather than the simpler transaction value method in establishing the origination of manufactured vehicles.

The importance of the American automobile industry to the North American economy and the ever-present

or adoptive children, brothers, sisters, parents, grandparents, or spouses).

Id. ch. 4, art. 415, 107 Stat. 2081, 32 I.L.M. 354–57.
160. NAFTA, supra note 3, ch. 4, art. 402(5)(e), 107 Stat. 2071, 32 I.L.M. 350. For a detailed explanation of “accumulation” under Article 404, see infra notes 169–73 and accompanying text.
163. Id. at 72–76.
164. McKim, supra note 38, at 341.
threat of international competition were responsible for this and other burdens placed on trade in automobiles. 166 Not only must the automobile industry trace the origination of every material that goes into their production, but NAFTA raised the percentage of originating materials required for access to trade preferences from 50% to 62.5%. 167 The two requirements not only provide an additional layer of protection for the American automobile industry, but also provide an incentive for automobile parts manufacturers, formally located in Asia, to build North American plants, because automobile manufacturers now will be looking for American-made parts to incorporate into their vehicles in order to qualify for NAFTA benefits. 168

Finally, NAFTA requires producers to use the net cost method when accumulating the value of originating resources used in the production of non-originating components sold to them for ultimate incorporation into their own products. 169 Manufacturers can use the accumulation method of valuing products when it purchases a component (“part A”) for incorporation into its newly manufactured product (“product AB”), where part A does not qualify as originating under regional value content rules even though it does contain some originating resources. 170 If product AB also fails to meet the regional value content test, the manufacturer may recalculate the regional value content by breaking the cost of part A into the various components that went into part A’s production. 171 Thus, rather than including the entire cost of part A as non-originating in calculating the regional value content of product AB, the manufacturer can determine how much of part A was originating. After determining this breakdown, the manufacturer of product AB can then accumulate the originating portion of part A into its own formula for determining the regional value content of its product AB. 172 The accumulation method,

167. NAFTA, supra note 3, ch. 4, art. 403(5)(a), 107 Stat. 2074, 32 I.L.M. 351.
168. Einstein, supra note 121, at 73.
170. Id. ch. 4, art. 404(1), 107 Stat. 2076, 32 I.L.M. 352.
171. Id.
172. Id.
therefore, allows the manufacturer of product AB to take credit for any portion of part A classified as originating rather than having to count the entire cost of part A as non-originating. The additional “credit” that the manufacturer of product AB may achieve through this method may be sufficient to reach the 50% regional value content that would qualify product AB as originating, and therefore, eligible for the trade benefits provided by NAFTA.\footnote{173}

The rules of origin also provide a \textit{de minimis} rule,\footnote{174} exempting goods from the rules of origin if they contain non-originating materials when the non-originating materials do not exceed 7% of the transaction value or of the total cost of the good.\footnote{175} Without the \textit{de minimis} exception, the Annex 401 rules requiring non-originating materials to undergo a change in tariff classification would weigh harshly on those goods with a very small percentage of non-originating materials that do not make the required tariff shift.

As one can see, the NAFTA rules of origin create a complex web of restrictions, requirements and exceptions that are difficult to understand and apply. These intricacies only compound the complexity of a process already made difficult by differences in language, culture, and history. Transferring NAFTA’s rules of origin to the FTAA will only make the “dance” among the Partner Nations increasingly difficult to perform. Whatever form the FTAA eventually takes, it must account for and adapt to the unique economies, cultures, histories and diplomatic rela-

\footnote{173} For a more detailed example of the accumulation method, see generally NAFTA: A Guide to Customs Procedures, U.S. Customs Service, at http://www.customs.ustreas.gov/nafta/docs/us/guidproc.html\#2\%20RULES%20OF (last visited Jan. 30, 2004). Recall that Article 402(5)(e) requires use of the net cost method of regional valuation when accumulation is used, and Article 401(d) tells us that the net cost method must reach at least a fifty percent threshold to be classified as originating.


\footnote{175} The \textit{de minimis} rule provides a certain list of goods that may not benefit from this exception. \textit{Id.} ch. 4, art. 405(3), 107 Stat. 2077–78, 32 I.L.M. 352–53. It also provides that the \textit{de minimis} rule for fabrics is based upon weight rather than cost, i.e., fabrics containing non-originating fibers or yarns will be exempt from the rules of origin if the non-originating components do not exceed 7% of the total weight of the finished good. \textit{Id.} at ch. 4, art. 405(6), 107 Stat. 2077, 32 I.L.M. 353.
tionships of each additional party. Rules of origin form the heart of any free trade area, and as such, it is the rules of origin that are most critical to the success of any FTAA.

III. RULES OF ORIGIN – HEARTBURN FOR THE FTAA

Even though the NAFTA rules of origin serve the three NAFTA partners well, the rules are not without their detractors. Chief among the complaints is that the rules are far too complex, and that paradoxically, the rules actually form a barrier to trade more than they dismantle trade barriers. The complexity of the rules and the cost of resources needed to identify, understand, track and comply with these rules are especially costly for developing nations and their industries. In fact, NAFTA’s rules of origin are so complex that they are accompanied by a two hundred page Annex that explains many of the intricate technical details an exporter must examine to determine the origination of a particular product. Studies that have evaluated administrative costs associated with rules of origin compliance reveal that companies spend anywhere from 1.4% to 5.7% of the value of the goods exported. Applying

176. “NAFTA presents one example of how onerous customs procedures can be an impediment to trade even after countries have agreed to eliminate border charges.” CUSTOMS PROCEDURES AND RULES OF ORIGIN, supra note 11, at 2–3. Flatters and Kirk state:

[R]ules of origin are an essential element of regional trading arrangements. But their use as protectionist devices, whether in North-South or South-South agreements, can also undermine and subvert the benefits of the trade liberalization they are meant to support. This is one of the great dangers of regionalism as a strategy for global integration.


177. Eugenio Diaz-Bonilla et al., supra note 65, at 5–6.


179. Id. at 8 (“Estimates of rules of origin administrative costs under the European Free Trade Association-European Community FTA range from 1.4
these same percentages to the combined trade between the United States and Canada reveals that the total administrative costs of NAFTA’s rules of origin could amount to anywhere from $8 billion to $31 billion a year. There is some evidence that importers and exporters are opting to forgo NAFTA’s free trade benefits simply because the costs of compliance with the rules of origin are too high. Both critics and supporters of the FTAA continue to raise concerns that the rules of origin themselves may form obstacles to trade. The number of concerns and difficulties identified with regard to the NAFTA rules of origin would not disappear if similar rules were incorporated into the FTAA, but likely would be magnified because of the greater number of partners involved and because of the larger number of developing countries with fewer technical resources to aid in compliance. Adopting rules of origin like NAFTA’s would defeat the FTAA’s purpose either by bringing trade to a halt or forcing most producers and developing countries to forgo free trade benefits due to the exorbitant compliance cost.

percent-to-5.7 percent of the value of export transactions, using company-level data.

180. Id. at 8.

In one example, Linda Stepp, a chief financial officer of Televideo, a video design and sales company in San Diego, expressed her concerns over the amount of documentation necessary in addition to the Certificate of Origin. She estimated her cost of complying with NAFTA to be about $50 per document after factoring in notarization fee and getting things stamped....In another example, at Honeywell Microswitch in Westmont, Illinois, it took six employees nearly six months just to ensure that the company's products — switches and sensors — qualified for the NAFTA's preferential treatment.

182. “Origin rules are designed to ensure that benefits from liberalization accrue to producers in FTAA countries by preventing free riding by producers in non-participating countries. Often, however, their inherent complexity results in the rules becoming obstacles to trade flows under FTAA.” CUSTOMS PROCEDURES AND RULES OF ORIGIN, supra note 11, at 2; see also Mariana C. Silveira, *Rules of Origin in International Trade Treaties: Towards the FTAA*, 14 *ARIZ. J. INT’L & COMP. L.* 411, 439 (1997) (noting that an FTAA working group had identified rules of origin as a potential restriction on free trade).
183. See Silveira, supra note 182, at 460–62.
Regardless of the type of rules of origin ultimately adopted by the FTAA, the Partner Nations would have to harmonize their customs procedures to a certain extent if they are to implement the rules successfully. Customs authorities in the various nations cannot consistently apply a set of rules if each applies different sets of procedures that fail to result in a predictable and efficient application process. \(^{184}\) Additionally, many Latin American countries lack access to high level technological resources available to the developed countries of Europe and North America. \(^{185}\) Such resources aid in updating regulations to reflect changing patterns of trade and are essential to policing compliance. \(^{186}\) The World Trade Organization has found that failure to modernize and reform customs procedures can produce a bureaucratic barrier to trade that is even more insurmountable than high import duties. \(^{187}\) In December 1995, the Chairman and CEO of Federal Express in an address to the Air Cargo Americas Conference in Miami stated that “[i]t makes little sense to have a network like ours that moves goods across continents in twenty-four to forty-eight hours when those goods become entrapped in archaic customs bureaucracies for days.” \(^{188}\) In order to prevent these kinds of delays, the Partner Nations must provide resources for adequate training of customs personnel who ultimately must apply rules of origin. In addition, the Partner Nations must provide adequate technological resources for administering the rules, particularly to less developed countries that lack such resources or possess antiquated or

\(^{184}\) “It is essential for the continued economic expansion of the United States that markets in our hemisphere become increasingly open to U.S. goods and services and there be clear, predictable and nondiscriminatory rules governing trade throughout the Americas.” McClintock, supra note 2, at 74.

\(^{185}\) CUSTOMS PROCEDURES AND RULES OF ORIGIN, supra note 11, at 3.

\(^{186}\) See Silveira, supra note 182, at 460.

\(^{187}\) Neil King, Jr. & Scott Miller, Cancún: Victory for Whom? Poor Nations’ Revolt Could Freeze Them Out of Big Trade Deals, WALL ST. J., Sept. 16, 2003, at A4 [hereinafter Cancún: Victory for Whom?]. As an example of the costs involved with such inefficiencies, some experts “have estimated that new customs procedures could add nearly 1% to economies of countries across Asia.” Id.

\(^{188}\) CUSTOMS PROCEDURES AND RULES OF ORIGIN, supra note 11, at 3 (quoting the Chairman and CEO of Federal Express in an address to the Air Cargo Americas Conference in Miami in December 1995).
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incompatible technology.\textsuperscript{189} Even now, the lack of a modern technological and communications infrastructure in some of the region’s developing countries prevent traders in those areas from determining and implementing developments or improvements that have emerged in either domestic or international trade law.\textsuperscript{190} The simplest of the rules of origin cannot bring about free trade in the Americas unless all countries develop consistent customs procedures across the Western Hemisphere. In addition, they all require access to the resources necessary for the efficient, fair and predictable application of the rules of origin finally adopted.

Agreeing on a common set of rules of origin for the FTAA will also be difficult both because Latin American nations already have adopted rules of origin under various free trade agreements which they have formed over the past two decades and because these rules are closely tied to the interests of domestic political groups.\textsuperscript{191} Like NAFTA’s special automobile industry provisions, these other trade agreements may contain special

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189. \textit{Id.} at 5. \textit{See also} Pawlak, \textit{supra} note 16, at 347 (discussing the burdens placed upon shippers and producers that force them to forgo preferential treatment as well as the economic strain that would be placed upon poorer nations to administer and enforce complicated rules of origin).

190. O’Hop, \textit{supra} note 8, at 164 (“Tools for legal research and reporting, which are taken for granted in the developed world, are still the exception in the developing world.”).

191. “[T]he United States belongs to only one of the 30 free trade agreements in the Western Hemisphere.” Robert Zoellick, \textit{supra} note 64, at A35.

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protective measures woven into them as a result of lobbying from critical industries pressuring their governments to protect their economic interests.\footnote{192} These special interest measures

make later harmonization very difficult if not impossible because industries may have changed their entire mode of doing business as a result of these anomalies.193 Even slight deviations could seriously injure the particular economic sector.194 In addition, the economic health of the participating nations may be closely tied to the particular industry, further complicating any attempt at harmonization. Any change to rules of origin developed under such circumstances seems unlikely.195 In fact, the U.S. automobile industry will seek to include within any subsequent FTAA a level of origination even higher than the 62.5% set by NAFTA.196 The U.S. automobile industry seeks such protection from the large and competitive market for

particularly when it comes to providing protection from foreign competitors). Most recently, Bush Administration efforts to achieve rapid progress on free trade agreements with Central America and Australia have encountered resistance from “[t]he sugar industry -- which accounts for less than 1% of all U.S. farm sales but 17% of agriculture’s political contributions since 1990.” Michael Schroeder, Sugar Growers Hold Up Push for Free Trade, WALL ST. J., Feb. 3, 2004, at A13. U.S. manufacturers that stand to benefit most from these two pacts “have lined up on the other side” with one manufacturer’s lobbyist expressing concern that such agreements might “be hijacked by a few protectionist interests, which frankly are unwilling to compete.” Id. (quoting William Lane, a Washington lobbyist for Caterpillar Inc., the Peoria, Ill. maker of construction and mining equipment).

193. Silveira, supra note 182, at 461.
194. CUSTOMS PROCEDURES AND RULES OF ORIGIN, supra note 11, at 4.
195. See Silveira, supra note 182, at 458 (noting that trade agreements tend to “reflect the position of the most powerful industries” giving rise to “an endless series of debates, and uneasiness in the negotiations”). See also id. at 435 (noting that international trade agreements sometimes establish special rules for particularly sensitive products); O’Hop, supra note 8, at 154 (explaining that existing subregional trade agreements in the Western Hemisphere were “designed to achieve specific economic objectives and to address almost exclusively the particular needs of its subregional constituency” and that a regional agreement like the FTAA would have to bring harmony to conflicting institutional and legal obstacles created by such self-serving agreements).

NAFTA certainly is not going to relinquish its “rules of origin” on which receiving internal tariff preferences absolutely depends. On the other hand, acceptance of NAFTA’s regime would detrimentally affect the MERCOSUR countries which might find themselves forced to switch their input sourcing from cheaper and higher quality sources in Europe and Asia, for example, in favor of North America in order to comply with the new rule-of-origin requirements.

McClintock, supra note 2, at 47–48 (internal citations omitted).
196. Silveira, supra note 182, at 458.
automobile parts in Brazil. Many similar special interest requests are likely to emerge from each of the remaining thirty-three Partner Nations. Such a state of affairs can only lead to endless debate and a negotiation process filled with great frustration and little progress.

The special interest arguments expected to arise could be resolved more easily if any of the existing regional trade agreements within the Western Hemisphere had a supranational institutional structure like that found within the EU. Among other things, the fifteen-member EU trading bloc has created a common political structure that helps to identify and serve EU

197. *Id.* at 458. See also Jeri Jensen-Moran, *supra* note 192, at 239 (“the automobile industry has already hinted it will want a rule even higher than 62.5 percent when negotiations begin with Mercosur, because the Brazilian market is much bigger and...a competitive supplier of automobile parts”).

198. The impact of interest group politics in multilateral trade negotiations can be seen in the breakdown of the WTO Doha Round of talks held in Cancún, Mexico in September, 2003. A major reason for the failure of these talks was the reluctance of developed nations like the United States and members of the European Union to agree to steep reductions in farm subsidies, which developing countries blame for depressing world-wide prices and in turn locking their farmers out of the global market place. Neil King, Jr. & Scott Miller, *Trade Talks Fail Amid Big Divide Over Farm Issues, Developing Countries Object to U.S., EU Goals; Cotton as a Rallying Cry*, WALL ST. J., Sept 15, 2003, at A1.

Before the talks broke off, American farmer groups attending the conference here said they were pleased [Robert B. Zoellick, the United States Trade Representative] was able to protect most of the farm bill passed in 2002, which raised subsidies by $40 billion...The farm states voted heavily in favor of Mr. Bush in the 2000 election, and were the backbone of the states that gave him the bulk of his electoral votes. Agribusiness, which profits from the low cost of corn, soybeans and other crops subsidized by American taxpayers, has shifted its allegiance to the Republican Party. Political contributions from agribusiness jumped to $53 million in 2002 from $37 million in 1992, with the Republicans' share rising to 72 percent from 56 percent, according to figures compiled by the Center for Responsive Politics.

interests over those of each individual member. Unfortunately, none of the existing trade agreements in the Western Hemisphere has such an institutional structure that can resolve the disputes that will certainly arise as the Partner Nations seek to find common ground upon which to build an FTAA.

Even if the Partner Nations can develop workable rules of origin, implementing these rules would pose yet another problem due to the diverse legal systems that exist throughout the Western Hemisphere. The legal systems of the majority of nations in the Western Hemisphere are based on civil law which resolves legal problems based on philosophical foundations quite different from common law nations like the United States and Canada. These different approaches to the law can lead to very different interpretations or applications of the same rule of origin. This was not a difficult obstacle for NAFTA negotiators to overcome, but the problems easily could multiply as the FTAA adds thirty-one additional partners to the mix. At the very least, it is a problem that must be anticipated and for which solutions should be explored.

Finally, and most importantly, there exists a simple problem of incompatibility between existing regional trade agreements. The two largest regional trade agreements in the Western Hemisphere are NAFTA and MERCOSUR. While NAFTA is a

200. See O’Hop, supra note 8, at 159–61.
203. See generally Mary Ann Glendon et al., Comparative Legal Traditions 16 (2d ed. 1994) (suggesting that interpretation and application of the law can lead to different outcomes based upon more than just legal history, but upon other factors such as the culture that creates the law, the language that expresses it and the approach from which it is addressed). O’Hop, supra note 8, at 163–64 (“Even among the civil law states, there is considerable diversity in the origin and content of their respective civil codes. This diversity is further reflected in the manner in which the harmonization of laws agreed to pursuant to international conventions becomes effective under domestic law.”).
204. Bruner, supra note 7, at 28. MERCOSUR is the common market for the Southern Cone established between Argentina, Brazil, Paraguay and
free trade agreement, which allows each of its members to establish their own unique tariffs for imported goods, MERCOSUR is a customs union, the defining characteristic of which is an agreement by all members to charge identical tariffs for each imported good. Of the two forms of regional trade agreement, the customs union is much more difficult to achieve because of the political and special interest obstacles the member nations must overcome to coordinate a single common external tariff on all products entering the territory encompassed by the customs union. NAFTA and MERCOSUR cannot be merged without changing the essential characteristics that make each agreement unique — characteristics that were presumably quite important in the negotiation process that produced each agreement. NAFTA could seek to become a customs union like MERCOSUR and establish a common external tariff, but GATT rules would require Mexico and Canada to lower their import duties to the lower amount already in place in the United States. Canada and Mexico might, of course, be reluctant to do so, but the greater problem is that the same GATT rule would oblige all members of any union between NAFTA and MERCOSUR similarly to lower external tariff rates to the 3.5% established by the United States. Except for computers and telecommunications equipment, MERCOSUR has estab-

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205. Bruner, supra note 7, at 28; Gantz, supra note 16, at 402.
206. See Gantz, supra note 16, at 402 (internal citations omitted).
207. A customs union like MERCOSUR would still make use of rules of origin although to a much more limited extent than a free trade area, so a merger between NAFTA and MERCOSUR would still not resolve the problem inherent in agreeing upon a common set of rules. Silveira, supra note 182, at 421–22, 430, 453.
208. General Agreement on Tariffs and Trade, Oct. 30, 1947, art. XXIV(2)(b), 61 Stat. A-3, 55 U.N.T.S. 187. GATT Article XXIV(5)(b), provides that whenever a regional trade agreement like a customs union is formed, the “duties and other regulations of commerce maintained in each of the constituent territories...shall not be higher or more restrictive” than those existing prior to formation of the customs union. Id.
209. McClintock, supra note 2, at 47 (internal citations omitted).
lished a common external tariff of 20% for all foreign imports. Due to its economic impact, it is highly doubtful that members of MERCOSUR would agree to lower their existing common external tariff by 16.5%.

Given the incredible number of problems involved in negotiating an FTAA, it is not surprising that the Bush Administration, upon receiving Trade Promotion Authority, embarked on a race to negotiate as many free trade agreements as possible within a short period of time. The haste with which the Bush Administration has initiated negotiating additional free trade pacts is, perhaps, an indication of the lack of confidence that it has with the FTAA process. It is also an indication that the Administration has not abandoned the “hub-and-spoke” strategy of establishing NAFTA-like rules as the hub of any free trade pact it negotiates. Establishing as many trade agreements as possible with smaller segments of Latin America seems to be the only viable alternative for the United States both because the NAFTA rules of origin pose too great an obstacle to forging a viable FTAA, and because achieving a customs union encompassing the entire Western Hemisphere would be politically impossible.

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210. Id. at 46–47.
211. As mentioned earlier, the Administration signed agreements with Chile, Singapore and Central America soon after having received authority, and it is currently negotiating or contemplating additional negotiations for similar free-trade agreements with the Dominican Republic, Morocco, Australia, Morocco, Panama, Bahrain, Thailand, Colombia, Peru, Bolivia, Ecuador and five Southern African Customs Union countries, which include Botswana, Lesotho, Namibia, South Africa and Swaziland. Trade Scene: No Bore in 2004, supra note 85. These, of course, are in addition to existing free trade agreements with Canada and Mexico (NAFTA), and Israel and Jordan. “The U.S. is now trying to hammer out free-trade deals with 14 countries....And as the [September, 2003 WTO Doha Round of talks in Cancún] broke down here, U.S. officials said that still more countries stepped forward to ask for bilateral trade deals.” Cancún: Victory for Whom?, supra note 187, at A4.
212. Feinberg, supra note 78, at 45 (1997). Some observers have referred to this strategy as “a virtual FTAA.” Kristi Ellis, Ambitious Agenda for FTAA, Women’s Wear Daily, Feb. 11, 2003 (quoting Professor Peter Morici at the University of Maryland School of Business for the proposition that the U.S. will continue to negotiate small trade agreements until they “finally get a virtual FTAA”).
213. The failure of the WTO Doha Round of talks held in Cancún, Mexico in September 2003, foreshadows the difficulties that will be faced by FTAA supporters, and perhaps the ultimate fate of the FTAA itself will be abandonment.
CONCLUSION

Negotiating and implementing rules and procedures for tracking the importation and exportation of products throughout the entire Western Hemisphere will not be an easy task. If the FTAA is ever to have a chance to succeed, not only must the nations of the Western Hemisphere overcome the obstacles of history, language and culture, but they also must dismantle and reconstruct institutional bureaucracies at the domestic level that, in part, have cemented existing rules and procedures. This latter challenge may very well be the greater of the two for the Partner Nations. Existing rules of origin, whether they are part of the NAFTA regime or belong to the more than two dozen other trade agreements already at work in the Americas, are not rules to be dismissed easily. These rules have been worked and reworked to achieve certain political and economic goals at both the domestic and international level. Surely, each of the hundreds, if not thousands, of provisions found within each of these agreements that may strike us as idiosyncratic or irrelevant has been forged by a very deliberate negotiation process involving great compromise and exhaustive political wrangling both at home and abroad. Any attempt at revising this complex set of relationships in order to integrate them into a larger and more complex hemispheric trade agreement will require greater political skill and greater compromise than the American nations have ever shared with one another.

Since the implementation of NAFTA in 1994, U.S. administrations have continued to pursue a hub-and-spoke strategy to spread NAFTA–like rules throughout the Hemisphere. How-

in favor of less complicated bilateral and regional trade agreements. The breakdown of talks in Cancun has even caused the Europeans, quintessential multilateralists, to reconsider their focus and ask whether pursuit of bilateral trade accords might now be in their best interest. Although the European Union is a party to several bilateral and regional trade pacts, it has not negotiated any such agreements since 1999, preferring to pursue a multilateral strategy through the WTO. Scott Miller, Bilateral Deals on Trade Draw Opposition in EU, WALL ST. J., Sept. 25, 2003, at A14. See also Victory for Whom?, supra note 187, at A4 (“The EU held off on new bilateral trade deals until the Doha round was completed, putting all its trade chips in the WTO process.”). Not to be left out, China and Japan also continue to pursue trade agreements with smaller blocs of neighbors, adding to the evidence of a worldwide crisis of confidence in the ability of a large number of states to hammer out multilateral trade agreements. Id.
ever, the eight-year absence of fast track authority, now referred to as Trade Promotion Authority, made extending NAFTA via hub-and-spoke difficult, if not impossible, because during the eight year hiatus, Latin American countries established an ever more complex set of trading relationships among themselves and among other nations and trading blocs around the world.  

Although the nations of the Western Hemisphere still desire access to the rich markets of the United States, the United States may no longer possess the leverage to dictate the terms of such access. The United States is realizing this as it proceeds with the FTAA negotiation process. Its reaction has been to pursue a parallel process of negotiating agreements with individual Latin American countries to achieve through bilateral negotiations what it ultimately may not be able to achieve through multilateral negotiations.

The United States cannot have it both ways. It cannot seek hemispheric unity on the one hand, and on the other hand, a series of separate trade deals that only continue the balkanization of trade relationships within the region. It may be able to convince smaller segments of the Western Hemisphere to deal with it on its NAFTA–like terms, but in the end it would only establish another layer of complexity over the already intricate set of trading relationships that exist throughout the Western Hemisphere.

214. For a brief discussion on the various trade pacts among Latin American states, see Curtiss & Atkinson, supra note 16, at 148.

215. See, e.g., Cancun: Victory for Whom?, supra note 187 (stating the “U.S. is now trying to hammer out free-trade deals with 14 countries”). See also Elizabeth Becker & Larry Rohter, supra note 83 (discussing the trade pact between the U.S. and Chile); Patrick Courreges, supra note 85 (discussing CAFTA whose partners include Costa Rica, Nicaragua, Honduras, El Salvador and Guatemala). Trade Scene: No Bore in 2004, supra note 85 (noting that the Bush Administration is currently negotiating or contemplating free-trade agreements with the Dominican Republic, Australia, Morocco, Panama, Bahrain, Thailand, Colombia, Peru, Bolivia, Ecuador and the five Southern Africa Customs Union countries, which include Botswana, Lesotho, Namibia, South Africa and Swaziland).
The nations of the Western Hemisphere, including the United States, will achieve truly free trade only when they compromise their established concepts of trade, and this may include abandoning ties to specific provisions found within existing rules of origin. The thirty-four democracies of the Americas must agree to negotiate creatively and openly with each other if they are to make each other stronger. One can only hope that the nations eventually will reach this level of cooperation and trust as the FTAA negotiations proceed.
THE WORLD BANK, THE IMF AND THE
GLOBAL PREVENTION OF TERRORISM:
A ROLE FOR CONDITIONALITIES

Olivera Medenica

I. INTRODUCTION

The Twin Towers, an architectural symbol of Western power, came crashing down on a beautiful and hopelessly tragic September morning. The incredible scale of the attack left us horrified, bewildered, and wounded as a nation. With ghastly images in our memory, the U.S. turned towards the bleak prospect of fighting an elusive enemy. Like any true economic and military superpower, our response was strong and immediate. But was our response efficient, and most importantly, are we safer now than before?

In an interview granted shortly after September 11, 2001, James Wolfhenson, the president of the World Bank, described the collapse of the Twin Towers as not only a terrorist attack of the grandest scale, but also as the image “of the South landing hard on the cradle of the North.” This statement is insightful because it is powerfully descriptive and suggests that a collective response is needed to address the issue. Although poverty may not be the sole cause of terrorism, it does play a role in its spread. If that is the case, ignoring such a connection is not only negligent, but as has been proven, deadly.

* J.D. Brooklyn Law School, New York, 2000; B.M. Manhattan School of Music, 1996. Ms. Medenica is a partner at Wahab Riveles & Medenica, and is currently teaching Legal Writing for the International Moot Court program at Brooklyn Law School. The author would particularly like to thank Judge Evan J. Wallach, Professor Claire Kelly, Kaiser Wahab and Leo Balk for taking the time to read her article and provide helpful comments and edits.


This Article argues that the World Bank and the International Monetary Fund ("IMF"), collectively the International Financial Institutions ("IFIs"), could play a central role in the war on terrorism. As international institutions with unrivaled resources at their disposal, both the World Bank and the IMF could begin incorporating broad anti-terrorism conditions within their financial assistance programs.\(^3\) The IFIs could expand beyond their respective mandates and impose conditions that would require states seeking financial assistance to implement an anti-terrorism framework designed to criminalize terrorist offenses, prevent potential terrorists and terrorist groups from using such states’ territory to further terrorist purposes, and allow for the exchange of information with the necessary international authorities concerning the activities and crimes of terrorists and terrorist groups. In return, the funds provided by the IFIs could assist these states in strengthening their economies and ameliorating prevalent levels of poverty.

Part II of this Article analyzes different definitions of terrorism and examines the leading factors contributing to its rise. Part III.A provides an historical and technical outline of the IFIs’ respective mandates and activities from their inception at the Bretton Woods conference to their current activities. Part III.B posits a new role for the IFIs and concludes that these institutions should expand their respective mandates by providing financial assistance to address the leading factors contributing to the spread of terrorism and conditioning such assistance on the fulfillment of the objectives contained within United Nations ("UN") Resolution 1373.\(^4\)

II. TERRORISM

Terrorism, as an act of political violence, has existed for as long as political ideologies have been promoted.\(^5\) In the wake of September 11\(^{th}\), the subject of terrorism has become a common

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3. Although the IFIs have begun to address the issue of terrorism, the institutions’ work has not been included as a condition for financial assistance and it has been limited to financing of terrorism and anti-money laundering issues.


staple of our daily news intake. But aside from religious fanaticism, scant attention has been paid to economic and social factors underlying the proliferation of this dreadful phenomenon. To fully understand terrorism, attention must shift from the criminal nature of the act to a perception of terrorism as a symptom of our social pathology. The following section will therefore explore the root causes of terrorism: first, through an examination of the various definitions of the term, and second, through an analysis of the key factors leading to or facilitating the development of this sociopolitical disease.

A. Definitions of Terrorism

Although the word “terrorist” has become a part of our everyday vocabulary, no single definition of the term has gained universal acceptance within the international community. This lack of consensus stems from the inherently pejorative nature of the term. It is a word loaded with negative connotations that are generally only applicable to one’s adversaries. As Brian Jenkins writes “[w]hat is called terrorism…seems to depend on one’s point of view. Use of the term implies a moral judgment; and if one party can successfully attach the label terrorist to its opponent, then it has indirectly persuaded others to adopt its moral viewpoint.” This proclivity for subjective judgment has spawned a great variety of definitions, each reflecting the political slant of the particular interest group. Title 22 of the U.S. Code, Section 2656f(d) defines terrorism as “premeditated, politically motivated violence perpetrated against noncombatant targets by subnational groups or clandestine agents.”

The U.S. Federal Bureau of Investigation (“FBI”) defines terrorism as “the unlawful use of force or violence against persons or property to intimidate or coerce a Government, the civilian population, or any segment thereof, in furtherance of political or

6. HOFFMAN, supra note 5, at 37; see also ALEX P. SCHMID, POLITICAL TERRORISM: A RESEARCH GUIDE TO CONCEPTS, THEORIES, DATA BASES AND LITERATURE 6 (1983).
7. HOFFMAN, supra note 5, at 31.
8. Id.
9. Id.
10. See id. at 38.
social objectives.” The U.S. Department of Defense defines it as “the unlawful use of — or threatened use of — force or violence against individuals or property to coerce or intimidate governments or societies, often to achieve political, religious, or ideological objectives.”

Each one of these examples partially defines terrorism. The first leaves out spontaneous acts of political violence along with the psychological dimension of terrorism. The second offers no insight as to what political or ideological aims might entail, and the third, although most complete, omits the social dimension of terrorism.

As explained by Bruce Hoffman, perhaps the best explanation of the term lies in its distinction from other types of violence. When contrasted with guerrilla warfare, ordinary criminals and the lunatic assassin, terrorism can be understood as:

- Ineluctably political in aims and motives;
- Violent — or, equally important, threaten[ed] violence;
- Designed to have far-reaching psychological repercussions beyond the immediate victim or target;
- Conducted by an organization with an identifiable chain of command or conspiratorial cell structure (whose members wear no uniform or identifying insignia); and
- Perpetrated by a subnational group or non-state entity.

Taking these elements into account, and for purposes of this Article, terrorism will be defined “as the deliberate creation and exploitation of fear through violence or the threat of violence in the pursuit of political change.”

15. Id.
16. Id. at 40.
17. Id. at 43.
18. Id.
B. State Failure

The argument is often made that poverty causes terrorism.\textsuperscript{19} Drawing such an equation merely provides an adumbrated explanation of the problem. It is well-known that Osama bin Laden, the alleged mastermind of worldwide Islamic terrorism, originates from great Saudi wealth.\textsuperscript{20} It is also fairly well known that most if not all of the September 11\textsuperscript{th} hijackers were highly educated and received money from their families.\textsuperscript{21} But even if there is no direct correlation between poverty and terrorism, there is some validity in recognizing the connection.\textsuperscript{22} Pov-

\begin{itemize}
  \item \textsuperscript{22} Friedman, \textit{supra} note 19 (quoting both U.S. Secretary of State Colin Powell’s and Secretary General of the UN Kofi Annan’s recognition that terrorism flourishes in impoverished countries); Demaria, \textit{supra} note 19 (quoting Philippine President Gloria Macapagal-Arroyo as stating, “it is evil that
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Property may not be the cause of terrorism, but terrorists can manipulate poverty to their advantage.

As Robert Rotberg notes, an alternative and more probable explanation to the poverty-terrorism synergy lies in the phenomena of failed states. According to Rotberg, “because failed states are hospitable to and harbor nonstate actors — warlords and terrorists — understanding the dynamics of nation-state failure is central to the war against terrorism.” How best to prevent state failure and strengthen weak states therefore becomes a critical component of any meaningful policy debate about terrorism prevention.

So what is state failure, and how does a state become a failing or failed state? As Rotberg states, “[n]ation-states fail because they are convulsed by internal violence and can no longer deliver positive political goods to their people.” He distinguishes between several incremental stages of nation-state failure: general weakness or apparent distress, failure, and collapse. The extent to which a state performs well on the success-failure spectrum hinges on its capacity to deliver political goods to its citizens. These political goods “encompass expectations, conceivably obligations, inform the local political culture, and together give content to the social contract between ruler and ruled that is at the core of regime/government and citizenry interactions.

Although each political good carries great weight, there is a hierarchy of political goods. None is as crucial as a state’s ob-

26. Id.
27. See id. at 1–2.
28. Id. at 3.
29. Id.
ligation to provide security to its citizenry; a state must be able to control its borders within and without.\textsuperscript{30} It must not only have the capacity to prevent cross-border invasions, but it must also provide its citizens the opportunity to resolve disputes without recourse to arms.\textsuperscript{31} Once security has been sustained, the delivery of other political goods becomes possible.\textsuperscript{32}

A state must also provide a predictable and recognizable system of adjudicating disputes.\textsuperscript{33} It must regulate and protect the rights of its citizens by establishing codes and procedures, as well as a judicial system that effectively symbolizes and validates the local principles of justice and fair play.\textsuperscript{34}

Another important political good is the right of citizens to liberally participate and contribute to the political process. This includes: “the right to compete for office; respect and support for national and regional political institutions, like legislatures and courts; tolerance of dissent and difference; and fundamental civil and human rights.”\textsuperscript{35}

Other remaining goods that similarly play an essential role in the development of a healthy, or successful, state include:

\begin{itemize}
  \item Medical and health care (at varying levels and costs); schools and educational instruction (of various kinds and levels) — the knowledge good; roads, railways, harbors, and other physical infrastructures — the arteries of commerce; communications infrastructures; a money and banking system, usually presided over by a central bank and lubricated by a national currency; a beneficent fiscal and institutional context within which citizens can pursue personal entrepreneurial goals and potentially prosper; the promotion of civil society; and methods of regulating the sharing of the environmental commons.\textsuperscript{36}
\end{itemize}

Whether a state is categorized as weak, strong, or failed will not depend on its success or failure to deliver a particular good, but rather on its overall performance in the hierarchy of political goods.\textsuperscript{37} Strong states will undoubtedly perform well in all of

\textsuperscript{30} Id.
\textsuperscript{31} Id.
\textsuperscript{32} Id.
\textsuperscript{33} Id.
\textsuperscript{34} Id.
\textsuperscript{35} Id.
\textsuperscript{36} Id. at 3–4.
\textsuperscript{37} Id. at 4.
the categories.\textsuperscript{38} Weak states, however, will provide a sporadic and inconsistent performance, fulfilling some or few of the political good categories.\textsuperscript{39} The fewer categories a state is capable of fulfilling, the more it tends to edge towards the brink of failure.\textsuperscript{40}

In contrast, failed states deliver limited quantities, if any, of essential political goods.\textsuperscript{41} They are deeply conflicted, divided by civil wars or disobedience, and are generally typified by weak institutions and a corrupt leadership.\textsuperscript{42} According to Rotberg, failed states share the following characteristics:

>[A] rise in criminal and political violence; a loss of control over their borders; rising ethnic, religious, linguistic, and cultural hostilities; civil war; the use of terror against their own citizens; weak institutions; a deteriorated or insufficient infrastructure; an inability to collect taxes without undue coercion; high levels of corruption; a collapsed health system; rising levels of infant mortality and declining life expectancy; the end of regular schooling opportunities; declining levels of GDP per capita; escalating inflation; a widespread preference for non-national currencies; and basic food shortages, leading to starvation.\textsuperscript{43}

Because failed states are unable or unwilling to deliver key political goods, they are vulnerable to attacks upon their fundamental legitimacy.\textsuperscript{44} When a self-serving ruling elite is perceived as working for itself and not the state, citizens begin to seek alternative sectional and community loyalties.\textsuperscript{45} Group leaders or communal warlords, some deriving support from outside sources, answer this demand for support and security.\textsuperscript{46} It is at this stage that terror is likely to breed.\textsuperscript{47}

In the final stages of failure, a state becomes truly collapsed.\textsuperscript{48} Although a rare and extreme case, the collapsed state is typified

\begin{itemize}
\item \textsuperscript{38} Id.
\item \textsuperscript{39} Id. at 4.
\item \textsuperscript{40} Id.
\item \textsuperscript{41} Id. at 6.
\item \textsuperscript{42} See id. at 5–6, 8.
\item \textsuperscript{43} Rotberg, Failed States supra note 23, at 132.
\item \textsuperscript{44} See id.
\item \textsuperscript{45} Id.
\item \textsuperscript{46} Id.
\item \textsuperscript{47} Id.
\item \textsuperscript{48} Id. at 133.
\end{itemize}
by a clear power vacuum.\textsuperscript{49} The state becomes a geographic expression of meaningless borders.\textsuperscript{50} In this state of deconstruction, warlords or local group leaders take over and install their version of statehood by setting up local security, markets and trading arrangements.\textsuperscript{51}

The relative successes and failures of states operate on a broad continuum, and no particular stage is terminal or permanent. The international community’s ability to recognize a state’s slide into failure is crucial in light of a failed state’s vulnerability as a breeding ground for terrorism. But mere recognition of these warning signs, although a feat by itself, is insufficient to produce positive change. The international community must be ready to react, and to this end, it must be ready to commit time, energy and most importantly, resources to help prevent a state’s slide into failure.

III. A NEW ROLE FOR THE IFIs

Although few may disagree that terrorism must be addressed on a global scale, questions remain as to how the international community should achieve such an objective.\textsuperscript{52} A meaningful response must be three dimensional. It must address the root causes of the problem, provide a regulatory framework to prevent future infractions and ensure compliance through an effective enforcement mechanism. The following section will examine a possible role for the IMF and the World Bank, first through a brief overview of the IFIs’ respective fields of operation and the extent to which these institutions’ policies and lending facilities have evolved over time; and second, through an analysis of loan conditions and their potential meaning in the war against terrorism.

A. The IMF and World Bank

The IMF and the World Bank were created out of coordinated efforts by the major Allied governments to revive international

\begin{itemize}
  \item \textsuperscript{49} See id.
  \item \textsuperscript{50} See id.
  \item \textsuperscript{51} See id. at 133–34.
\end{itemize}
trade in the post-World War II era.\textsuperscript{53} The sharp economic downturn of the Great Depression and the military investment, both human and economic, of World War II had left the global economy in severe need of a panacea for its fiscal ailments.\textsuperscript{54} In 1944, representatives of 45 governments met at the UN Monetary and Financial Conference at Bretton Woods, New Hampshire, in order to finance the rebuilding of a war-torn Europe and to prevent future economic depressions.\textsuperscript{55} The consensus was to emphasize transnational commerce by building a system supported by cooperation and interdependence in the fields of trade and monetary policy.\textsuperscript{56} Out of this agreement emerged the IMF and the World Bank.\textsuperscript{57}

1. The Institutional Organization of the IMF

The IMF was created as a specialized agency of the UN designed to promote the stability of the international monetary system.\textsuperscript{58} Its central objective is to prevent economic crises from occurring by advising member states on the soundness of their economic policies and to provide temporary financing for member states experiencing balance of payments problems.\textsuperscript{59}

\begin{itemize}
  \item \textsuperscript{54} See Swaminathan, supra note 53, at 164. See generally International Monetary Fund, \textit{What is the International Monetary Fund}, at http://www.imf.org/external/pubs/ft/exrp/what.htm (last visited Oct. 30, 2003) [hereinafter \textit{What is the IMF}].
  \item \textsuperscript{55} See \textit{JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS} 11 (2002). See also \textit{What is the IMF}?, supra note 54.
  \item \textsuperscript{56} Swaminathan, supra note 53, at 164.
  \item \textsuperscript{57} Id.; see also Stiglitz, supra note 55, at 11.
  \item \textsuperscript{58} \textit{What is the IMF}?, supra note 54.
  \item \textsuperscript{59} See id. Benefiting from an almost global membership of 183 states, the IMF reports to the ministries of finance and the central banks of governments of its member states. See id.; Stiglitz, supra note 55, at 12. A Board of Governors, representing all member states, is the highest authority within the institution and meets once a year to decide on major policy issues. See \textit{What is the IMF}?, supra note 54. Day-to-day operations are left to the Executive Board which meets several times per week at the IMF’s headquarters in Washington, D.C. See id. The Executive Board consists of a total of 24 Executive Directors with the United States, Japan, Germany, France, United Kingdom, China, Russia, and Saudi Arabia, having their own seats on the Board, and the remaining directors elected on a rotating two-year basis. See id. Decisions are made based on a weighted voting system with the state with the
The IMF’s statutory purposes are embodied in its Articles of Agreement. Its purposes include the promotion of balanced world trade expansion, exchange rate stability, the establishment of a multilateral system of payments, and temporary financial assistance to member states experiencing balance of payment problems. To further its goals, the IMF examines the larger “quota” having more votes. See id. These quotas are essentially capital subscriptions that members pay upon joining the institution and are intended to reflect each member’s relative size in the global economy. See id. As quotas are determined by the economic size of a country, it is the major developed countries that benefit from greater voting powers. STIGLITZ, supra note 55, at 12. As a result of this, the United States benefits from an actual veto power. Id.


61. Article I of the Articles of Agreement of the International Monetary Fund provides:

The purposes of the International Monetary Fund are:

(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
performance of each member’s economy as a whole, focusing mainly on its macroeconomic policies — policies on exchange rates, the management of money, and the member state’s government budget — and financial sector policies. The IMF also places due consideration on a member state’s structural policies, such as labor market policies, that could potentially affect macroeconomic performance. Additionally, the institution advises its members on the best course of action in re-evaluating national policies so they more effectively pursue objectives such as high employment, low inflation, and sustainable economic growth. This technical assistance is further supplemented with training programs for government and central bank officials of member states.

An important aspect of the institution’s organization is its ability to provide loans to member states experiencing balance of payment problems. Maintaining a healthy balance is a central precondition to the IMF’s founding purpose of promoting global economic stability. Should a member state find itself unable to comply with this condition, Article I of the IMF’s Articles of Agreement provides that it is required to make funds “temporarily available to [member states] under adequate safeguards...to correct maladjustments in their balance-of-payments without resorting to measures destructive of national or international prosperity.”

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.


63. What is the IMF?, supra note 54.
64. Id.
65. Id.
67. Id.
The institution’s lending, however, is conditional on the borrowing state’s adoption of IMF policies designed to correct its balance of payments problems.\textsuperscript{68} Article V(3)(a) of the IMF’s Articles of Agreement provides that

\textit{[t]he Fund shall adopt policies on the use of its general resources... and may adopt special policies for special balance of payments problems, that will assist members to solve their balance of payments problems in a manner consistent with the provisions of this Agreement and that will establish adequate safeguards for the temporary use of the general resources of the Fund.}\textsuperscript{69}

These performance-based conditionalities enable the IMF to “independently...examine [the] country’s need for balance of payments assistance and to require the adoption of corrective policies before funds are disbursed.”\textsuperscript{70} Conditions may include trade liberalization measures, depreciation of the exchange rate, decreasing the fiscal deficit, and restrictions on the credit provided by domestic banks.\textsuperscript{71} According to the IMF, “[t]he conditionality associated with IMF lending helps to ensure that by borrowing from the IMF, a country does not just postpone hard choices and accumulate more debt, but is able to strengthen its economy and repay the loan.”\textsuperscript{72}

\begin{footnotesize}
\begin{enumerate}
\item What is the IMF?, supra note 54.
\item Swaminathan, supra note 53, at 166; see also International Monetary Fund, Regulation of International Finance: Guidelines on Conditionality, Executive Board Decision No. 6056-(79/88), 1 B.D.I.E.L. 391 (Mar. 2, 1979).
\item Mary C. Tsai, Globalization and Conditionality: Two Sides of the Sovereignty Coin, 31 LAW & POL’Y INT’L BUS. 1317, 1321 (2000).
\item What is the IMF?, supra note 54. The IMF provides for various preventative and protective measures to ensure that the borrowing member state has fulfilled the loan’s conditionalities. Compliance is established where the borrowing state has satisfied certain criteria “designed to measure the impact of fiscal and monetary policy on external viability.” Swaminathan, supra note 53, at 166. The institution’s standards for determining the borrowing member state’s compliance “will normally be confined to (i) macroeconomic variables, and (ii) those criteria necessary to implement specific provisions of the Articles or policies adopted under them. Performance criteria may relate to other variables only in exceptional cases...” International Monetary Fund, Executive Board Decision No. 6056-(79/38), 1.B.D.I.E.L. 393 (Mar. 2, 1979), reprinted in JOSEPH GOLD, CONDITIONALITY 30 (International Monetary Fund,
2. The Institutional Organization of the World Bank

The World Bank is a multilateral institution that enables member states to assist in the collective “promotion, worldwide, of sustainable economic development and poverty reduction.” These objectives are pursued through lending, the production of research and economic analysis and the provision of policy advice and technical assistance.

A product of World War II, the World Bank was initially envisioned to address the financial needs of a post-war reconstruction. Harry Dexter White, a U.S. Treasury official and one of the original drafters of the plan for the World Bank, stated that the primary objectives of the World Bank were to “provide or otherwise stimulate long-term, low-interest-rate loans for reconstruction and for the development of capital-poor areas.”

Reconstruction was, nevertheless, the World Bank’s dominating objective during the initial decade and a half of its life. By the early 1960s, however, the political topography of the world had been drastically altered. Adapting to this changing political reality led the World Bank to shift its priorities “from reconstruction to development and from Europe to the developing world.”

Pamphlet Series No. 31, 1979). If the IMF deems that the borrowing member state has failed to comply with these conditionalities, it can refuse to release the next disbursement. Tsai, supra note 71, at 1322.


74. THE WORLD BANK: STRUCTURE AND POLICIES, supra note 73, at 10.

75. Id. at 14.

76. Id.

77. Id.

78. Id.

79. Id. Commonly perceived as a single lending institution specializing in development strategies, the World Bank is actually a large organization comprising an amalgam of four smaller units operating under the title of ‘World Bank Group.’ Id. at 12. The original and central member of the World Bank Group is the International Bank for Reconstruction and Development (“IBRD”). Id. Its principal objective is “to borrow funds and lend these on to qualifying member governments or to public sector institutions for agreed projects.” Id. The second unit of the World Bank is the International Development Agency which functions as an aid agency, mainly confining its activi-
Although the membership of the World Bank is coextensive with the membership of the IMF, the working objectives of the World Bank differ markedly from those of the IMF, most noticeably in that the World Bank functions first and foremost in its banking capacity as a financial intermediary. It raises money by selling bonds on the international capital market and subsequently lends these funds to member states at a small mark-up over the World Bank's AAA borrowing rate.

Ties to 60 “IDA countries” that have a low GDP per capita. Although the IBRD and the IDA are almost entirely coextensive, differences basically center on the duration of the loan, its interest rates and the source of the loaned funds. In essence, “[t]he Bank, as IDA, provides both development assistance and development aid while, as the IBRD, it provides assistance and enhanced access to capital.” The third unit of the World Bank is the International Finance Corporation (“IFC”), which was founded in 1956. This institution’s main objective is to strengthen domestic industries by lending to private sector institutions and taking equity shares in private sector enterprises. The fourth and last unit is the Multinational Investment Guarantee Agency (“MIGA”), which was created in 1988. Its objective is to guarantee “private sector investors against expropriation and repatriation risks in developing countries.”


An AAA-rating is the highest possible rating issued by rating agencies such as Moody’s and Standard & Poor’s. An AAA rating signifies a guarantee that anyone who purchases AAA-rated bonds will be sure to get their money back.
lends either “directly to a member government or [requires that its] loans be] guaranteed by the member government in whose territory the project [or program] is located.”

In addition, the World Bank restricts the use of such loans “for the foreign exchange component of specific [programs or] projects.”

Disbursement of aid is, however, conditional on the borrowing state’s adoption of specified conditionalities. Article III(4) of the World Bank’s Articles of Agreement provides that the World Bank may provide loans “to any member or any political subdivision thereof and any business, industrial, and agricultural enterprise in the territories of a member,” subject to the condition that the member state fully guarantee the repayment of the principal and interest.

The World Bank is further obligated to “pay due regard to the prospect that the borrower... will be in [the] position to meet its obligations under the loan...” The World Bank’s conditionalities are comprehensive, and generally include policy and structural reforms in the borrowing state including improved governance, the elimination of corruption and gender equality, among many others.

3. The Changing Nature of the World Bank and the IMF

Since their inception in 1944, the World Bank and the IMF have changed significantly in their respective scope of operations. Lending facilities have expanded from short-term remedial measures based on specific projects, to extensive policy-

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82. Swaminathan, supra note 53, at 168; The WORLD BANK: STRUCTURE AND POLICIES, supra note 73, at 12.


84. Id.

85. World Bank Article of Agreement, supra note 80, art. III, sec. 4., 60 Stat. at 1443, 2 U.N.T.S. at 144.

86. Id. World Bank Articles of Agreement, supra note 80, art. III, sec. 4, para. 5, 16 U.S.T. at 1443–44, 2 U.N.T.S. at 144.

oriented programmatic interventions, often encompassing important regulatory and structural changes in developing member states. These institutions’ ranges of activities have also become increasingly intertwined, most distinctively during the last two decades.

The 1980s trumpeted the benefits of free market ideology, and the IMF and the World Bank became the “new missionary institutions” emblematic of this change.88 From this prevalent political climate emerged a new “Washington Consensus,” a doctrine based upon the consensus of the IMF, the World Bank, and the U.S. Treasury.89 The Washington Consensus was dedicated to: “(i) deregulation and opening domestic markets to foreign goods and services; (ii) freeing trade and (iii) opening domestic capital markets to the free flow of international capital.”90 The Bretton Woods institutions were to promote these objectives by: “(i) facilitating the rapid liberalization of the goods markets and removing or reducing barriers to trade (ii) encouraging Governments to tighten fiscal and monetary policies (iii) promoting stable exchange rates and (iv) liberalizing capital markets.”91 Although the IMF and the World Bank’s respective missions remained and continue to remain separate and distinct, it is during this time period that their activities became increasingly co-dependant and intertwined.92 A brief retrospective of these institutions’ lending facilities and respective activities provides a revealing illustration of this structural shift towards a Washington Consensus policy-based orientation.

a. World Bank Lending Facilities

The World Bank’s founders intended primarily to provide assistance by guaranteeing private loans.93 In the 1950s, however, the World Bank’s original scope was expanded to provide direct loans to developing states experiencing a scarcity of private ex-

88. STIGLITZ, supra note 55, at 13.
90. Id.
91. Id.
92. STIGLITZ, supra note 55, at 13.
ternal sources of finance.\textsuperscript{94} These loans were provided for through Structural Adjustment Programs (“SAP”) whereby financing could serve as a “[vehicle] for the design and implementation of projects, particularly in the infrastructure sector.”\textsuperscript{95} In the late 1970s, the World Bank further expanded its scope of operations to focus on inappropriate public policies in developing countries that were burdened with “large fiscal deficits…unsustainable balance-of-payments deficit[s] and…open or repressed inflation.”\textsuperscript{96} Local governments often further exacerbated the rampant financial hardship of these countries by pursuing “expansionary demand policies.”\textsuperscript{97}

Conscious of the difficulties that such unstable macroeconomic environments presented, the World Bank cast aside the use of project-oriented initiatives and started resorting to Structural Adjustment Lending (“SAL”).\textsuperscript{98} This lending facility was geared for “quick-disbursing balance-of-payments support to assist [developing] member countries in implementing a less costly adjustment to external shocks.”\textsuperscript{99} These loans, however, imposed significant conditions upon the disbursement of financial assistance. Member states were expected to “achieve both long-term macroeconomic stabilization and structural transformation of [their] economies by addressing the fundamental causes of [their] economic crises.”\textsuperscript{100} More specifically, they were required to “bring…the level of demand and its composition ([the proportion of] tradable relative to non-tradable goods), into line with the level of output and external financing.”\textsuperscript{101} These objectives were to be accomplished through the implementation of policies and legislation designed to achieve the necessary

95. Swaminathan, supra note 53, at 169.
96. Vittorio Corbo \& Stanley Fischer, \textit{Adjustment Programs and Bank Support: Rationale and Main Results}, in \textit{ADJUSTMENT LENDING REVISITED: POLICIES TO RESTORE GROWTH} 7 (Vittorio Corbo et al. eds., 1992) [hereinafter Corbo \& Fischer, \textit{Adjustments Programs}].
97. \textit{Id}.
99. \textit{Id}.
100. Corbo \& Fischer, \textit{Adjustments Programs}, supra note 96, at 7 (emphasis in original).
101. \textit{Id}.
macroeconomic corrections. The recurrent use of this facility throughout the 1980s resulted in SALs accounting for a quarter of World Bank lending by the end of the decade. In order to ensure the success rates of SALs, however, the World Bank limited the availability of this lending facility to member states already benefiting from an IMF sponsored stabilization program. In this way, the World Bank essentially came to condition its loans upon explicit approval from the IMF. Although this arrangement did improve the probabilities for high success rates, this “no Fund programme, no SAL” rule eventually proved a nuisance. The World Bank therefore introduced the Sector Adjustment Loan (“SECAL”), which was directed at states lacking an IMF program. These loans “support[] policy changes and institutional reforms in a specific sector” and “focus on major sectoral issues such as the incentive and regulatory frameworks for private sector development, institutional capability, and sector expenditure programs.”

The most noteworthy characteristic of the SALs and SECALs, however, is their heavy emphasis on policy-based objectives. Whereas the World Bank was initially focused on small, project-based facilities, it eventually expanded to address the general macroeconomic stability and balance of payments problems of developing member states.

b. IMF Lending Facilities

The IMF similarly shifted from small scale lending facilities to comprehensive initiatives heavily slanted towards policy-

102. See Jonathan Cahn, Challenging the New Imperial Authority: The World Bank and the Democratization of Development, 6 HARV. HUM. RTS. J. 159, 160 (1993) (arguing the World Bank uses it leverage to “legislate entire legal regimes...and often rewrite[s] a country’s trade policies, [and] fiscal policies”). Id. at 160.
103. See id. at 175–76.
105. See id.
106. Id.
108. See Cahn, supra note 102, at 174–75; see also Distant Relations, supra note 94; see also Until Debt Us Do Part, supra note 104.
oriented objectives. The IMF was created to offer member states temporary facilities in order to maintain the stability of the international monetary system. To achieve this objective, the IMF provided, and continues to provide, for diverse means of access to available funds, the amount of which is directly related to each member state’s quota.

At its inception, funds were divided into a “reserve tranche” and four equivalent “credit tranches.” The reserve tranche was part of a member’s own reserves kept on deposit with the IMF and access to it was virtually unimpeded. Each of the credit tranches, however, represented 25% of the member’s quota and a member’s access to any of them was conditioned on the IMF’s authorization. While the first tranche was fairly easy to obtain, access to the remaining three credit tranches was subject to much closer scrutiny and “almost always require[d] a stand-by or similar arrangement” between the IMF and the borrowing member state.

These stand-by arrangements were essentially agreements between the IMF and member states providing for the latter’s borrowing of hard currencies, should the need arise. As they were intended to “provide short-term balance-of-payments assistance for deficits of a temporary or cyclical nature,” they had to be repaid within three years and “were assessed near market interest rates.” Moreover, stand-bys were only disbursed in installments and included “rigid performance [based] conditionalities.”

109. See Distant Relations, supra note 94.
110. What is the IMF?, supra note 54; see also Sisters in the Wood; A Fund by Design, ECONOMIST, Oct. 12, 1991, at 14 [hereinafter A Fund by Design].
112. See id.
113. Id.
114. Id.
115. Id.
116. Id.
117. Id.
118. Swaminathan, supra note 53, at 171.
119. Id.
tates that these lending facilities were not meant to address any issues of a “structural or socioeconomic nature” within the borrowing member state, but rather solely focused on the IMF’s primary objective of economic stabilization.\textsuperscript{120}

The IMF, however, began expanding its facilities by the early 1980s as it experienced difficulties in addressing balance of payments problems through its customary lending facilities.\textsuperscript{121} To address the complexities of an increasingly unstable monetary environment, the IMF introduced the Extended Fund Facility (“EFF”).\textsuperscript{122} This facility was designed to allow member states to borrow up to 140 percent of their quota with a repayment period of four to ten years instead of three to five years.\textsuperscript{123} Still an insufficient tool to address the pervasive debt obligations of the poorest states, the institution further expanded its facilities in 1986 by establishing the Structural Adjustment Facility (“SAF”), which charged an interest rate of only one-half percent.\textsuperscript{124} SAF loans included a repayment period of five to ten years, and “were financed by sovereign repayments to the IMF during the 1970’s and disbursed to finance three-year stabilization programs.”\textsuperscript{125}

As the SAF resources neared depletion, the IMF introduced yet another type of loan, the Enhanced Structural Adjustment Facility (“ESAF”).\textsuperscript{126} The funds were raised through contributions of major developed member governments, and borrowing states could receive double the amount obtainable under the

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{120} See id.
\item \textsuperscript{121} Id.
\item \textsuperscript{122} Id.; see also International Monetary Fund, Executive Board Decision No. 4377-(74/114), Sept. 13, 1974, art. I(iv), in Selected Decisions of the International Monetary Fund and Selected Documents 33 (1987).
\item \textsuperscript{123} Swaminathan, supra note 53, at 171; see also International Monetary Fund, Executive Board Decision No. 6339-(79/179), Dec. 3, 1979, in Selected Decisions of the International Monetary Fund and Selected Documents 50, 50–54 (1976); International Monetary Fund, Executive Board Decision No. 6830-(81/65), Apr. 22, 1981, in Selected Decisions and Selected Documents of the International Monetary Fund 515, 515–16 (June 30, 1997).
\item \textsuperscript{124} Swaminathan, supra note 53, at 172; see also International Monetary Fund, Structural Adjustment: Concessional Facilities Resist Low-Income Countries, IMF Survey: Supplement on the IMF 1, 21 (1993).
\item \textsuperscript{125} Swaminathan, supra note 53, at 172; see also Until Debt Us Do Part, supra note 104.
\item \textsuperscript{126} Swaminathan, supra note 53, at 172.
\end{enumerate}
\end{footnotesize}
SAF. The major difference, however, was that the condition-
alities and the scrutiny attached to these loans was much
stricter. In addition, “ESAF funds were disbursed in smaller
installments than under the SAF, and subjected to frequent
performance-based tests.” The IMF’s satisfaction with the
performance of its new lending facilities at the close of the de-
cade resulted in its establishment of about 30 SAF and ESAF
facilities in Africa, and the virtual disappearance of EFFs and
standbys from the continent.

The IMF’s use of the SAF and ESAF lending facilities marked
a change in the institution’s method of addressing balance of
payments inequities. Whereas loans were initially short-term
and typically focused on redressing balance of payments prob-
lems, they gradually evolved into policy-based instruments re-
quiring the implementation of important structural and policy
changes within the borrowing government. Furthermore, as
the majority of these stabilizing facilities were disbursed to the
developing world, the IMF’s activities increasingly became de-
velopmental in nature.

This overlap of activities between the IMF’s progressive pol-
icy-based facilities and the World Bank’s original developmen-
tal mandate was eventually formally reinforced in an official
agreement between the two Bretton Woods institutions. In
March of 1989, the World Bank and the IMF entered into a
“concordat” whereby the two institutions formalized their al-
ready established practice that World Bank structural adjust-
ment loans would exclude member states lacking an IMF stabi-
lization program. They further agreed that “the IMF would
have ‘primary responsibility’ over short-term stabilization and
exchange rates, and the Bank would be in the lead on medium
and longer-term structural reform.” In this way, the World
Bank and IMF operations became officially and permanently

127. Id.; see also Until Debt Us Do Part, supra note 104.
128. Swaminathan, supra note 53, at 172.
129. Id.
130. Id.
131. Id.
132. Id. at 172–73.
133. Id. at 173.
134. Id.; see also Until Debt Us Do Part, supra note 104.
135. Until Debt Us Do Part, supra note 104.
interconnected and their combined policies of stabilization and structural adjustment developed into a standard feature of World Bank and IMF interventions.

4. Conditionality

A central and controversial aspect of World Bank and IMF activities is reflected in the institutions’ use of conditions for their lending facilities. As with many exchanging partners, the IFIs require debtor states to provide credible commitments to increase certainty of repayment and ensure cooperation in the implementation of the loans. These commitments, or conditions, essentially provide an infrastructure which the IFIs believe will allow the debtor state to stabilize, grow, and pay off the debt. Although the IFIs have been severely criticized for the inclusion of conditions reflecting policy-oriented objectives, conditionalties remain an integral component of the institutions’ lending facilities and have grown to include matters previously considered outside of the institutions’ scope of activities.

a. Conditions Defined

The conditions that the various borrowing states submit to are quasi-contractual in nature, as is underscored by the definition of “conditionality.” Tony Killick defines aid conditionality as “a mutual arrangement by which a government takes, or promises to take, certain policy actions, in support of which an IFI...or other agency will provide specified amounts of financial assistance.” Others define it as “the linking of the disbursement of a loan to understandings concerning the economic policy which the government of the borrower country intends to

137. Chossudovsky, supra note 136, at 45; Stiglitz, supra note 55, at 44.
138. Stiglitz, supra note 55, at 44–45; see also discussion, infra at Part II.A.3.a.
139. The definitions included in this section are equally applicable to the IMF’s and World Bank’s practices.
pursue.” 141 These conditions enable the IMF and the World Bank “independently to examine the country’s need for balance of payments assistance and to require the adoption of corrective policies before funds are disbursed.” 142

“Although the failure of a member state to meet these conditions is not a fortiori a breach of contract or a violation of international law,” there are three important repercussions for non-compliance. 143 First, the institutions may limit, or restrict, the noncompliant nation’s credit. 144 In order to ensure compliance, the IMF and the World Bank condition the release of credit upon the borrowing state’s fulfillment of performance criteria previously stipulated in a credit agreement. 145 A borrowing state must therefore fulfill these performance criteria in order to be deemed compliant with the conditions. 146 Second, the institutions can suspend the next disbursement if they determine that the borrowing state has failed to comply with these conditions. 147 Finally, because private creditors consider the institutions’ approval of a member state’s economy a “seal of approval,” the institutions’ determination that a particular state has been noncompliant can result in the practical elimination of the debtor state’s private funding. 148 As these repercussions can have disastrous financial consequences, a debtor state has every incentive to comply with the loan agreement’s terms and conditions. 149

While loan agreements and conditions are of a mandatory nature, they are meant to result from an ongoing dialogue be-

142. Swaminathan, supra note 53, at 166.
143. Tsai, supra note 71, at 1322.
144. Id.
146. Tsai, supra note 71, at 1322.
147. Id. at 1322; see also Head, supra note 145, at 945.
149. See Tsai, supra note 71, at 1322.
tween the debtor state and the IFI in question. For instance, a government seeking IMF assistance must provide evidence that it is “seriously committed to economic reform.” This will usually take the form of a “letter of intent” outlining “the government’s major orientations in macro-economic policy and debt management.” The typical loan agreement will therefore include the debtor state’s proposed policy reforms concerning various sectors of the economy and government, while the arrangement itself, will contain additional policy proposals, review schedules, and binding conditions. Similarly, in the case of many indebted states, the borrowing government “is obliged under its agreement with the [financial institutions] to outline its priorities in a…’Policy Framework Paper.’” These government-generated documents, although heavily influenced by the institutions’ input, eventually form the basis for the final loan agreement and its appurtenant conditions.

b. Conditions as a Policy Tool

As a general matter, conditionalities are a reflection of policies endorsed by the IFIs. The inherent nature of loan agreements enables the institutions to prescribe a set of policy actions, which the debtor state must accept in order to receive the necessary funding. Although the institutions’ economic prescriptions have remained consistent since the 1980s, an examination into their policy objectives reveals that conditionalities have gradually expanded in scope to include not only economic but political considerations as well.

150. See CHOSSUDOVSKY, supra note 136, at 53–54.
151. Id. at 53.
152. Id.
154. CHOSSUDOVSKY, supra note 136, at 54.
155. Id. at 52.
156. Id.
The Washington Consensus emerged in the 1980s as an economic orthodoxy that has permeated the institutions’ lending facilities since its inception. 158 A by-product of free market ideologies, “[t]he consensus’ policy prescriptions include opening trade, fiscal restraint, prudent macroeconomic management, deregulation and privatization.” 159 The consensus evolved from the Latin American financial crisis of the 1980s where “[l]oose monetary policy led to inflation running out of control.” 160 Based largely on the political climate at the time, the prescriptions utilized in dealing with the crisis (i.e., fiscal austerity, privatization, and market liberalization), were permanently adopted by the IFIs as the models for future financial assistance packages. 161 These policies translated into comprehensive programs of macro-economic stabilization and structural economic reform. As explained by Professor Chossudovsky, “[s]tructural adjustment is viewed by the IFIs as consisting of two distinct phases: ‘Short-term’ macro-economic stabilization (implying devaluation, price liberalization and budgetary austerity) to be followed by the implementation of a number of more fundamental…structural reforms.” 162 Conditions under the Washington Consensus may therefore require the debtor state to implement reforms including currency devaluation; 163 “liberalization of the labor market;” 164 reduction of the budget deficit; 165 “ceilings” on state expenditures; 166 price liberalization; 167 trade liberalization; 168 privatization of state enterprises; 169 tax reforms; 170 priva-
tization of agricultural land;\textsuperscript{171} deregulation of the banking system;\textsuperscript{172} liberalization of capital movements;\textsuperscript{173} and poverty reduction through targeted social programs.\textsuperscript{174}

Beginning in the early 1990s, the World Bank and IMF fundamentally shifted their policies and strategies by introducing the concept of “good governance” both as an objective and a condition for financial assistance.\textsuperscript{175} This shift in policy reflected an increasing recognition by the IFIs “that the reasons for underdevelopment and mismanaged government are ‘sometimes attributable to weak institutions, lack of an adequate legal framework, damaging discretionary interventions, uncertain and variable policy frameworks and a closed decision-making process which increases risks of corruption and waste.’”\textsuperscript{176} This change also resulted from growing pressure by donor governments to address the prevalent corruption, economic mismanagement and bureaucratic ineptness preventing the repayment of their financial investments.\textsuperscript{177}

The World Bank defines governance as encompassing “the form of political regime; the process by which authority is exercised in the management of a country’s economic and social resources for development; and the capacity of governments to design, formulate and implement policies and discharge functions.”\textsuperscript{178} The World Bank has distinguished “six main dimensions of good governance: [v]oice and accountability, which includes civil liberties and political stability; [g]overnment effectiveness, which includes the quality of policymaking and public service delivery; [t]he lack of regulatory burden; [t]he rule of law, which includes protection of property rights;
The IMF broadly defines governance as encompassing “all aspects of the way a country, corporation, or other entity is governed.” According to the IMF, “[i]t includes the economic-policy interactions that fall within the mandate and expertise of the IMF,” as well as “their effectiveness; their transparency, and thus the accountability of policy makers; and the extent to which they meet internationally accepted standards and good practices.”

The IMF has recognized two spheres in which it considers itself best placed to contribute to good governance, namely:

- Improving the management of public resources through reforms covering public sector institutions (e.g., the treasury, central bank, public enterprises, civil service, and the official statistics function), including administrative procedures (e.g., expenditure control, budget management, and revenue collection); and

- Supporting the development and maintenance of a transparent and stable economic and regulatory environment conducive to efficient private sector activities (e.g., price systems, exchange and trade regimes, and banking systems and their related regulations).

The introduction of good governance adds a normative concept to the economic orthodoxy of the Washington Consensus, giving rise to what some analysts have described as a “post-Washington Consensus.” This newly defined consensus brings three important dimensions to the IFIs’ lending facilities. First, the concept of governance recognizes the importance of politics and its influence over development matters within the debtor state. It underscores the need to reform “not only the policies but also the institutional framework in which policies are formulated.”

179. Santiso, supra note 157, at 4 (emphasis added).
181. Id.
182. Id. (emphasis in original).
184. Id.
185. Id.
fact that macroeconomic policy changes must be complemented
with effective democratic institutions that are able to support
the social consequences of structural adjustment programs.  

The IFIs’ post-Washington Consensus therefore requires
“strengthening the institutions of governance, enhancing the
rule of law and enhancing accountability and transparency.”

A second dimension of the new consensus concerns the state.
During the 1980s and 1990s, the IFIs were essentially focused
on “balancing public finances and reducing the size of the bu-
reaucracy.”  The role of the state was relegated to second place
as the institutions placed an emphasis on “strengthening non-
state actors and promoting decentralization and local govern-
ance.”  The reforms sought by the IFIs, however, necessitate a
strong and effective state governed by the rule of law.  The in-
stitutions’ lending facilities have included the dual focus of sta-
bilizing and liberalizing the economy while simultaneously “re-
forming the state and strengthening governing institutions.”

These latter adjustments entail “improving the efficiency and
effectiveness of governing institutions (in particular the judici-
ary and parliaments), developing sound financial markets with
appropriate regulations and supervision, enhancing legal and
regulatory environments, improving the quality of the public
sector and building social capital and cohesion.”  While the
state is expected to become leaner, the transition necessitates
strong political institutions and a responsive bureaucracy.  The
IFIs have therefore also begun to acknowledge the crucial role
of the state and the importance of good governance in providing
an appropriate legal and regulatory framework to support the
institutions’ reforms.

Finally, the post-Washington Consensus recognizes the need
to strengthen public institutions.  Public institutions are de-

186. Id.
187. Id.
188. Id.
189. Id. at 15.
190. Id. at 14; see also Moises Naim, Washington Consensus or Washington
18912666.
192. See id. at 14.
mechanisms that shape the behavior of individuals and organizations in society.\textsuperscript{193} As the Washington Consensus often ignored issues of institutional reform, the post-Washington Consensus places an emphasis on addressing fundamental institutional weaknesses, inappropriate public policies and unenforced legal frameworks.\textsuperscript{194}

While the post-Washington Consensus adds another dimension to the IFIs’ lending facilities, it neither supplants nor limits the policies initially espoused by the Washington Consensus. The institutions continue to view sound macroeconomic policies as an indispensable basis of financial assistance. Remaining steady in its financial prescriptions, the IFIs’ post Washington Consensus has merely broadened the reform agenda to include the complex realm of national politics.\textsuperscript{195}

B. Conditions to Address Terrorism

As international institutions with unmatched resources at their disposal, the World Bank and the IMF are uniquely positioned to address state failure and the prevention of terrorism. To this end, the IFIs could restructure their loan agreements to take into account the distinguishing characteristics of a state’s slide into failure (i.e., its political goods deficit) in the context of terrorism prevention. While loan funds could help a state deliver key political goods, conditions on such loans could serve as a vehicle for the implementation of an anti-terrorism regulatory framework.\textsuperscript{196} Incorporating these principles within the IFIs’

\textsuperscript{194} Santiso, supra note 157, at 15.
\textsuperscript{195} Id. at 16.
\textsuperscript{196} Both the IMF and the World Bank have done some limited work in terms of including anti-terrorism considerations within their policies. However, these considerations are currently at a preliminary stage and are limited to the issues of anti-money laundering and the financing of terrorism. Moreover, it is not clear whether these considerations will be included as a conditionality in the IFIs’ financial assistance programs. See Monetary and Exchange Affairs and Legal Departments, International Monetary Fund & The Financial Sector, World Bank, Twelve-Month Pilot Program of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Assessments and Delivery of AML/CFT Technical Assistance: Joint Interim Progress Report of the Work of the IMF and the World
loan conditions presents two important issues. First, can the IFIs condition their loans on antiterrorism prevention where their respective charters prohibit them from addressing questions of political and civil rights? Second, how could such loan conditions be structured when the international community has not yet agreed upon a comprehensive terrorism convention? The following sections will address these two questions.

1. Moving Beyond Antiquated Mandates

In examining a possible role for the IFIs in the war against terrorism, it is essential to fully appreciate their founding purposes. In this regard, attention must turn to the IFIs’ constitutional mandates and the significance of their respective scopes of operations over fifty years after the Bretton Woods conference.

The World Bank was primarily founded with the objective of assisting in the economic development of developing member states and to promote private foreign investment. By contrast, the IMF’s purpose is to promote the stability of the international monetary system. An important aspect of the IFIs’ financial assistance programs is their categorical refusal to address questions of political and civil rights within the borrowing member state. According to the World Bank’s Articles of Agreement:

The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I.

The World Bank’s Articles further provide that it is to “make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted...without

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197. See discussion supra at Part III.A.2.
198. See discussion supra at Part III.A.1.
199. World Bank Articles of Agreement, supra note 80, art. IV, sec. 10., 60 Stat. at 1449, 2 U.N.T.S. at 158.
regard to political or other non-economic influences or consider-
ations.” 200

Although the IMF’s Articles of Agreement do not have a simi-
lar provision, their general stipulation requiring it to “be guided in
all its policies and decisions by the purposes set forth” 201 has been
interpreted as having a similar effect. 202 Moreover, Article
IV provides that in exercising surveillance over the exchange
rate policies of its member states, the IMF shall adopt prin-
ciples for the guidance of its members and that “[t]hese principles
shall respect the domestic, social and political policies of mem-
bers.” 203

The IFIs’ apolitical stance has generated considerable debate in
recent years. 204 It is often argued that the IFIs’ Articles of
Agreement place a legal constraint on the IFIs’ lending prac-
tices and that financial assistance should therefore not be with-
held on the basis of non-economic reasons. 205 This argument is
based on the belief that IFI loans should be non-discriminatory
and that in supporting economic, social and cultural rights for
all, the IFIs have paved the way for greater political freedoms
while remaining politically neutral. 206 According to these “strict
interpretation” advocates, “[n]o reasonable interpretation…can
transform prohibition into permission.” 207

Although literally correct, this argument has been under-
mined by the IFIs’ actual practice, particularly within the past
ten years. 208 Both the World Bank and the IMF have signifi-

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200. Id. at art. III, sec. 5, para. b, 60 Stat. at 1443–44, 2 U.N.T.S. at 146.
201. IMF Articles of Agreement, supra note 60, art. I, 29 U.S.T. at 2205, 2
U.N.T.S. at 42.
202. Joseph Gold, Political Considerations Are Prohibited by Articles of
Agreement When the Fund Considers Requests for Use of Resources, 1983 IMF
SUR. 145, 146 (1983). Sir Joseph Gold was General Counsel to the IMF from
1960-79. Id. at 148.
203. IMF Articles of Agreement, supra note 60, art. IV, sec. 3, para. b, 29
U.S.T. at 2209.
204. Morais, supra note 87, at 88.
205. For an outline of these arguments see Morais, supra note 87, at 88.
206. Morais, supra note 87, at 88–89.
207. Id. at 89.
208. See Santiso, supra note 157, at 2 (“During the 1980s and 1990s, the
scope of [the IFIs’] conditionalities both widened and deepened as IFIs at-
ttempted governmental and social re-engineering.”); see also Morais, supra
note 87, at 90–94 (“the record clearly shows that the IFIs are actually doing
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cantly expanded their respective scopes of operation since the institutions’ inception at the close of World War II.209 Initially structured as short-term remedial measures, the IFIs’ lending facilities have developed into extensive policy-oriented programmatic interventions, often encompassing substantial regulatory and structural changes within the borrowing member state.210 Most notably, however, the IFIs’ introduction of “good governance” as both an objective and condition for financial assistance has further blurred the distinction between “politics” and “economics.”211 This “post-Washington Consensus” has not only legitimized the IFIs’ promotion of measures to fight corruption and improve transparency and accountability of institutions and officials, but has also led to the IFIs’ active involvement in the promotion of legal and judicial reforms.212 In this regard, the IFIs have recommended and assisted member states in “drafting new laws, amending existing laws, reforming court systems and training judges.”213 These legal reforms have touched upon politically sensitive areas such as “corruption among public officials (both politicians and civil servants), local government reform, civil service reform, reform of the court system, tax reform, strengthening regulatory and supervisory institutions, enhancing women’s rights, social security or pension reforms, and promoting public participation.”214

Aside from empirical evidence of the IFIs’ increasingly political endeavors, it remains debatable whether a legal analysis of the IFIs’ articles of agreement leads to the conclusion that these much more than they have ever done to promote human rights in a comprehensive and meaningful way”). Id. at 90.

209. See discussion supra Part III.A.3.

210. See Morais, supra note 87, at 89 (listing the additional areas the IFIs have financed such as “reform of civil service, reform of public sector enterprises, legal and judicial reform, reform of local governments…rights of indigenous peoples,” to name but a few). Id. at 89.

211. See Santiso, supra note 157, at 1; see also Morais, supra note 87, at 90.

212. See Santiso, supra note 157, at 14 (“An important dimension of the post-Washington consensus is the recognition that politics matters for development. It suggests that sustaining development requires reforming not only the policies but also the institutional framework in which policies are formulated.”) Id.; see also Morais, supra note 87, at 94 (“IFIs have become very active in promoting legal and judicial reforms in their member countries.”). Id.

213. Morais, supra note 87, at 94.

214. Id. at 95.
institutions are strictly prohibited from delving into the political realm. Both the IMF and the World Bank were formed as specialized agencies of the UN. As such, one might argue that the UN Charter is hierarchically superior to the IFIs' own articles of agreement. Article 55 of the UN Charter provides that "the United Nations shall promote...universal respect for, and observance of, human rights and fundamental freedoms for all without distinction as to race, sex, language, or religion." Although the UN Charter also contains a provision prohibiting interference in internal political affairs, the UN has repeatedly interpreted this provision as inapplicable to human rights because such matters are not considered to be the prerogative of a sovereign state. If that is the case, why should the IFIs be considered exempt from fulfilling the fundamental objectives of a hierarchically superior institution?

Legal analysis aside, it is clear that the IFIs’ apolitical stance has become outdated and that the international donor community has given growing recognition to the political barometer of borrowing member states. To this end, the IFIs should begin applying financial and technical assistance in the context of anti-terrorism prevention. Terrorism is not only a politically motivated act, but it is also an act that has been widely recognized as a violation of human rights. As such, and considering

215. See id. at 90–94.
216. Id. at 84.
217. U.N. CHARTER art. 55.
218. Id. art. 2, para. 7.
220. See generally Morais, supra note 87.
221. See discussion supra Part I.A.
the IFIs’ current practice, it falls squarely within their respective scopes of operation.

2. Framework

The next question necessarily becomes: how are anti-terrorist conditions to be formulated? A significant response must not only combine prevention with prosecution, but must also successfully address the idiosyncrasies of state failure and the domestic prevention of terrorism. Perhaps most importantly, such conditions must be aligned with an anti-terrorism standard accepted by the international community (i.e., the international donor community).

a. International Conventions and Protocols

Although there are a host of multilateral conventions addressing terrorist acts, there is no comprehensive multilateral convention governing terrorism alone. Specifically, the existing ten conventions and two protocols cover: airports and airplane hijacking, attacks upon “internationally protected persons,”

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thefts of nuclear materials;\textsuperscript{225} the taking of hostages;\textsuperscript{226} unlawful acts against maritime navigation and fixed platforms on the continental shelf;\textsuperscript{227} terrorist bombing;\textsuperscript{228} the financing of terrorism;\textsuperscript{229} and the making of plastic explosives.\textsuperscript{230} Most of these instruments place legal obligations upon contracting states to: criminalize the acts covered and establish appropriate penalties for crimes committed; provide jurisdiction for certain offenses; provide custody and make a preliminary factual inquiry of the alleged offenders; give notification to interested states of the actions taken; prosecute the alleged offender if the state does not grant extradition; consider the offense to be an “extraditable offence” for purposes of an extradition treaty; and provide assistance in connection with criminal proceedings regarding the offences covered.\textsuperscript{231}

While these conventions and protocols are of tremendous importance, they are inadequate in addressing state failure and the domestic prevention of terrorism. As Jennifer Trahan


231. \textit{See} Trahan, \textit{supra} note 52, at 220.
notes, they are filled with gaps and inconsistencies and only highlight the need for a comprehensive multilateral convention. First, these instruments have little, if any, preventative focus. If prevention is addressed, it is usually formulated in broad language and limited to a single article. The Montreal Convention, for instance, states that “Contracting States shall, in accordance with international and national law, endeavour to take all practicable measures for the purpose of preventing the offences” covered by the convention. The Convention on the Prevention and Punishment of Crimes Against Internationally Protected Persons also provides for state cooperation by “exchanging information and co-ordinating the taking of administrative and other measures as appropriate to prevent the commission of those crimes.” This open-ended language not only lacks specificity but may also result in states taking little or no action at all.

Second, some of these conventions and protocols are inapplicable if the acts covered by these instruments occur solely in one state. For instance, if a terrorist act is committed within

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232. Trahan, supra note 52, at 220–21.
233. Id. at 222.
234. Id.
235. Montreal Convention, supra note 223, art. 10, para. 1, 24 U.S.T. at 571.
236. Protected Persons Convention, supra note 224, art. 4, para. b, 28 U.S.T. at 170, 1035 U.N.T.S. at 170; see also Maritime Convention, supra note 227, art. 13, 1678 U.N.T.S. at 230, 231.
237. Although some conventions include a preventative focus, encumbering conditions diminish the benefits of such language. For instance, certain conventions require that information be “accurate and verified” before sharing it with other interested states. See Financing of Terrorism Convention, supra note 229, art. 18, para. 3, G.A. Res. 109 at 412; Terrorist Bombings Convention, supra note 228, art. 15, para. b, G.A. Res. 164 at 393. Where terrorist attacks are in question, this may simply take too much time. Other conventions provide detailed steps for the prevention of terrorism but include a lengthy phase-in process for their implementation. See Plastic Explosives Convention, supra note 230, art. 4, para. 2–3, SEN. TREATY DOC. NO. 103-8, 2122 U.N.T.S. at 375. Perhaps the best example of a convention including detailed steps for the prevention of terrorism is the Financing of Terrorism Convention. See Financing of Terrorism Convention, supra note 229.
238. Trahan, supra note 52, at 225; See also Financing of Terrorism Convention, supra note 229, art. 3, G.A. Res. 109 at 405; Terrorist Bombings Convention, supra note 228, art. 3, G.A. Res. 164 at 390; Hostage Convention, supra note 226, art. 13, T.I.A.S. 11081 at 11, 1316 U.N.T.S. at 210; Montreal Convention, supra note 223, art. 4, para. 2–3, 24 U.S.T. at 569.
a particular state, and the alleged offender and victims are nationals of that state, then these conventions do not apply. Accordingly, should such a situation arise, officials from that state are under no international obligation to share information about such an offense even if it may be politically related to a potentially larger international crime. Similarly, other states are under no obligation to provide assistance in possible criminal proceedings within that state. Although such provisions were meant to safeguard the sovereignty of each contracting state, it may prove counterproductive in an era of increasingly global terrorism.

Third, and perhaps most importantly, because these conventions and protocols include little if any language addressing the prevention of terrorism and do not address acts committed within a single state, they impose no real obligation to combat domestic terrorists that are active within a particular state but have not yet committed a terrorist act. Thus, a condition requiring debtor states to sign on to these conventions before receiving aid from IFIs would be helpful, but would not necessarily be adequate to address the root causes of the problem.

b. UN Resolution 1373

Perhaps one of the best examples of the international community’s commitment to the fight against terrorism is UN Reso-
Adopted on September 28, 2001, Resolution 1373 forms the foundation of the UN’s counterterrorism efforts. This resolution declares international terrorism a threat to “international peace and security” and imposes binding obligations on all UN member states. It also establishes a Counterterrorism Committee (“CTC”) consisting of all members of the Security Council to monitor the implementation of the resolution.

In Resolution 1373, the Security Council mandates that states:

- Refrain from providing any form of support to terrorist groups;
- Take the necessary steps to prevent the commission of terrorist acts;
- Deny safe haven to those who finance, plan, support, or commit terrorist acts;
- Prevent those who finance, plan, facilitate or commit terrorist acts to use their territories to further terrorist purposes against other states;
- Ensure that any person financing, planning, or perpetrating terrorist acts is brought to justice and that such acts are established as criminal offences in each state’s domestic laws;
- Afford one another assistance in connection with criminal proceedings relating to the financing or support of terrorist acts;
- Prevent the movement of terrorist(s) through effective border controls.

Resolution 1373 also addresses the financing of terrorism, requiring states to prevent and suppress the financing of terrorist acts, criminalize the funding of terrorist groups by their nationals, freeze the financial assets of terrorists, and prohibit their nationals from providing financial assets to terrorists. In addition, states are called upon to increase the exchange of infor-
mation regarding terrorists and to become parties to the various international conventions and protocols covering terrorism.\textsuperscript{248}

In essence, Resolution 1373 “requires all member states to review their domestic laws and practices to ensure that terrorists cannot finance themselves or find safe havens for their adherents or their operations on these states’ territory.”\textsuperscript{249} To this end, the CTC is charged with the review of reports submitted by member states of the UN detailing the steps undertaken to fulfill the objectives of Resolution 1373.\textsuperscript{250} Through this on-going dialogue, the CTC is to focus on technical capacity building and to “work with each state to implement the resolution at its fastest capable speed.”\textsuperscript{251} The reports that have been submitted to the CTC thus far have therefore “varied in both quality and length, largely reflecting the different levels of capacity among states to implement Resolution 1373 and different levels of resources states have to prepare a report under Resolution 1373.”\textsuperscript{252}

Although the non-threatening, capacity-building language of Resolution 1373 contributed to its widespread support, it is also one of its major weaknesses. There is simply no end-date as to the resolution’s implementation, nor is there a timeframe as to how long this process could potentially take.\textsuperscript{253} The CTC also has no intention of declaring states to be in compliance with the requirements of resolution 1373.\textsuperscript{254} In fact, as of April 2003, the CTC declared that it will not operate as a sanctions committee and therefore “will not report to the Security Council those states it has determined are not in compliance with the obligations imposed by Resolution 1373.”\textsuperscript{255} There is therefore no ultimate requirement, other than diplomacy, to comply with the resolution’s objectives.

\begin{enumerate}
\item \textsuperscript{248} \textit{Id}. para. 3.
\item \textsuperscript{250} \textit{Id}.
\item \textsuperscript{251} \textit{Id}. at 335.
\item \textsuperscript{252} \textit{Id}.
\item \textsuperscript{253} \textit{Id}.
\item \textsuperscript{254} \textit{Id}. at 336.
\item \textsuperscript{255} \textit{Id}.
\end{enumerate}
Another problem with Resolution 1373 is that some states simply lack the technical and financial resources to implement all of the concerns contained in the resolution. Pursuant to Resolution 1373, the CTC has sought to address this issue by identifying each state’s specific needs and matching them with donors capable of providing the necessary assistance. To date, over fifty member states have expressed an interest in receiving assistance to enable them to adequately implement Resolution 1373. Unfortunately, the CTC does not have the resources to provide such assistance. The successful implementation of Resolution 1373 is therefore largely dependant upon outside donors that are capable and willing to provide the necessary assistance, whether financial or technical.

Finally, it is questionable whether the submission of written reports by member states is sufficient to fulfill the resolution’s objectives beyond its preliminary stages. Once states have reported back to the CTC on their progress with regards to Resolution 1373, written submissions may not be sufficient to adequately monitor the newly enacted legislation and assess the quality of its application. Perhaps effective implementation will require on-site monitoring by the CTC; an authority that is neither explicitly, nor arguably implicitly, granted by Resolution 1373.

256. Security Council Resolution 1377 invites the CTC “to explore ways in which states can be assisted, and in particular to explore with international, regional and subregional organizations: [t]he promotion of best-practice in the areas covered by Resolution 1373 (2001)...[t]he availability of existing technical, financial, regulatory, legislative or other assistance programmes which might facilitate the implementation of Resolution 1373 (2001)...[and] [t]he promotion of possible synergies between these assistance programmes.” S.C. Res. 1377, U.N. SCOR, 4413th mtg., Supp. 1, at 295, U.N. Doc. S/RES/1377 (2001).

257. Rosand, supra note 249, at 339.

258. The CTC divided its work into three stages: Stage A would require states to implement the necessary legislation; Stage B would require an executive machinery capable of handling these legislative changes; and Stage C would require its proper implementation. See Rosand, supra note 249, at 335–36.

259. Rosand, supra note 249, at 339.
c. A potential role for the IFIs

The IFIs could, however, play a vital role in addressing these issues and fulfilling the objectives of Resolution 1373. Both the IMF and the World Bank could begin incorporating Resolution 1373 into their lending facilities by imposing conditions on their loans requiring the implementation of Resolution 1373 within a specified timeframe. Each disbursement of funds would therefore become contingent on a state's actual incorporation of certain counterterrorism measures within its national laws. Consideration should also be given to make funds available on a grant basis to those states most in need of assistance in implementing Resolution 1373. These grants should be used exclusively for the purposes of Resolution 1373 and could impose the same conditions and timeframes as the IFIs' lending facilities.

Most importantly, however, the subject areas covered by these conditions could be expanded beyond the IFIs' traditional mandates to include areas typically considered outside their respective fields of operation. In addressing the root causes of terrorism and the strengthening of weak states, the IFIs' conditions could emphasize such important areas as prevention, suppression and the exchange of information. For instance, a state could incorporate into its national laws preventative measures such as the following:

- Preventing the use of its territory as a base for planning, organizing, executing, attempting or taking part in terrorist crime in any manner whatsoever. This includes the prevention of terrorist infiltration into, or residence in its territory either as individuals or groups, receiving or giving refuge to, training, arming, financing, or providing any facilitation to terrorists;
- Developing and strengthening systems for the detection of the movement, importation, exportation, stockpiling and use of weapons, munitions and explosives and of other means of

aggression, murder and destruction as well as procedures for monitoring their passage through customs and across borders;

- Developing and strengthening systems concerned with surveillance procedures and the securing of borders and points of entry overland and by air in order to prevent illicit entry;

- Strengthening mechanisms for the security and protection of eminent persons, vital installations and means of public transportation.

As for suppressive measures, they could include:\(^{261}\)

- Arresting the perpetrators of terrorist offences and prosecuting them in accordance with national law or extraditing them in accordance with relevant provisions of any applicable treaties;

- Providing effective protection for those working in the criminal justice field;

- Providing effective protection for sources of information concerning terrorist offences and for witnesses of such offences;

- Extending the necessary assistance to victims of terrorism.

Furthermore, technical assistance could be provided through collaboration between the IFIs, the CTC, and the states receiving financial assistance. In order to maintain the integrity of a genuine dialogue, the states in question could appoint a committee of three experts in the subject of terrorism.\(^{262}\) These experts would have the responsibility of communicating with CTC experts appointed by the UN for the specific purpose of engaging in a discourse with states sponsored by the IFIs. Not only would such a structure provide a forum for the exchange of expertise, but it would also provide a conduit for the exchange of information.

In this regard, once this collaboration is established, states receiving financial assistance could enact measures facilitating the exchange of information between these states and the CTC

\(^{261}\) Id. at 157.

\(^{262}\) These experts could be drawn from a variety of different fields such as academia, the government or private practice.
with regards to potential activities and crimes of terrorists and terrorist groups. For instance, these measures could include: 263

- Promoting the exchange of information with the CTC concerning:

  a) The activities and crimes of terrorist groups and of their leaders and members; their headquarters and training; the means and sources by which they are funded and armed; the types of weapons, munitions and explosives used by them; and other means of aggression, murder and destruction;

  b) The means of communication and propaganda used by terrorist groups, their modus operandi; the movements of their leaders and members; and the travel documents that they use.

- Notifying the CTC in an expeditious manner of the information it has concerning any terrorist offence that takes place in its territory and is intended to harm the interests of that state or of its nationals and to include in such notification statements concerning the circumstances surrounding the offence, those who committed it, its victims, the losses occasioned by it and the devices and methods used in its perpetration;

- Cooperating with the CTC in the exchange of information for the suppression of terrorist offences and promptly notifying the CTC of all the information or data in its possession that may prevent the occurrence of terrorist offences in foreign territory, against such foreign state’s nationals or residents or against their interests. 264

Although such conditions would go a long way in the fight against terrorism, it is important to note that these measures are not meant to modify or supplant the IFIs’ emphasis on the concept of “good governance.” The success of these measures is almost entirely based on a state’s ability and willingness to adequately implement them. Accordingly, while loan funds provided by the IFIs should serve to address a state’s delivery of key political goods in the context of state failure, it is important for the IFIs to consider the strength of such a state’s good gov-

263. See Arab Convention for the Suppression of Terrorism, supra note 260, at 158.
264. See id.
ernance policies. Similarly, although a state’s grant eligibility should largely be based on its capacity to deliver political goods, the international donor community must be provided with some level of protection and assurance that these funds will be used to fulfill the IFIs’ intended purposes. Good governance must therefore remain an essential component of the IFIs’ financial policies.

IV. CONCLUSION

Restructuring the IFIs’ conditions to address terrorism raises two important legal questions. First, whether such restructuring falls outside of the IFIs’ respective mandates and, second, whether the IFIs can adequately address the issue when the international community has not yet agreed upon a comprehensive multilateral convention.

Both questions can be answered in the affirmative. But the most important question remains whether we can achieve the necessary political consensus to support these changes. Although this Article does not purport to provide the ultimate solution to the eradication of terrorism, it does provide a method through which the international community can help in preventing future attacks. As we have seen, the importance of setting such a regulatory framework cannot be underestimated. The international donor community must therefore be committed to a long-term investment in the war on terrorism without the expectation of immediate results.

As Abraham Lincoln once stated “you cannot escape the responsibility of tomorrow by evading it today.” Accordingly, if nothing is done today to prevent tomorrow’s terrorist attacks, we must be ready to accept collectively our responsibility for failure to prevent such attacks from occurring.

RATIONAL IRRATIONALITY:
WHY PLAYING THE WORLD TRADE ORGANIZATION AS A SCAPEGOAT REDUCES THE SOCIAL COSTS OF ARMCHAIR ECONOMICS

Joseph Siprut*

INTRODUCTION

The World Trade Organization (“WTO”) may be one of the most reviled institutions on the planet. If so, then this villainous role is one that the WTO should happily continue to play. This Article proposes a theoretical model of the political economy of international trade that conceives of the WTO as something more than a mere institution administering multilateral trade agreements. Like any regime of multilateral agreements premised on reciprocity, the WTO promotes free trade by mobilizing export interest groups to counteract the pressures of domestic producer interest groups, thereby making tariff reductions politically feasible.

But the WTO may serve the free trade cause in a less obvious manner. As illustrated below, because the average voter believes that unrestricted free trade produces negative consequences, politicians may treat adherence to the multilateral treaties administered by the WTO as a “necessary evil” to achieve alternative goals deemed more acceptable by voters. Because adherence to multilateral trade agreements will nevertheless increase the social wealth that flows from free trade, politicians enjoy the best of all political worlds. Not only can politicians take credit for an increasingly wealthy economy by reference to particular domestic policies, but to appease voters who dislike free trade and simply refuse to think otherwise, politicians can plead deference to the WTO. Accordingly, supporting free trade agreements will remain, on balance, perfectly consistent with self-interested political behavior.

* Joseph Siprut is a Chicago-based litigation attorney. Special thanks are owed to John O. McGinnis, Bryan Caplan, John Hasnas, and William Mock, Jr. for insightful discussions on this topic.
To provide the theoretical underpinning for this model, this Article proceeds as follows. Part I explains how free trade is an outgrowth of human nature and makes the specialization of labor possible. As the principle of comparative advantage illustrates, more wealth is created when individuals and nations specialize in what each does best. By contrast, protectionist policies undermine the benefits that flow from free trade, and pose a threat to increased societal welfare.

As Part I illustrates, however, the true nature of democratic systems is such that harmful legislation is often passed because of the disproportionate influence of the interest groups that stand to benefit from the legislation. In the context of international trade, protectionist tariffs may be erected because of the concentrated lobbying efforts of the domestic producers who face competition from foreign imports. Although this legislation may impose social costs, the politicians who are in a position to support such legislation will do so if it advances their personal interests — i.e., if it increases the odds of reelection or enhances personal stature.

Part II examines the nature of the WTO, which, it is argued, operates as a solution to many of the problems canvassed in Part I. The WTO makes tariff reduction politically feasible because, under a system of reciprocal tariff reductions, export interests have an incentive to mobilize. As Part II points out, however, voters may firmly believe that free trade produces negative consequences in the aggregate. Indeed, the theory of “rational irrationality” posits that, not only do voters lack incentives to purchase information in order to stay informed on political matters, but, when the private costs of error are de minimus, voters will indulge their bliss beliefs and maintain positions which are downright irrational. Because voters may therefore cling to these anti-free trade beliefs even if information or evidence to the contrary is freely disseminated and is otherwise obtainable at minimal cost, self-interested political actors therefore have less incentive to repeal protectionist legislation. Part II concludes by arguing, however, that by treating adherence to the WTO as a necessary evil to achieving ends more popular with voters, the pursuit of increased market access remains politically feasible behavior.
I. THE PROBLEM

A. What Are We Fighting For? The Benefits of Free Trade

Any attempt to adequately canvass the body of literature demonstrating the beneficial effects of free trade would certainly be in vain. But to establish the theoretical base for subsequent sections of this Article, it is useful to discuss some of the classic arguments for free trade and the costs of protectionism.

By their very nature, human beings “are motivated by utility-maximizing considerations,” and “when an opportunity for mutual gain exists, ‘trade’ will take place.” Like other animals that live in groups, humans gain resources by exchange. Declining marginal value motivates our exchange, and if the exchange is consecrated, both parties gain.

Accordingly, if opportunities for exchange are maximized, wealth increases because individuals gain incentives to create

1. See, e.g., DENNIS C. MUELLER, PUBLIC CHOICE II 238 (1989) (“Few issues elicit greater agreement among economists than the proposition that society's welfare is maximized when there is free trade.”). For economically sophisticated arguments against free trade, see ELHANAN HELPMAN & PAUL R. KRUGMAN, MARKET STRUCTURE AND FOREIGN TRADE: INCREASING RETURNS, IMPERFECT COMPETITION, AND THE INTERNATIONAL ECONOMY (1985); PAUL R. KRUGMAN, RETHINKING INTERNATIONAL TRADE (1990). For a further sampling of anti-free trade literature, see Jim Chen, Globalization and Its Losers, 9 MINN. J. GLOBAL TRADE 157, 159 (2000) (arguing that “[t]o the extent that globalized society must choose, it should systematically favor the environment over jobs and even culture”); WILLIAM GREIDER, ONE WORLD, READY OR NOT (1997) (arguing that global capitalism is reproducing the “terrible exploitations” of the industrial era). For a scathing review of One World, see John O. McGinnis, Keynesian Capers, NAT'L REV., May 5, 1997, at 54 (“[Greider's] solution to economic dislocation is to take every social theory that has failed at the level of the nation-state and globalize it.”).

2. MUELLER, supra note 1, at 267.

3. See John O. McGinnis, The Origins of Conservatism, NAT'L REV., Dec. 22, 1997, at 32 (“Because of innate reciprocal altruism, exchange is thus as natural to man as song is to a songbird.”).

4. For example, if Jones has one hundred apples and Smith one hundred oranges, by hypothesis, the value of an additional apple to Jones is worth less than the value of an additional apple to Smith. If Smith and Jones agree to exchange an apple for an orange, therefore, both are better off despite the absence of any raw production. Jones will continue to trade with Smith until the marginal value of additional oranges to Jones is no more than the marginal value of additional apples.
what others demand. Moreover, if individuals compete with one another to supply a particular set of goods, each gains an incentive to produce the product as efficiently as possible and to sell the product as cheaply as possible. The consumer ultimately votes for the winner of this contest with his pocketbook.

Moreover, because humans function as group animals and exchange goods and services with one another rather than attempting to gather all life-sustaining materials individually, individuals are afforded the opportunity to specialize in “producing” certain goods, and then trading those goods for other necessary goods for which that individual may lack a comparative advantage. This is the insight at the heart of David Ricardo’s principle of comparative advantage and Adam Smith’s theory of division of labor. Put simply, two individuals will both gain by trade by producing the goods for which each has a comparative advantage. Smith has a comparative advantage over Jones in producing a good (X) if Smith’s cost of producing X relative to the cost of producing other goods is lower than Jones’

5. John O. McGinnis, The Political Economy of Global Multilateralism, CHI. J. INT’L L. 381, 382 (2000). Professor McGinnis also notes, however, that humans also have innate tendencies toward gaining wealth through organized hierarchy, which facilitates outright expropriation to the benefit of those higher in the “pecking order.” Id. McGinnis views this as a fundamental argument for constitutional structures — both on the national and international level — that maximize opportunities for exchange and constrain hierarchy.

6. This insight, of course, is far from new or original. See Grady Miller, The Legal and Economic Basis of International Trade 1 (1996) (“[T]he extensive networks and practices of export trading were probably more firmly established as a concept two millennia ago than they are today. In fact, many of the trading and legal traditions in use today were perfected in a far earlier age.”).


In every country it always is and must be the interest of the great body of the people to buy whatever they want of those who sell it cheapest. The proposition is so very manifest, that it seems ridiculous to take any pains to prove it; nor could it ever have been called in question, had not the interested sophistry of merchants and manufacturers confounded the common sense of mankind.

Id.


9. See generally Smith, supra note 7, at 7–16.
cost of producing X relative to Jones' cost of producing other goods.\textsuperscript{10} Or, by way of example, suppose that Smith can produce both more apples and more oranges than can Jones — say Smith can produce either 20 apples or 40 oranges, while Jones can produce, at most, either 10 apples or 10 oranges. Smith enjoys a comparative advantage, relative to Jones, only in the production of oranges; Jones enjoys a comparative advantage over Smith in the production of apples. The reason is that each orange produced by Smith costs him $\frac{1}{2}$ an apple, while each orange costs Jones one full apple. But each apple produced by Smith costs him two oranges, while each apple produced by Jones costs him only one orange.

Accordingly, even though one individual may be superior to another in producing all goods, both individuals will nevertheless improve their lot by producing only the goods for which each enjoys a comparative advantage, and then trading with one another.\textsuperscript{11}

\textsuperscript{10} DAVID FRIEDMAN, HIDDEN ORDER 69 (1996). Friedman notes: The error of confusing absolute advantage ("He can do everything better than I can") with comparative advantage typically shows up in the claim that because some other country has lower wages, higher productivity, lower taxes, or some other advantage, it can undersell our domestic manufacturers on everything, putting our producers and workers out of work. This is used as an argument for protective tariffs — taxes on imports designed to keep them from competing with domestically produced goods.

\textsuperscript{11} The gains from trade are not limited to wealth creation. As John Stuart Mill noted:
If these principles are valid with respect to individuals, then they are valid with respect to individual nations. But just as individual trade may make certain individuals worse off in the short term, so too may international trade. In the primitive example above, where individuals acquire goods in exchange for producing a good or providing a service that others desire, supply may exceed demand. The specter of competition, which on the one hand creates incentive for each producer to produce efficiently and to sell his goods cheaply, may also result in at least some producers no longer being able to find consumers interested in those producers’ goods. Were this not the case, no incentive would exist to be efficient, and the driving force of free trade would be undermined.

In the context of international trade, therefore, uniform free trade will not necessarily make everyone within a nation better off — at least not in the short term. In any industry where the comparative advantage for a particular product lies abroad, it will become cheaper to import the goods than to pay for domestic production. Consequently, the same goods are passed on to

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"The economical advantages of commerce are surpassed in importance by those of its effects which are intellectual and moral. It is hardly possible to overrate the value, in the present low state of human improvement, of placing human beings in contact with persons dissimilar to themselves, and with modes of thought and action unlike those with which they are familiar."

*JOHN STUART MILL, PRINCIPLES OF POLITICAL ECONOMY* 581 (1909).


Issues of international trade commonly are framed in terms of nations and not of individuals....Yet, this use of language, while undoubtedly economical, has some problematic features. In reality, individuals trade, not nations, a fact of considerable importance for understanding international economic relations, yet one that is widely ignored. Models that construe trade as between nations and not as between individuals stem from notions of economic nationalism that characterized the mercantilist era.

*Id.*
consumers more cheaply than would have been possible before. However, domestic producers must accordingly lower the resale price of their product to compete with the foreign imports. Consumers win, but domestic producers in this particular industry are, from their own vantage point, worse off than they were before — at least in the short term.

B. The Problem of Interest Groups

Although the gains from trade in the aggregate far outweigh the costs, the benefits are diffuse: an influx of foreign imports in a particular industry will afford a potentially broad base of consumers the opportunity to buy the industry’s goods at a relatively cheaper price. The cost of these imports, by contrast, is heavily concentrated: domestic producers may see profit margins reduced, jobs cut, or their doors closed entirely. Moreover, individuals specialize in production, not consumption. Producers in industries adversely affected by free trade will accord-

13. See John O. McGinnis & Mark L. Movsesian, The World Trade Constitution, 114 Harv. L. Rev. 511, 522 (2000) ("Workers often cannot change industries easily because they have nontransferable skills. Owners’ capital, moreover, may not be mobile because the owners have invested it in industry-specific assets. As a result, workers and owners in industries that lack a comparative advantage stand to lose a significant portion of their income.").

14. But cf. id. at 522 ("[F]ree trade may make many of these workers and owners better off, as open borders create higher-paying jobs and higher returns to capital.").

15. Lindert & Kindleberger, supra note 12, at 227. The authors provide the following example to illustrate the importance of production to an individual over his consumption:

If an import barrier would raise the price of all automobiles by ten percent, an auto worker would know which side of his bread has more butter. The barrier brings a 10 percent markup in the product from which he derives all of his earnings. To be sure, it also means that a car would cost him 10 percent more, but the cost of owning a car is only, say, 6 percent of his yearly expenses....So the import barrier would only raise his cost of living by .10 x .06 = 0.6 percent, while giving him a share of an auto-industry pie that is 10 percent larger. For an auto consumer not employed in the auto industry, the barrier simply means a 0.6 percent loss in real income.

Id.

16. This Article repeatedly discusses the benefits of, and from the perspective of particular groups, the costs of, “free trade.” In reality, of course, there is no choice between unrestricted free trade and total protectionism; rather, in the context of political markets, the choice will invariably concern erecting
ingly try to persuade the government to erect protectionist barriers to trade in furtherance of their own self-interest. If the costs of mobilization are not prohibitive, these domestic producers will invest the resources necessary to lobby for a tariff that will bestow benefits to these groups in excess of the costs necessary to effectively endorse the legislation. Put another way: interest groups that face organization costs of less than one dollar in order to gain one dollar of benefits from trade regulations will be effective demanders of those regulations.

By contrast, the individuals that stand to gain from free trade in any given industry will find that the costs of mobilization often outweigh the benefits of free trade — i.e., the benefits that flow from foreign imports. In other words, the benefits to a particular individual of a cheaper product will almost certainly be outweighed by the costs any one person must incur to fight a protectionist measure — flying to Washington to meet with a some protectionist barrier or removing one. For simplicity's sake, however, when this Article describes how “free trade” might impact a particular industry, and the incentives such an impact generates, it is meant to refer to relaxing whatever protectionist measures might already exist in that particular industry (or refusing to erect new ones).

17. See, e.g., ROBERT Z. LAWRENCE & ROBERT E. LITAN, SAVING FREE TRADE: A PRAGMATIC APPROACH 23–24 (1986) (arguing that when faced with competitive threats, interest groups will invariably pressure the legislature to pass protectionist measures).

18. See Gordon Tullock, The Welfare Costs of Tariffs, Monopolies, and Theft, 5 WESTERN ECON. J. 224, 228 (1967) [hereinafter Tullock, The Welfare Costs of Tariffs] (“One would anticipate that the domestic producers would invest resources in lobbying for the tariff until the marginal return on the last dollar so spent was equal to its likely return producing the transfer.”).


The interest group theory of government seeks to explain governmental behavior on the basis of the costs of organizing interest groups in order to seek wealth transfers through the aegis of the state (or, what is analytically the same thing, the costs of organizing interest groups to resist governmental expropriation of wealth).

Id.

20. See LINDERT & KINDLEBERGER, supra note 12, at 228.
Congressman, drumming up support, or even taking the time to write a letter of protest, notwithstanding the fact that such measures, in isolation, are unlikely to have any effect in the first place.  

reaching them and in getting them to commit effort to the common cause....By contrast, more concentrated groups find it easier to get together and contribute to a common lobbying effort. Each member, being a sizable part of the group's total membership and resources, knows that his participation does indeed make a difference....

Id. (emphasis in original) See also McGinnis & Movsesian, supra note 13, at 523–24. McGinnis notes:

As concentrated groups, workers and owners can obtain substantial benefits from government action. Consequently, these groups have strong incentives to provide campaign contributions and electoral support in return for protectionist policies. In contrast, groups that benefit from free trade, such as consumers, are diffuse, and their gains, though large in the aggregate, tend to be small on an individual basis. These groups have comparatively few incentives to contribute time and money to lobby for free trade policies. Moreover, they face high agency costs in monitoring legislators to determine whether their representatives are yielding to interest groups at the expense of society as a whole.

Id. (citing to MANCUR OLSON, JR., THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 145 (1965)).

21. A recent example of this principle in action that made national headlines is the furor surrounding President Bush's decision to impose tariffs on steel imports. See James Cox, Bush Slaps Tariffs on Steel Imports, USA TODAY, Mar. 6, 2002, at B1. The picture accompanying the article captures an impassioned group of protestors outside the White House in Washington, D.C., holding a sign that reads: “You don't have to blow up a blast furnace to destroy a steel mill; illegal foreign imports are doing the job.” These steel workers, as noted above, have a strong incentive to mobilize and invest the resources necessary to campaign for protective barriers.

To its credit, Cox’s article actually recognizes the direct effect of imposing the tariff in a subheadline: “Consumers will pay more....” and later identifies the costs of tariff imposition to include, in addition to increased consumer prices, lost jobs for manufacturers that purchase steel (who will now find its operating costs increased after steel prices rise), political retaliation, and undermining the Bush administration's “free-trade message.” Id. Not surprisingly, however, there were no reports of individual consumers outside the White House that day protesting against tariffs. But see James Cox, Steel Tariff Ruling Tests Bush, USA TODAY, Nov. 11, 2003, at A1 (noting that a WTO appellate panel “upheld an earlier ruling that Bush violated trade rules in March 2002 with three-year tariffs on imported steel”). See also Paul Wiseman & James Cox, Competing Interests Tangle Textile Policy: Bush Pledged to Help Pakistan, but U.S. Industry Fought Plan, USA TODAY, Apr. 2, 2002, at B1 (noting that President Bush handed Pakistan only one-third of the
Accordingly, the potential winners of free trade, who are the victims of protectionist policies, nonetheless lack incentive to engage in individual lobbying efforts because the costs are prohibitive relative to the diffused costs of a particular protectionist measure (or diffused gains from the lack thereof).\textsuperscript{22} In the trade concessions Pakistan had requested in the wake of a post-September 11th economic slump after U.S. textile producers vehemently protested granting any relief to Pakistani imports).

At base, however, the request for “protection” is nothing more or less than a request for a transfer of wealth. \textit{Cf.} Tullock, supra note 18, at 226 and accompanying text (noting that the social costs of tariffs far exceed a mere transfer of wealth, and that the costs of tariffs are equivalent to a government mandate that an industry run itself inefficiently). The cries of steel employees to erect protectionist tariffs may effectively be translated as: We want an extremely large group of people to each pay a small amount of money (the increase in the price of goods) to us. \textit{See also} Robert Nozick, \textit{Anarchy, State and Utopia} 272 (1974) (“The illegitimate use of a state by economic interests for their own ends is based upon a preexisting illegitimate power of the state to enrich some persons at the expense of others.”).

In fairness, lobbyists and interest groups are not necessarily willful “rent seekers.” \textit{See generally} Daniel Klein, \textit{If Government Is So Villainous, How Come Government Officials Don’t Seem Like Villains?}, 10 ECON. & PHIL. 91 (1994) (“In most cases, people do not perceive themselves to be rent seekers….’’); Gordon Tullock, \textit{Future Directions for Rent-Seeking Research, in The Political Economy of Rent-Seceking} 477 (Charles K. Rowley et al. eds., 1988) (“The student who did not understand the arguments against protective tariffs, and who is later hired as a lobbyist by the cotton textile industry, probably operates with a good conscience when he retains false economic arguments.”).


[S]pecial interests — auto manufacturers, steel companies, the textile industry, and others — have much to gain by enlisting the aid of government to protect them from foreign competition. On the other hand, the large majority of the population, comprised of unorganized consumers, has little to lose by any particular protectionist legislation, and may not even know that the measure is costing it money in the form of higher prices. \textit{Id.} McGee proceeds to quote Vilfredo Pareto to succinctly sum up the state of affairs: “A protectionist measure provides large benefits to a small number of people, and causes a very great number of consumers a slight loss. This circumstance makes it easier to put a protectionist measure into practice.” \textit{Id.} (quoting Vilfredo Pareto, \textit{Manual of Political Economy} 379 (Ann S. Schwier & Alfred N. Page eds., Ann. S. Schwier trans., Augustus M. Kelley Publishers 1971) (1927)).
aggregate, however, the social costs of protectionism are enormous.

While it cannot be denied that a free flow of foreign imports may result in a loss of domestic jobs in the particular industry in question, and that erecting protectionist barriers therefore “saves jobs” to an extent in that industry, the net effect of protectionism may well be to reduce the total number of jobs.

23. This threat of competition is, of course, the primary reason why the groups that face a competitive threat from free trade would be acting in their self-interest to expend resources in an attempt to erect protective barriers. See supra Part I.A.


The trade restrictions secured by protectionist interest groups are particularly deleterious to social welfare. It is well established in economic theory that the most effective way to increase the income of disadvantaged groups is through direct transfer payments. For instance, direct transfer payments are preferable to rent control as a method of improving housing for the poor because direct transfers lack the substantial deadweight loss that accompanies rent control. Instead, it is better to provide the poor with housing vouchers. Similarly, with the wealth generated by free trade, society can provide transfers to people with less income, including those for whom trade provides no advantage or even a net disadvantage. For example, instead of pressuring the Japanese automobile industry to adopt voluntary export restraints in the 1980s, the United States could have paid cash compensation to American autoworkers. This strategy would have cost far less than the $3 billion that American consumers ultimately spent in higher car prices.

Id. (citations omitted). See also Barbara Hagenbaugh, Steel Tariffs Catch Some in Middle, USA TODAY, July 24, 2002, at B1 (noting that the imposition of tariffs on steel imports has caused many “mom-and-pop” manufacturers, who “use steel to make goods that go into everything from cars to ovens to batteries,” to worry that they will have to close their doors).
Moreover, in any situation where a particular industry is protected from more efficient competitors through government legislation, the government may be said to be subsidizing inefficiency. It makes little sense to “force consumers to spend an extra $160,000 a year in the form of higher prices to protect a job in the auto industry that pays roughly $30,000 or $40,000 a year.”

25. This point assumes the competition is “more efficient” because the same product is offered for lower prices than the domestic competition. Were this not the case, domestic producers would not face a competitive threat.

26. See McGee, Protectionism in the United States, supra note 22, at 545. Professor McGee also cites to studies illustrating that trade restrictions raise the cost of imported goods in the United States by 20% on average, and raise the price of comparable, domestically produced goods by 10% to 14%. Id. at 553 (citing Alan Murray, A Free-Trade Bastion, U.S. Isn’t Half as Pure as Many People Think, WALL ST. J., Nov. 1, 1985, at A1). McGee continues:

Trade restrictions on automobiles, clothing, and sugar cost U.S. consumers $14 billion in 1984, which amounted to a 23% income tax surcharge for families with incomes under $10,000, but translated into only a 3% surcharge for families with incomes over $60,000. Protectionism in the textile industry alone has been estimated to cost poor families almost 9% of their disposable income. Another study found that textile quotas cost the poorest fifth of the U.S. population 3.6% of their income, but resulted in a 0.3% increase in income for the top fifth.

Id. (citations omitted). See also Rowley, The International Economy, supra note 12, at 665–66 (noting a study by Hufbauer and Elliot in which the potential gains to consumers from removing all tariff and quantitative restrictions for the year 1990 alone were calculated to be $70 billion). Cf. Paul Wiseman, China’s Low-Cost Labor Lures More Japanese Companies, USA TODAY, Nov. 21, 2002, at B1 (noting the Japanese fear of cheap Chinese labor, but observing that now “with gusto, Japanese executives are descending on Chinese boomtowns...spending their nights crooning into the karaoke machines of local bars and their days scouring the industrial landscape for factories they can do business with.”).


It is often argued that trade protection preserves jobs in the United States (the so-called ‘Perot effect’). If so, the cost to consumers of preserving such jobs is extremely high. In a quarter of the 21 sectors scrutinized by Hufbauer and Elliot (1994), the cost per job saved was in excess of $500,000 per annum even ignoring rent-seeking costs...Thus, consumers expended more than six times the average annual compensation of manufacturing workers to preserve jobs through import restraints, even ignoring rent-seeking costs. Once rent-seeking costs are accounted for, consumers expended more than
A detour through formal economic theory will illustrate this point more explicitly. Figure 1\textsuperscript{28} shows a commodity that can be produced domestically at the cost of $P_1$ and imported at $P_0$. With a given demand and no tariff, $Q_0$ units will be purchased at a price of $P_0$. If a protectionist tariff is imposed, then $Q_1$ units will be purchased at a price of $P_1$. Consumers will consequently be paying a higher price for the commodity then they otherwise would in the absence of the protectionist tariff, so the increase in price is a transfer of wealth from some members of the community to others. The corresponding welfare loss — a transfer more than outright loss to the economy — is represented by the shaded triangle.

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\item ten times the average wage earned by a worker in such a protected job.
\end{itemize}

*Id.* See also James P. Miller, *Steel Tariffs Paint Bush into Corner*, CHI. TRIB., Sep. 19, 2003, at 3–1 (noting that “[e]ver since the tariffs were put into effect...U.S. makers of everything from barbecue grills to auto parts and bulldozers have complained loudly that the tariffs have disrupted steel supplies, raised their costs and made it harder than ever to compete with offshore competitors.”).

For an argument based entirely on first principles against any such redistributive scheme, see NOZICK, *supra* note 21, at 272 (“The illegitimate use of a state by economic interests for their own ends is based upon a preexisting illegitimate power of the state to enrich some persons at the expense of others.”); Rowley, *The International Economy, supra* note 12, at 668. Rowley notes:

Although the large majority of economists view the issue of free trade versus protection exclusively in utilitarian terms, the issue should also be viewed from a rights-based perspective. Free trade follows as an inevitable implication for any individual who endorses the philosophy of John Locke as it does for any individual who endorses Jasay’s principles of *first, avoid doing harm and when in doubt, abstain.*

Protection violates the economic freedom of those who wish to engage in trade, encroaching as it does upon their property and contract rights. Any government that imposes trade restraints in the absence of the unanimous consent of those who are thus coerced commits a tort and should be exposed to potential civil suits to compensate those who suffer harm.

*Id.* (emphasis in original).

28. The graph in Figure 1 appeared in Tullock, *The Welfare Costs of Tariffs, supra* note 18, at 225 fig. 1.
There are, however, a number of significant costs ignored by this analysis. The actual effects of the tariff would be much more far-reaching. Because the domestic producers are now engaged in producing a commodity that, absent the protectionist tariff, could be produced and imported more cheaply, resources are being inefficiently utilized. As Gordon Tullock has pointed out, the situation is therefore indistinguishable from any situation in which the government forced a domestic industry to abandon an efficient method of production and adopt an inefficient one. 29 Thus, the real welfare loss incurred by the tariff would not just be the wealth transfer represented by the shaded triangle in Figure 1, but rather the entire area to the left of the triangle (bounded vertically on both sides by \( P_1 \) and \( P_0 \)). In other words, “a tariff shifting production from the production of export goods to import-replacement goods where the country has a comparative disadvantage is, in fact, a governmental requirement that the goods be obtained in an inefficient manner....” 30 Accordingly, the cost of a protectionist tariff is the shaded triangle “plus the difference between domestic cost of

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30. *Id.*
production and the price at which the goods could be purchased abroad, \(^{31}\) represented here in Figure 2.

![Figure 2](image)

Moreover, as discussed above, \(^{32}\) governments do not simply impose protectionist tariffs unilaterally. Domestic producers will expend resources to hire interest groups to engage in political lobbying, and foreign exports will likely expend resources attempting to counteract the effects of domestic special interest lobbying. These expenditures, which may ultimately offset each other in part, are pure waste in terms of social wealth. \(^{33}\) They are spent, not increasing wealth, but in attempts to transfer or resist the transfer of wealth. \(^{34}\) The opportunity costs of failing

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31. *Id.*

32. *See supra* notes 16–19 and accompanying text.

33. *See Charles K. Rowley & Robert D. Tollison, Rent-Seeking and Trade Protection, in The Political Economy of Rent-Seeking* 222 (1988) [hereinafter Rowley & Tollison, Rent-Seeking] (“Clearly, societies characterized by widespread monopoly and dissipative rent-seeking will, ceteris paribus, be significantly less wealthy than those that are not.”).

34. *See Tullock, The Welfare Costs of Tariffs, supra* note 18, at 225; Jonathan R. Macey, *Public and Private Ordering and the Production of Legitimate and Illegitimate Legal Rules*, 82 CORNELL L. REV. 1123, 1144 (1997) (“Special interest legislation is undesirable because economic actors expend vast amounts of resources to obtain rent-seeking legislation, to comply with it..., to avoid having to comply with it,...and to prevent it from being enacted in the...
to invest these same resources elsewhere in the economy (where they might actually create wealth) therefore imposes additional societal costs.\(^{35}\)

The effects of special-interest lobbying become clearer by examining the “supply side” of public legislation, i.e., the incentive structure of politicians and bureaucrats. What might be deemed the “high school civics”\(^{36}\) conception of the relationship between legislators and their constituents is one of agency. We expect that our legislators will act on our behalf, and, in questions of policy, will consult our interests and behave accordingly.\(^{37}\) But in fact, this model of the legislator-constituent relationship paints a far rosier picture than reality will bear.

“Economics treats the individual actor as the fundamental unit of analysis,”\(^{38}\) and derives its predictive power based on a fundamental conception of human nature.\(^{39}\) In ordinary markets, the individual actor is

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\(^{35}\) And not least of all, any tariff involves expenditure on administrative costs necessary to maintain the tariff — for example, “customs inspectors...who do the actual collection and coast guards who prevent smuggling.” Tullock, The Welfare Costs of Tariffs, supra note 18, at 225.

\(^{36}\) The “high school civics” label was borrowed from Donald J. Boudreaux, Review Essay, Was Your High School Civics Teacher Right After All?, 1 INDEP. REV. 111 (1996).

\(^{37}\) See Mark L. Movsesian, Are Statutes Really “Legislative Bargains”? The Failure of the Contract Analogy in Statutory Interpretation, 76 N.C. L. REV. 1145, 1175 (1998). Nevertheless, the author concedes that the issue of whether a legislator should consult the interests of his constituents and behave accordingly on issues of policy has been the source of a “longstanding debate on the nature of political representation.” Id. at n.186.


\(^{39}\) See, e.g., JAMES BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT 18 (1962). The authors stress the focus on the individual actor in economic theory by emphasizing that:

[E]conomic theory does not try to explain all human behavior, even all of that which might be called ‘economic’ in some normally accepted sense of this term. At best, the theory explains only one important part of human activity in this sphere....No economist, to our knowledge, has ever denied that exchange takes place which is not “economic”....The theory requires for its usefulness only the existence of
a person who, as a consumer, strives to maximize his own sense of well-being, given the constraints imposed by a limited budget and the prices of available goods, who, as a worker, strives to maximize his income, given his native talents, the skills he has acquired, and his tastes for work and leisure, and who, as a business owner, strives to maximize his profits, given the constraints imposed by technology, by the costs of inputs and the tastes and preferences of buyers. No matter what role he plays, however, the individual actor is assumed to be guided largely by self-interest.\textsuperscript{40}

The central tenet of public choice theory\textsuperscript{41} is the emphasis of the methodological individualism of economic analysis (traditionally reserved for the study of market actors) in the study of politics and political actors.\textsuperscript{42} Once the rational actor model is applied to the realm of politics, several insights become immediately obvious. Public choice rejects the construction of vague, ambiguous collective units, such as “society,” the “people,” or the “national interest.”\textsuperscript{43} Actors in the public sector have the same self-interested incentives as market actors; the “public interest,” however defined, is no longer the guiding light of po-

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  \item the economic relation to a degree sufficient to make prediction and explanation possible.
  
  Even if the economic forces are not predominant enough in human behavior to allow predictions to be made, the formal theory remains of some value in explaining one aspect of that behavior and in allowing the theorist to develop hypotheses that may be subjected to conceptual, if not actual, testing. Reduced to its barest essentials, the economic assumption is simply that the representative or the average individual, when confronted with real choice in exchange, will choose ‘more’ rather than less.

  \textit{Id.} (emphasis in original).
  
  
  41. \textit{See generally} \textit{id.}
  
  42. \textit{See} Shughart & Razzolini, \textit{Introduction, supra} note 38, at xxii.

  While for model-building purposes ‘self-interest’ is frequently construed narrowly to mean wealth maximization, the rational actor model is in fact much more general. Economists assume that individuals pursue the maximization of utility, of which money wealth is only one component, thereby allowing for the fact that human action is guided by a variety of goals and objectives….

  \textit{Id.}
  
  43. \textit{Id.}
Elected officials will strive for reelection, and appointed officials will strive to secure larger agency budgets and to advance their careers. If a political actor supports legislation at the behest of particular interest groups, he will be rewarded by these groups with increased campaign contributions or promises of large blocs of votes. Policy proposals will there-

44. Lest it be said that these tenets of public choice theory paint an unduly pessimistic view of human nature (as is asserted in Steven Kelman Public Choice and Public Spirit, 87 PUBLIC CHOICE 80, 80–94 (1987)), it should be noted that:

[P]ublic choice no more denies the existence of 'public spirit' than economics denies the existence of altruism. Specialists in neither field have ever argued that self-interest is the only motivator of human action. Rather, the shared assumption of economics and public choice is that self-interest is the most important of the many and varied forces that animate the behavior of complex individuals.

Shughart & Razzolini, Introduction, supra note 38, at xxvi (emphasis in original). The basis of this assumption, therefore, is not a cynical view of human nature, but the recognition of "repeated empirical testing showing that models based on self-interest do a better job of explaining observed behavior than models based on alternative behavioral assumptions." Id. On a similar note, commentators have also advanced the following explanation for the utility of adopting such an assumption:

Compared with the more standard works in political science, our analysis may seem to involve a "pessimistic" view of human nature. For scientific progress, however, it is essential that all conceivable assumptions about human behavior be tested. If our models provide some explanations of real-world events, and we believe that they do, our assumptions must have some empirical validity, quiet apart from the "attractiveness" of the human characters that inhabit our hypothetical model world.

BUCHANAN AND TULLOCK, supra note 39, at 266.

45. Shughart & Razzolini, Introduction, supra note 38, at xxii; LINDERT & KINDLEBERGER, supra note 12, at 226. Lindert and Kindleberger point out, however, that the reelection-maximizing assumption need not imply the cynical view of politicians

who will stop at nothing to get reelected and who care only about the glory, salary, and power that come with retaining office....The incumbents may in fact be motivated primarily by their own loftier vision of the national interest and how they would serve it with some key steps if reelected.

Id.

46. See McGinnis & Movsesian, supra note 13, at 523 n.59 ("[I]nterest groups may exercise great leverage over legislators through campaign contributions or independent political expenditures." (citing Daniel H. Lowenstein,
fore be evaluated by the extent to which a politician’s odds of reelection (or personal stature) are enhanced or diminished by implementing the policy. 47

C. High School Civics Fails Again: The True Nature of Democracy

Thus far this Article has shown that trade is as natural to humankind as is “song to a songbird,” 48 and that free trade allows individuals to reap the benefits of comparative advantage and specialization of labor. 49 It has also demonstrated, however, that while the benefits of free trade are often diffuse, those adversely affected by competition will bear heavily concentrated costs. 50 Consequently, these groups have a strong incentive to lobby for protectionist measures to forestall competition. Consumers who might otherwise reap the benefits of open barriers, by contrast, lack incentive to mobilize in lieu of organization costs and will therefore not wield any significant degree of influence over political markets relative to organized interest groups. Political actors, for their part, will act in accordance with their own self-interest by attempting to implement policies that benefit interest groups willing to reciprocate with campaign contributions or votes of gratitude at the next election. The protectionist legislation that will potentially emerge from this process, however, imposes enormous societal costs in the aggregate.

None of the foregoing, however, explains why, if political actors are truly self-interested, efforts to promote socially harmful legislation for the benefit of a privileged few is truly a self-interested act. After all, if the majority of voters (consumers)

47. See, e.g., LINDERT & KINDLEBERGER, supra note 12, at 227 (“Any incumbent knows that to get reelected he needs to approach each individual issues asking, ‘How can I maximize the votes and campaign backing of those people for whom this is the issue that is key to their election sentiments?’”).

48. See McGinnis, supra note 3 and accompanying text.

49. See supra Part I.A.

50. See supra Part I.B.
will end up paying higher prices for particular products as a result of protectionist legislation, then surely they will penalize the politicians who supported the legislation by withholding their votes in the next election. This, of course, is one of the central virtues of democracy: well-informed voters replace government officials who fail to serve the public interest with officials who better serve the public interest, and therefore “prevent government from being a toady to special-interest groups.” Much the same way that actors in private markets self-interestedly absorb information and act accordingly, voters will monitor the politicians they vote into office to ensure that these politicians do not support harmful interest-group legislation.

This conception of political markets constitutes what might be deemed the second tenet of high school civics. Much like the first tenet, however, it must be condemned as grossly naïve and simply not consistent with reality. Private-property markets and political markets are fundamentally distinct in that “there is no such thing as a voiceless private-property market participant.”

51. For a recent and highly sophisticated exposition of this view, see DONALD WITTMAN, THE MYTH OF DEMOCRATIC FAILURE 5 (1995).
52. Boudreaux, supra note 36, at 115 (criticizing Wittman).
53. The “first tenet” of high school civics was discussed above at supra Section I.B (arguing that politicians do not scrutinize laws by the extent to which they benefit the public, but rather by the extent to which supporting such laws will earn the favor of interest groups who can increase the politician’s odds of re-election).
54. See Rowley & Tollison, Rent-Seeking, supra note 33, at 224. The authors note:

[The standard] theory concludes that once governments are informed of the clear net benefits of unilateral trade liberalization, they will do away with trade protection, compensating losers, if necessary, via a non-distortionary tax/subsidy intervention. Much of the international trade literature seems to be dedicated to this process of information transmission. However, governments patently do not respond as the pure theory predicts they will. Public choice explains theoretically why governments accept generalized wealth destruction by maintaining and even extending trade protection policy even in a well-informed political market.

Id.
55. See Boudreaux, supra note 36, at 116. A simple example may be used to drive home this distinction:
conveys information about the value a participant places on a particular product. In the aggregate, this information combines to create the pattern of prices existing at any moment. Moreover, because every individual who participates in a private market will bear the cost of his actions, or reap the benefits thereof, private market participants have a strong incentive to purchase information and use it to guide their decision-making.

Political markets, by contrast, possess neither of these characteristics. Even if voters are well-informed, the sheer volume of issues on the table during any particular election precludes registering approval or disapproval for any individual issue. As Boudreaux puts the point,

[i]ssues from abortion to school choice to government provision of medical services to farm subsidies to child-welfare policies to tax rates to...you name it, government has some potential say over them. Literally tens of thousands of issues are at stake in every national election (with almost as many issues at stake in state elections). And yet, each voter during each six-year span has a maximum of nine ballots to cast in four national elections. During any six-year period...each voter is allowed to vote twice for a president/vice-president team, four times for a U.S. Representative, and a maximum of three times for a U.S. senator...[These] are the only windows of opportunity for American voters to speak politically on national issues.\[57\]

Accordingly, the claim that voters will register disapproval of attempts to pass harmful interest-group legislation with their votes is naively optimistic. A voter cognizant of his Congressman’s support for various protectionist legislative proposals may decide that the politician’s positions on abortion, campaign

Every time we buy or sell something — or refuse to buy or sell something — we communicate with property owners around the world by adding our “voice” to the market. If you purchase a new Honda Accord today, you reveal to the market that you value such a car by at least the price you pay for it. If you sell some labor services today, you reveal to the world that you will perform such services for a wage at or above the amount your employer pays you.

Id.  
56. For a discussion of the incentives of voters to acquire and digest political information, see infra notes 58–62 and accompanying text.  
57. See Boudreaux, supra note 36, at 117.
finance reform, or the environment take precedence over harmful protectionist legislation.\textsuperscript{58} Put simply, commercial policy is not formed by direct public referenda.\textsuperscript{59}

Moreover, the second tenet of high school civics posits that voters have a rational incentive to acquire and digest political information. This incentive is presumably a corollary of the view that voters recognize their duty to operate as a check on (costly) self-interested political behavior. In practice, the excessive level of noise in political elections precludes registering approval or disapproval of specific attempts to pass harmful interest-group legislation. What is more, on balance, citizens have a strong disincentive to pay the cost of acquiring and digesting political information. Thus, not only are voters precluded in practice from checking harmful political behavior because of excessive political noise; voters are ill-equipped to identify interest-group legislation in the first place.

If the average voter watches the evening news or occasionally skims a newspaper, she may know if a particular candidate is a Democrat or a Republican, and that between two candidates of each major political party, one is more likely to be further “to the right” than the other.\textsuperscript{60} This knowledge in itself, however, is largely useless. For voters to deter opportunistic political behavior they must be informed of specific proposals or attempts to support specific legislation. In reality, however,

\begin{quote}
[how many American voters know that the national government subsidizes sugar farmers and peanut farmers? How many Americans understand the consequences of deficit financing? How many can distinguish the government’s budget deficit from the so-called trade deficit? Indeed, how many vot-
\end{quote}

\textsuperscript{58} See Boudreaux, \textit{supra} note 36, at 118 (further noting that “[i]nterest groups can obtain a great deal of pork if such pork is bundled with other government programs and policy issues”).

\textsuperscript{59} See Lindert \& Kindleberger, \textit{supra} note 12, at 225. The authors continue: “Voters are not given the chance to go to the polls and vote for and against, say, ‘Proposition P: The import duty on motorcycles shall be raised from 5 percent to 10 percent ad valorem: Yes…No.’” \textit{Id.} at 225–26. It should be noted, however, that private markets — including, e.g., markets for residential location — face some of the same bundling problems, albeit to a lesser extent. When an individual purchases a home, to take one example, many variables are undoubtedly at play: proximity to family, proximity to grocery stores, crime rates, local school systems, and so forth.

\textsuperscript{60} See Boudreaux, \textit{supra} note 36, at 117.
ers know most federal regulations can be looked up in the Code of Federal Regulations — a document of double-columned small print that now gobbles up almost twenty feet of library shelf space? I suspect very few.\footnote{Boudreaux, \textit{supra} note 36, at 122.}

It is highly improbable that the average citizen could possibly monitor the number of actions taken by incumbents to act as a sufficient check on socially harmful behavior, or comprehend the full implications of any proposals championed by other candidates, \textit{even if he wanted to}. But what is more, not only does the average citizen have a strong disincentive to pay the cost of acquiring political information because she is unlikely to understand all of it in the first place; the odds of any citizen’s “research” paying off \textit{for that person} are infinitesimal. In other words, if the odds of a single vote changing the result of an election are mathematically zero, and if voting is the one method by which citizens register their voice in political markets,\footnote{My assumption here that the average voter may “express his voice” only in elections follows from the previous discussion of the costs of mobilization as prohibitive, \textit{supra} Part I.B.} then a strong disincentive to pay the costs of acquiring information exists.\footnote{These same premises also lead to the conclusion that individual citizens may choose not to vote \textit{at all}. See, \textit{e.g.}, U.S. Census Bureau, \textit{Current Population Survey: Voting and Registration in the Election of November 2000} (Feb. 2002) (noting that nineteen million registered voters did not cast ballots in the 2000 presidential election, and that of the nineteen million non-voters 20.9\% of voters reasoned they were “too busy,” 14.8\% refrained from voting because of “illness,” and 12.2\% were “not interested”), \textit{available at http://www.census.gov/prod/2002pubs/pb20-542.pdf}. See \textsc{Gordon Tullock}, \textit{On Voting} (1998), for more formalistic arguments concerning the nature of voting behavior.} Voters will therefore remain rationally ignorant. By contrast, since private-market actors must bear the full costs — or reap the full benefits — of their actions, a strong incentive exists to acquire information. Accordingly, the analogy between private and political markets simply cannot be maintained. The “problem of interest groups” lives.
II. THE SOLUTION

A. Leading By Example: The United States Constitution as a Model for International Federalism

In the context of international trade, the principal task of trade institutions like the WTO should be to “restrain protectionist interest groups and thereby promote both free trade and representative democracy.” The American political structure, through the United States Constitution, offers compelling instruction on how institutions can simultaneously promote free trade and democratic governance.

Much the same way that interest groups lobby for protectionist tariffs at the federal level, such groups may attempt to lobby for entry barriers at the state level. Perhaps the most famous exposition of the danger of interest groups was set forth by James Madison in *The Federalist No. 10*. There, Madison recognized that individuals and groups would try to use the power of government to further their own interests. Several institutional mechanisms of the United States Constitution reflect this concern. For example, the large Republic described in *The Fed-

64. The foregoing discussions of the nature of interest groups and the fallacy of “high school civics” are not, of course, confined to the context of free trade.
65. McGinnis & Movsesian, supra note 13, at 536.
66. Id. (“The original Constitution established mechanisms that restrict protectionist interest groups, and subsequent generations have developed further structural limitations. These constraints have made representative democracy more reflective of majority will, improved regulatory efficiency, and promoted economic growth through trade.”).
68. See Buchanan and Tullock, supra note 39, at 25 (“[Madison’s] numerous examples of legislation concerning debtor-creditor relations, commercial policy, and taxation suggest that perhaps a better understanding of Madison’s own conception of democratic process may be achieved by examining carefully the implications of the economic approach to human behavior in collective choice.”); John O. McGinnis, *The Origins of Conservatism*, NAT’L REV., Dec. 22, 1997, at 34 (“...Madison observed that the greatest problem for any political structure is how to protect the ‘unequal faculties for acquiring property’ from government interference.”). McGinnis argues that “Madison recognized the very inequality that makes this prosperity possible also makes the protection of the different abilities to acquire property more difficult because it exacerbates the danger that the government will be used as a mechanism for redistribution from one faction to another.” Id.
eralist No. 10 decreased the power of local factions by “pitting them against one another in a more extended polity.” Generally, bicameralism and the separation of powers both operate to frustrate interest groups by imposing more powerful barriers to rent-seeking legislation than simple majoritarian structures. Moreover, the Commerce Clause of the United States Constitution is employed to strike down state legislation that discriminates against, or unduly burdens, interstate commerce. Thus, the creation of an open national market encourages competition among the states for the investment of resources.

The WTO fosters an international trade regime that replicates this brand of federalism. In the same way that forcing state governments to compete for “the capital and skills of a national citizenry imposes substantial limits on a state government’s ability to expropriate, the emerging free trade regime performs the same essential function, tempering the enduring and inevitable avarice of the government and its rulers on a global scale.”

70. Id.
71. See U.S. Const. art. 1, § 8, cl. 3 (“The Congress shall have Power...To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.”). See Hughes v. Oklahoma, 441 U.S. 322, 336 (1979) for the modern commerce clause test. It should be noted, however, that the dormant commerce clause power is merely inferred from the affirmative grant of federal power found in the commerce clause itself. See generally Richard A. Posner, The Constitution as an Economic Document, 56 Geo. Wash. L. Rev. 4, 17 (1987) (“A number of provisions of the [U.S.] Constitution seem to have an implicit economic logic. This is perhaps the clearest with respect to the “negative” or “dormant” commerce clause...”).

International federalism is appropriate for our time because individuals still have the attachments to their nation-states to resist regulatory regimes being imposed by world government. Thus, an international federalism can plausibly be created because the World Trade Organization and other global economic organizations can police the conditions for regulatory competition among nation-states while citizens in those nation-states can be counted on to resist the expansion of regulatory power in international institutions.

Id. at 9–10.
B. The World Trade Organization

With this background in place, this Article now probes the WTO’s constitutional structure and illustrates why its internal provisions and mechanisms enshrine a regime of international federalism that ultimately promotes economic growth within its member nations.73

The WTO was established by the Final Act of the Uruguay Round of trade negotiations in 1994,74 and is responsible for administering multilateral trade agreements negotiated by its members.75 Its principal functions may be described as follows:

First, the WTO provides a substantive code of conduct directed at the reduction of tariffs and other barriers to trade, and the elimination of discrimination in international trade relations. Second, the WTO provides the institutional framework for the administration of the substantive code. Thus the WTO provides an integrated structure for the administration of both all past trade agreements and the agreements under the Uruguay

73. It should be noted at the outset that this section offers an account of global multilateralism, and the WTO in particular, in necessarily broad strokes. It does not, accordingly, seek to criticize or defend particular treaties or the present composition of the WTO. Rather, this section confines itself to illustrating why the nature of an international regime such as the WTO will tend to reign in the costs of opportunistic rent-seeking by interest groups. For present purposes, it is sufficient merely to note that politics is a game of compromise: invariably, particular WTO provisions that cause more social harm than good in the aggregate have hitchhiked along with more economically sound provisions. So long as these questionable provisions remain the exception, and not the norm, the model illustrated in this section posits that the WTO will continue to facilitate economically sound policies more often than not.

74. “Although the Final Act was signed in April 1994, the WTO did not actually come into existence until the following year.” See McGinnis & Movsesian, supra note 13, at 530 n.96 (citing David A. Gantz, A Post-Uruguay Round Introduction to International Trade Law in the United States, 12 Ariz. J. Int’l & Comp. L. 1, 7 (1995)).

75. The WTO presently has 146 member states. For a list of the WTO’s membership, see World Trade Organization, The Organization: Members and Observers, at http://www.wto.org/English/thewto_e/whatis_e/tif_e/org6_e.htm (last visited Nov. 16, 2003). It was created in part because the legal foundations of the GATT were weak (GATT was, and is, a treaty — i.e., it contained no institutional provisions) and in part because two issues on the agenda of the Uruguay Round were not covered by GATT: services and intellectual property rights. Bernard M. Hoekman, Trade Laws and Institutions 3 (1995).
Round of Trade Negotiations. Third, the WTO ensures the implementation of the substantive code. It provides a forum for dispute settlement in international trade matters, and conducts surveillance of national trade policies and practices. Fourth, the WTO acts as a medium for the conduct of international trade relations amongst member States. Particularly, it is to act as a forum for the negotiation of further trade liberalization, and improvement in the international trading system.\(^\text{76}\)

The WTO should therefore be regarded as “both an institution embodying a set of rules and principles concerning the use of policies that affect trade flows, and as a market in which members exchange market access ‘concessions’ and agree on the ‘rules of the game.’”\(^\text{77}\) For example, the periodic reductions in world tariffs provided for by the WTO have been called its “core feature.”\(^\text{78}\) Even before the inauguration of the WTO, General Agreement on Tariffs and Trade (“GATT”) members met approximately once every ten years in negotiating rounds that reduced tariffs on goods on a reciprocal basis.\(^\text{79}\) These rounds produced dramatic reductions in world tariffs.\(^\text{80}\) The ratio of the value of duties collected to the value of imports dropped from approximately 37% before the adoption of GATT to less than 5% in the early 1990s.\(^\text{81}\) The inauguration of the WTO continues this pattern of reciprocal tariff reductions and expands the scope of the system through new agreements pertaining to in-
intellectual property, services, health and safety measures, and product standards. 82

The theoretical underpinning of this regime of reciprocity is as follows. Governments (i.e., collectives of individual domestic political actors) lack incentive to reduce trade barriers unilaterally. Indeed, as discussed, 83 politicians will face strong interest group pressure to erect new protectionist legislation. Under a multilateral trade agreement that mandates reciprocity, however, domestic export interests stand to reap benefits that largely offset the specific losses incurred by protected industries. Removing protectionist barriers in a domestic market will result in increased market access abroad. With foreign markets for their goods, these domestic export interests will, under a reciprocity regime, naturally exert pressure on political actors that will largely counteract the pressure mounted by domestic producers to maintain protectionist barriers. 84 If reciprocity was


83. Supra Parts I.B – I.C and accompanying text.

84. McGinnis & Movsesian, supra note 13, at 545–46 (noting that the “WTO system mobilizes the interest groups that stand to win — workers and owners in industries that will prosper because of free trade — to counterbalance the interest groups that stand to lose”). It should be noted, however, that tariff reductions alone cannot ensure a free trade regime. Id. As the authors powerfully indicate:

Protectionist groups can frustrate the effect of tariff reductions by persuading national governments to impose nontariff barriers. Even if a member complies with GATT-mandated tariff reductions on a given product, for example, the member could offset the effect of these reductions by imposing quotas on the number of imports allowed into the country. Therefore, just as the United States Supreme Court has developed a doctrine to prevent state nontariff discrimination against out-of-state imports, the WTO has established a series of rules that prevent members from adopting measures that negate the value of GATT tariff reductions. Id. at 546–47. The authors continue by noting, for example, that:

[A]rticle III of GATT prohibits members from imposing special internal taxes on imports — sales taxes, for example — that exceed taxes on “like domestic products.” Because members might impose discriminatory internal regulations on imports, article III also requires members to accord imports “treatment no less favorable than that accorded like products of national origin in respect of all laws, regula-
not mandated by the multilateral trade agreement, however, there would be no guarantee of market access abroad, and domestic export interests would therefore take little interest in opposing a protectionist barrier.86

Accordingly, agreements administered by the WTO create pressure for liberalizing access to markets over time in a way that is politically more feasible than unilateral action. Indeed, reciprocal liberalization of market access has been a necessary (although perhaps not sufficient) condition for the reduction of barriers.86 Domestic producers may lose from removing protectionist barriers to imports, but domestic exports win — if reciprocity is in effect.87 But the situation is not a net wash, of course, because consumers benefit from free trade.88 The self-interested politician assumed by public choice theory may be moved to act at the behest of powerful interest groups if the

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85. See Lindert & Kindleberger, supra note 12, at 231–34 (noting that when export interests have been organized, policy has tended toward freer trade). The authors quote John Stuart Mill: “A good cause seldom triumphs unless someone’s interest is bound up in it.” Id.

86. Hoekman, supra note 75, at 4.

87. Rowley, The International Economy, supra note 12, at 659. Rowley notes:

If a free trade agreement (FTA) must liberalize completely trade among the partner nations, a particular government might endorse an agreement in two types of situations. The first is the situation in which the FTA generates substantial welfare gains for the average voter and in which the adversely affected interest groups fail to coordinate their efforts to defeat the accord. The second is the situation in which the agreement creates profit gains for exporters in excess of the combined losses imposed on import-competing industries and on the average voter.

Id.

88. See supra Part I.A and accompanying text.
stakes are high enough. However, if countervailing pressures offset the interest groups — or if the pressures of one export group counteract the forces of an import interest group — then, all things being equal, self-interested politicians should look with favor upon the consumer benefits of a free trade regime.

For this analysis to hold, however, the average voter is presumed to actually prefer free trade — or at worst, that the average voter remains rationally ignorant. In fact, however, there is reason to believe that the average voter — the individual who, as a consumer, will benefit from free trade — is likely to outright oppose it. If this is true, then politicians faced with offsetting interest group pressure from import and export industries may not necessarily advance free trade policies by default. Free trade may produce gains in the aggregate, but any self-interested politician would obviously take notice if the majority of his constituency believed that free trade was an evil. The following section therefore examines consumer beliefs on free trade in more detail, and considers the extent to which the WTO may operate to counteract the potentially harmful effects of these beliefs, thereby further advancing free trade.

C. The Missing Link: Rational Irrationality

It is often said that the proposition that free trade creates wealth among nations has been “well established since at least the beginning of the nineteenth century.”[89] This is undoubtedly true — if it is taken to mean “well-established among economists.” As far as the general public is concerned, however, quite the opposite is true.

The positive economic beliefs of economists and the public appear to be systematically inapposite.[90] Professor Bryan Caplan has synthesized data from the Survey of Americans and Economists on the Economy to directly contrast the views of the general public and professional economists.[91] The results are

89. McGinnis & Movsesian, supra note 13, at 521.
startling. For example, Question 26 of the Survey of Americans and Economists on the Economy (1996) (“The Survey”) asked: “Which do you think is more responsible for the recent increase in gasoline prices: the normal law of supply and demand, or oil companies trying to increase profits?” As Caplan notes, “only 22% of the general public accepted the supply-and-demand explanation, compared to 85% of economists, while 73% and 8% respectively affirmed the second explanation.”

The Survey further asked both the general public and its group of professional economists a series of questions on “Why the Economy Is Not Doing Better Than It Is.” The results appear below in Table 1.

92. Caplan, The Logic of Collective Belief, supra note 91, at 226. Cf. JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY 383 (1954) (noting that “the ideas of economists and political philosophers...are more powerful than is commonly understood,” and that “the world is ruled by little else”).

93. This table appeared in Caplan, The Logic of Collective Belief, supra note 91, at 227 (citing The Survey, Questions 27 and 29). Caplan also takes up, and adequately treats, the “two main ways one might try to vindicate the unbiasedness of non-economists’ economic beliefs. The first is to maintain that the differences reflect economists’ self-serving biases...The second is that economics attracts and/or molds individuals with specific ideological and political views.” Caplan, Systematically Biased Beliefs About Economics, supra note 90, at 434 (citations ommitted).
Table 1

<table>
<thead>
<tr>
<th>Explanation</th>
<th>General Public</th>
<th>Economists</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Major Reason</td>
<td>Minor Reason</td>
</tr>
<tr>
<td>Too Many People are on welfare.</td>
<td>70*</td>
<td>22</td>
</tr>
<tr>
<td>Foreign aid spending is too high.</td>
<td>66*</td>
<td>23</td>
</tr>
<tr>
<td>There are too many immigrants.</td>
<td>47</td>
<td>32*</td>
</tr>
<tr>
<td>Companies are sending jobs overseas.</td>
<td>68*</td>
<td>25</td>
</tr>
<tr>
<td>Business profits are too high.</td>
<td>46</td>
<td>36*</td>
</tr>
<tr>
<td>Technology is displacing workers.</td>
<td>46</td>
<td>38*</td>
</tr>
<tr>
<td>Companies are downsizing.</td>
<td>59*</td>
<td>30</td>
</tr>
</tbody>
</table>

Source: Survey of Americans and Economists on the Economy, Questions 27 and 29  *=median belief

Caplan proposes a theory of “rational irrationality” to explain the systematic divergence of populist beliefs from those of pro-
professionally trained economists. People will choose to hold systematically biased beliefs based on little or no information with a high level of certainty when the private costs of error are negligible. Some beliefs, in other words, have practical consequences for the individual that holds them. But others do not. The rational irrationality model assumes that people have preferences for beliefs themselves as well as for outcomes, and that when the private costs of error are small enough, people can indulge their preferred beliefs.

For example, if an individual believes that protectionist tariffs produce net gains for the economy, the private costs of error are effectively zero. The odds of this individual's vote changing the outcome of an election are zero, so the odds of his belief ultimately "coming back to bite him" are zero. By contrast, if the individual chooses to believe that the automobiles in the street he is about to cross are mere apparitions, and that they may therefore be disregarded, the costs that this erroneous belief may impose on him are enormous. It should therefore come as no surprise that few people are willing to believe that the automobiles in the street are apparitions, but that many people apparently believe that ghosts haunt houses. The former imposes high private costs of error; the latter does not. Thus, if an indi-

94. See also FRIEDMAN, supra note 10, at 78. Friedman notes that his father-in-law would not consider questioning Friedman's views on physics, a subject in which Friedman holds a Ph.D. Nevertheless, Friedman's father-in-law is quick to disagree with Friedman's views on economics, despite the fact that Friedman has been writing and lecturing on economics for the past twenty years, and his father-in-law, as Friedman notes, has never taken an economics course in his life.
96. Id.
97. Id. at 227–28. See also McGinnis & Movsesian, supra note 13, at 524. The authors note:

[Protectionist groups enjoy an additional advantage: they can exploit nationalist sentiments. These sentiments, which are often deeply rooted in a country's tradition and culture, can have a positive impact on politics by encouraging the production of public goods. For example, they facilitate the common defense and aid in rallying opposition to totalitarian oppression, as in Eastern Europe at the end of the Cold War.

Id. See generally ROBERT H. FRANK, PASSIONS WITHIN REASON x (arguing that irrationality may be biologically selected).
individual derives pleasure — consumption value — from the belief that particular houses are haunted by ghosts, he may \textit{rationally} adopt this (irrational) belief, because holding the belief presumably imposes no private costs. Similarly, in the political context, individual voters “can cheaply indulge their systematically biased beliefs at the ballot box knowing that they are extraordinarily unlikely to alter the outcome.”

But the \textit{social} costs — the costs in the aggregate — of rationally indulging irrational beliefs may be enormous. Political markets represent the paradigmatic example. Individual voters may cheaply indulge their private fantasies without their marginal vote affecting the election’s outcome, but when \textit{all} rationally irrational voters do so, the outcome \textit{does} vary. Accordingly, the voter tendency toward rational irrationality threatens to impose significant social costs — more so than those that might flow from “mere” rational ignorance alone. Rationally ignorant voters lack incentive to purchase information when the odds of their “investment paying off” — i.e., their vote changing the outcome of an election — are zero. But when information is provided at no cost, e.g., through the media or political debates, the rationally ignorant will at least process it. Rationally irrational voters, by contrast, already believe they have all the information they need, and will vote in accordance with their (irrational) beliefs. That is, “if voters are rationally ignorant about the specifics of trade policy, they can still support general procedures to curtail protectionist pressures. But such procedures would win no favor from voters who affirmatively favor protectionism due to their rationally irrational overestimates of the social benefits of protectionist policy.”

98. Caplan, \textit{The Logic of Collective Belief}, supra note 91, at 219 (also noting that “voter rationality…will normally be an under-produced collective good”) (citation omitted).


100. Caplan, \textit{The Logic of Collective Belief}, supra note 91, at 224. Caplan further notes:

\[\text{[T]he rationally ignorant at least acknowledge that they have [an information] problem, so they are open to compensatory political measures. Politicians who support such measures win the voters' favor. The rationally irrational, however, deny that they have a problem; they don't want the political system to “help them” overcome their ir-}\]
Politicians will naturally be sensitive to the belief systems of their constituents. If the majority of voters believe that free trade is an evil to be combated, then politicians must take heed, and for the very same reasons that politicians are susceptible to the influences of interest groups: if reelection and prestige are the goals, then politicians must pay attention to the interest groups (and class of voters) who make a difference in elections.\textsuperscript{101}

Thus, the WTO is revealed to serve an additional, perhaps “hidden,” purpose. It operates as a “scapegoat” for politicians attempting to deflect the wrath of constituents angered by free-trade-oriented policies. Politicians may simply plead deference to the WTO as necessary to achieve other, more worthy (read: more popular), societal goals, while at the same time enjoying the stream of benefits that flow from increased market access. For example, a politician might claim that participation in the various multilateral trade agreements administered by the WTO is necessary to preserve diplomacy with foreign countries, which in turn might be considered essential to the preservation of human rights in impoverished countries — a more “noble” goal in society’s eyes.\textsuperscript{102} Whether this is true or not is one thing;

\begin{quote}
  rational biases. In their eyes, such compensatory political measures are useless at best, and insulting at worst. Politicians who support them have little to gain and much to lose.
\end{quote}

\textit{Id.} at 224.

\textsuperscript{101} If the excessive level of noise in political markets, coupled with rational ignorance, precludes voters from checking harmful political behavior, supra Section I.C, then concededly, the opposite might hold true as well. That is, even if voters on balance oppose free trade, that factor is merely one of many on the table during an election year, and the noise level in political markets may therefore check the potential damage caused by this belief. But the irrational tendencies of voters nevertheless become relevant to the personal calculus of politicians because ignorance is no longer at issue; by hypothesis, many voters go to the booths firmly believing that unencumbered free trade is an evil that must be stopped. This tendency therefore threatens to impose greater social costs than mere ignorance because voters cannot be persuaded to adopt “rational” policies; they will simply believe what they want to believe.

\textsuperscript{102} See John O. McGinnis, World Trade Agreements: Advancing the Interests of the Poorest of Poor, 34 Ind. L. Rev. 1361, 1361–62 (2001) (noting that free trade is a way to help the world’s poor, and that free trade agreements help the expansion of civil rights in developing countries). McGinnis further notes that multilateral trade agreements might actually advance human rights more than The Universal Declaration and other human rights conventions, because expanding trade increases the wealth of foreign nations, which
what matters from a politician’s perspective is simply whether his constituency believes it.\textsuperscript{103}

In summary, the multilateral treaties administered by the WTO — at least to the extent that they call for increased market access under a reciprocity regime — mobilize domestic export interests and counteract the interest group pressure mounted by domestic producers who stand to face increased competition in the aftermath of increased domestic market access. Politicians in a position to support agreements calling for increased market access will then prefer to act in furtherance of this goal, because, in the aggregate, free trade will create wealth. These politicians will then naturally take credit for increased societal wealth, and will presumably explain these benefits by reference to some domestic policy or other implemented by that politician. But what is more, to appease the voter who, while enjoying the benefits of free trade, still condemns free-trade policies, politicians may simply plead deference to a multilateral trade agreement administered by the WTO as if adherence to the agreement is some “necessary evil” to achieve a greater good, thereby giving political actors the best of all political worlds. Politicians will accordingly reap all the benefits of free trade without assuming personal responsibility for its “evils” in the eyes of those constituents who believe free trade should be curbed.\textsuperscript{104} Accordingly, even though the
majority of voters may believe that free trade causes harm, playing the WTO as a scapegoat makes support of increased market access politically feasible.\textsuperscript{105}

CONCLUSION

The average voter may irrationally believe that free trade is an evil that should be combated, but, on the theoretical model proposed by this Article, the costs these beliefs threaten to impose are reduced by the WTO. Irrational beliefs that impose no private costs may, in general, impose great social costs in the aggregate — particularly in the context of political elections, where an entire electorate indulging their bliss beliefs may eventually bring about socially disastrous policies. But at least insofar as free trade is concerned, if the average voter believes that adherence to the WTO is a necessary means to achieving a more worthy end, then voters will tolerate the increased market access mandated by the WTO’s multilateral treaties, and society will continue to enjoy the benefits that flow from free trade. unlikely that the WTO was created for this reason. But if it was not created for this purpose, then perhaps there is less reason to believe these good (and unintended) effects will last.

\textsuperscript{105} It may be questioned whether using the WTO in this manner is not without its own set of costs. For example, perhaps “playing the WTO as a scapegoat” further encourages the (possible) natural hypocrisy of political actors, or contributes to the accumulation of public disinformation. It may even be said that by playing the scapegoat card, the WTO negotiating process may itself become distorted, because without proper negotiating alignments internally, parties may not have the best-laid agendas. These are all points worthy of consideration. Nevertheless, for present purposes, the thesis of this Article is simply — and is limited in scope to stating — that rational irrationality poses a problem to the proliferation of free trade agendas, but that it turns out that the WTO’s status as a potential whipping child has the unintended, and somewhat surprising, consequence of making free trade more palatable.

“It’s good to be the king.”

I. INTRODUCTION

Astronomical executive pay has been referred to as “the most egregious governance failure of the 20th century.” Although excessive executive remuneration has long been a newsworthy topic in the United Kingdom (“U.K.”), beginning in the early and mid-1990s “interest in the topic reached unprecedented levels.” There were several reasons for this piqued interest in the salaries of the country’s executives. For one, the “gross pay of chief executives in larger U.K. public companies rose nearly 600% between 1979 and 1994.” In addition, “remuneration levels seemed to bear little relation to corporate performance.” Finally, as corporations were increasing their executives’ pay, they were also cutting back on rank and file employee positions.

Although executive pay was a hot topic in the United States (“U.S.”) throughout the 1990s, it didn’t reach its pinnacle until early 2001. This was mainly due to the thriving U.S. economy — investors and shareholders were “too optimistic about their personal economic future to be very concerned about executives getting rich.” However, with the economic slowdown beginning in early 2001, and the recent corporate scandals such as Enron, Worldcom, and Tyco, good corporate governance is now on the radar screen of most shareholders.

3. Brian R. Cheffins & Randall Thomas, Should Shareholders Have a Greater Say over Executive Pay?: Learning from the U.S. Experience, 1 J. CORP. L. STUD. 277, 278 (2001). For a general discussion, see id. at 278–82.
4. Id. at 279.
5. Id.
6. Id.
7. Id. at 298–99.
8. Id. at 279.
9. Id. at 299. See also Jerry Useem, Have They No Shame?, FORTUNE, Apr. 28, 2003, at 59; Andrew Hill & Caroline Daniel, U.S. Investors Are Grow-
Essentially, within the realm of corporate governance topics, executive pay has preoccupied investors the most. Indeed, in 2003 “[e]xecutive pay ha[d] taken over as the top concern of corporate governance from last year’s biggest worry, the independence of auditors.”\textsuperscript{10} “Yet although executive compensation was one of the first targets that critics of corporate America attacked after the spate of scandals [in 2002], it is still proving the toughest to reform.”\textsuperscript{11}

This Note analyzes the issue of executive compensation through a comparison of the U.S. and the U.K., with a focus on the rights and responsibilities of shareholders in challenging executive pay. Part II compares the U.S. and U.K. systems of corporate governance, including corporate structure, composition of share ownership and corporate governance laws in both countries. Part III examines whether executive compensation is excessive. Part IV discusses the details of setting compensation and the related disclosure regimes in the U.K. and the U.S. In particular, it examines the methods by which executives are paid and sets out the laws regulating the setting of compensation in both countries. Part V addresses the issue of how shareholders can challenge executive compensation, with a focus on challenges through voting. Specifically, this section discusses challenges by shareholder proposals, challenges to share option plans, and challenges at the annual meeting. Part VI focuses on recent amendments to the U.K. Companies Act and to the New York Stock Exchange listing rules. Finally, Part VII discusses shareholder responsibilities and stresses the need for greater shareholder involvement in the compensation process.

II. COMPARING THE U.S. AND U.K. SYSTEMS OF CORPORATE GOVERNANCE

There are many similarities between the corporate sectors of the U.S. and the U.K. Both systems are “characterized by a relatively large number of quoted companies, a liquid capital market where ownership and control rights are traded fre-
In other words, both systems have capital markets and wide dispersal of ownership. Since dispersed ownership is found in both the U.S. and the U.K., “[t]he U.S. is...a particularly important country against which to compare U.K. governance because unlike Continental Europe and most of the rest of the world, the underlying structure of its capital markets and companies is similar.”

A. Corporate Structure in the U.S. and U.K.

At the outset, it is important to note some specific similarities between corporate structure in the U.S. and U.K. Both the U.S. and the U.K. “have a ‘shareholder economy’ where private enterprise is about maximizing profits for those who invest.” As a result, “shareholders occupy the central position with respect to companies.” The system of ownership and control in both countries has been called an “outsider/arm’s-length” system. “Outsider” refers to the fact that most firms do not have a “core” group of shareholders with “inside” influence, but rather have dispersed ownership “among a large number of institutional and individual investors rather than being concentrated in the hands of family owners, banks or affiliated firms.” The term “arm’s-length” is used to describe the fact that investors “are rarely poised to intervene and take a hand in running a business.” Essentially, this role is left to the corporate executives.

Since the U.S. has a common law legal system and market-based economy, the main form of corporation in the U.S. is the publicly-held company with widely-dispersed ownership. This creates an agency problem between the shareholders, who own

14. Id.
15. Cheffins & Thomas, supra note 3, at 297.
16. Id.
17. Id. at 297–98.
18. Id. See generally Rafael La Porta et al., Corporate Ownership Around the World, 54 J. of Fin. 471 (1999).
19. Cheffins & Thomas, supra note 3, at 298.
20. Id.
the company, and the executives and directors, who manage the company.\textsuperscript{21}

Each of the fifty U.S. states has its own business corporations law and each corporation is governed by the law of the state of its incorporation.\textsuperscript{22} Each corporation draws up articles of incorporation setting out the duties and rights of shareholders and directors.\textsuperscript{23} The shareholders, being owners of the corporation, are given certain rights, including the right to vote, such as voting for the board of directors.\textsuperscript{24} The board, in turn, chooses executives to run the day-to-day operations of the firm and set dividends.\textsuperscript{25} Often, in the U.S., the positions of chairman of the board of directors and chief executive officer are held by one person.\textsuperscript{26}

The U.K.’s corporate structure is similar to that of the U.S. At least part of the U.K.’s corporate governance system has been shaped by “its political and social history and attitudes.”\textsuperscript{27} It has been suggested that the fact that the U.K. is an island has led to its “[i]nsularity” which “has bequeathed the U.K. a sense of welcome separateness which no amount of foreign entanglement can destroy.”\textsuperscript{28}

The general model of corporate management and control in the U.K. involves “two main organs: the board of directors and the general meeting of members.”\textsuperscript{29} Pursuant to a company’s articles of association, the board may “appoint and confer any of their powers upon one or more executive (or ‘managing’) direc-

\begin{footnotes}
\item[22] See Jonathan P. Charkham, \textit{Keeping Good Company: A Study of Corporate Governance in Five Countries} 174 (1994).
\item[24] See Douglas M. Branson, \textit{Corporate Governance}, Director’s Selection, §1.01, at 1–2 (The Michie Company, 1993) (“Most central to shareholders’ role then is their power to elect directors, and statutes typically refer to that shareholder power expressly.”). \textit{See also} Charkham, supra note 22, at 182.
\item[27] Charkham, supra note 22, at 249. \textit{See generally} Roe, supra note 21.
\item[28] Charkham, supra note 22, at 250.
\item[29] Stapledon, supra note 12, at 6.
\end{footnotes}
tors, which in effect allows the creation of a third organ — executive management.\textsuperscript{30}

Essentially, “the board of directors is the most important day-to-day organ in the company.”\textsuperscript{31} The board of directors has “the power to manage the business of the company, and the general meeting is not permitted to interfere with its exercise.”\textsuperscript{32} However, this does not mean that the annual general meeting (“AGM”) (analogous to the “annual meeting” in the U.S.) is without purpose. At the AGM, the shareholders may remove directors without cause by vote, which requires a simple majority.\textsuperscript{33} In addition, shareholders may vote at the general meeting to alter the articles of association, which requires a three-quarters super-majority.\textsuperscript{34} The board of a typical public company in the U.K. is comprised of both non-executive directors and executive directors.\textsuperscript{35} The board, as a whole, does not typically manage the day-to-day operations of the company; rather, the board delegates these duties to the chief executive (also called the “managing director”) and other executive directors.\textsuperscript{36} Unlike in the U.S., the roles of chairman and chief executive are generally separated.\textsuperscript{37} The executive management of the company, which consists of executive directors and executive officers (who are not members of the board), plan the company’s

\begin{itemize}
\item \textsuperscript{30} Id.
\item \textsuperscript{31} STAPLEDON, supra note 12, at 6–7.
\item \textsuperscript{32} Id. at 7.
\item \textsuperscript{33} Companies Act 1985, c. 6, § 303 (Eng.).
\item \textsuperscript{34} Companies Act 1985, c. 6, § 9.
\item \textsuperscript{35} STAPLEDON, supra note 12, at 7. Although this is not a requirement under U.K. law, the Combined Code suggests that the board have an appropriate balance of executive and non-executive directors (including independent non-executives) so that no individual or group of individuals can dominate the board’s decision making. See Financial Services Authority, Listing Rules, § 1, paras. B1–B3, Schedules A, B (June 1998). See also DEPARTMENT OF TRADE AND INDUSTRY (“DTI”), CONSULTATION PAPER, REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS (June 7, 2002) [hereinafter Higgs Report].
\item \textsuperscript{36} STAPLEDON, supra note 12, at 7.
\item \textsuperscript{37} Who’s in Charge?, supra note 26, at 20. See also Press Release, Pensions Investment Research Consultants, Companies Face Increasing Risks By Ignoring Shareholders’ Views On Corporate Governance (Dec. 2003), available at http://www.pirc.co.uk/Annual_review_2003.pdf [hereafter PIRC] (approximately 10% of companies have a combined chairman and chief executive).
\end{itemize}
strategy. However, “it is normally necessary for the approval of the board to be obtained for major transactions or changes in strategy, and [it is] sometimes necessary for shareholder approval to be obtained as well.”

In an average company, the board of directors will meet monthly to discuss strategy and to monitor the performance of executive management. The board of directors and senior executives owe a fiduciary duty to the “company as a legal entity separate from its shareholders and creditors.” However, directors also have the duty, when making decisions, to consider the interests of the company’s employees (stakeholders).

The right to vote is common in most ordinary shares of publicly listed companies in the U.K. Most of the publicly listed U.K. companies “have only one class of ordinary shares, with each ordinary share carrying one vote on a poll at a general meeting of the company.” Similar to the U.S. system, the articles of association of the U.K. company will set out this one-share, one-vote system. There are two types of general meetings where shareholders exercise their right to vote: the AGM and the extraordinary general meetings (“EGM”). The matters upon which shareholders are required to vote are set out in the Companies Act of 1985, the company’s articles of association, the London Stock Exchange Listing Rules and the general law. Some examples of matters on which shareholders have a right to vote include: changes to the articles of association, the company and purchase of its own shares, removal of directors,
transactions between the company and someone related to the company\textsuperscript{49} and a voluntary winding up of the company.\textsuperscript{50}

B. Composition of Share Ownership in the U.K.

According to the most recent U.K. government survey of share ownership on the U.K. Stock Exchange, released in July 2003, overseas/foreign investors account for 32.1\% of U.K. equity; individuals account for 14.3\%;\textsuperscript{51} banks accounts for 2.1\%; and insurance companies, pension funds, and other institutional shareholders account for 49.4\%.\textsuperscript{52} Therefore, in the U.K., institutional shareholders hold a sweeping majority of equity capital of publicly-listed companies.\textsuperscript{53} Despite such a large percentage of equity ownership in public companies, institutional shareholders (e.g., pension fund trustees) are not required to exercise their vote.\textsuperscript{54}

The market where most publicly listed stocks are traded in the U.K. is the London Stock Exchange (“LSE”).\textsuperscript{55} The LSE is one of Europe’s leading exchanges and consists of both domestic and international companies. Although the LSE has been in existence for approximately 200 years, in 1986 it experienced what is considered the “Big Bang” — when the market truly opened its doors and grew exponentially. Currently, the LSE

\begin{footnotes}
\textsuperscript{49} Financial Services Authority, Listing Rules, 2000, c. 11 (Eng.).
\textsuperscript{50} Insolvency Act, 1986, c. 45, § 84(1) (Eng.).
\textsuperscript{51} The proportionate share ownership of individuals has decreased steadily in the U.K. In 1963, approximately 54\% of U.K. equities were held by individuals while in 1998, the figure dropped to a mere 16.5\%. See Geof Stapledon, Analysis and Data of Share Ownership and Control in U.K., at 4, at http://www.dti.gov.uk/cld/staple.pdf (last visited Jan. 2, 2004). Stapledon attributes this decline to “the growing proportionate holding of the institutions, and...individuals swapping their money from directly held shares to indirect investment in equities via investments in unit trusts, investment trusts and pension funds.” Id.
\textsuperscript{53} Stapledon, supra note 12, at 4. Since the early 1960s, institutional investor equity holdings in public companies has increased significantly. In 1963, individuals owned approximately 54\% and institutional investors owned 29\%. However, in 1994, individuals owned a mere 20\% and institutional investors owned approximately 60\%. Id. at 4–5.
\textsuperscript{54} Stapledon, supra note 12, at 85.
\textsuperscript{55} Information about the LSE is available at http://www.londonstockexchange.com.
\end{footnotes}
has about 2,700 companies which trade on its markets (the main market has more than 2000 companies, with approximately 400 international issuers, and the secondary AIM market has more than 700 companies with approximately 50 overseas issuers) for a market value of approximately £3 trillion (or $5.49 trillion U.S. dollars).

C. Corporate Governance Law in the U.S. and U.K.

Before delving into the specifics of corporate governance law in both countries, it is important to note that the U.S. and U.K. have a "shared legal heritage encompassing the common law and principles of equity."

In the U.S., corporate governance is monitored through a combination of state and federal statutes, SEC rules (regarding disclosures, proxies, and proposals), and common law. Generally speaking, the board of directors has a fiduciary duty to the corporation to act in the corporation's best interest. This means that directors are prohibited from self-dealing and from using corporate control for their own financial gain (i.e., insider trading). Common law governs subjects such as conflicts of interest, fiduciary duties, self-dealing, business judgment, and waste. Much like the U.S., the U.K. is a common law country with its corporate governance law comprised of an amalgamation of different sources: Codes (mainly voluntary), the Companies Act of 1985, the Stock Exchange Listing Rules, and common law.

56. Within the main market there are special groupings for certain sectors including techMARK (an international market for innovative technology companies), techMARK Mediscience (for healthcare companies), and landMARK (for U.K. regional companies). See London Stock Exchange website, at http://www.londonstockexchange.com (last visited Feb. 12, 2004).
57. The Alternative Investment Market (AIM) is a market for growing companies and has only been around since 1995. See London Stock Exchange website, at http://www.londonstockexchange.com (last visited Feb. 12, 2004).
58. Despite the fact that about 85% of the 2,700 companies listed on the Exchange are U.K. companies, approximately 61% of the LSE's equity market value derives from international companies. This is most likely because the foreign companies which choose to trade on the LSE are comparably large. See London Stock Exchange website, at http://www.londonstockexchange.com (last visited Feb. 12, 2004).
59. As of the time of publication, the exchange rate is £1 to $1.86 (Feb. 9, 2004).
60. Cheffins & Thomas, supra note 3, at 297.
There are four corporate governance codes in the U.K., which act as “self-regulatory controls and [are] enforceable only through shareholder pressure and the Stock Exchange Listing Rules.” The Cadbury Code, issued in 1992, was the first such code promulgated in the U.K. The Code recognized the importance of corporate governance to the U.K.’s competitive economy and recommended a “Code of Best Practice,” which focused mainly on “openness, integrity and accountability.” This Code of Best Practice included nineteen recommendations relating to the board of directors, non-executive directors, executive directors, and auditors. For purposes of remuneration, it is important to note that the Cadbury Report suggested that shareholders be given a vote on directors’ service contracts and that there be full and clear disclosure of the salaries of directors and executives. In addition, the Cadbury Code recommended that publicly listed corporations have remuneration committees comprised of non-executive directors.

In 1995, a second code, named the Greenbury Code, was issued by the Greenbury Committee, focusing solely on managerial remuneration. The Code focused on increased disclosure of compensation, especially in annual reports to shareholders. Similar to the preceding Cadbury Code, the Greenbury Code also suggested that remuneration committees for publicly listed
corporations consist of non-executive directors.\textsuperscript{71} It went further to suggest that shareholders should have direct access to the chairman of the company’s remuneration committee at the annual meeting.\textsuperscript{72}

In 1998, the Hampel Report was published, restating, many of the same corporate governance concerns.\textsuperscript{73} The Report stressed the end of the “box ticking” approach to corporate governance—\textsuperscript{74} the drafters of the Report did not want U.K. companies to merely look down a list of good corporate governance practices and check them off as they accomplished them. In other words, the Report aimed for corporate governance as a means (to a competitive international economy in the U.K.), not as an end in itself.\textsuperscript{75} The Report developed a set of principles, as opposed to the guidelines which the preceding codes had delineated.\textsuperscript{76} According to Hampel, the single overriding objective of all listed companies should be to enhance shareholder wealth. The Report, however, was met with a mixed reaction since it left open many questions, such as “What is a principle, and what is a rule?” and “What will companies have to comply with?”\textsuperscript{77}

The Combined Code, which followed the Hampel Report and is known as the Code of Codes, is essentially a combination of all three voluntary codes.\textsuperscript{78} It adopted the principles set out in the Hampel Report and covered all issues of corporate governance including, board issues, remuneration, the role of the

\textsuperscript{71} Id. at A1, A4.
\textsuperscript{72} Id. at A8.
\textsuperscript{73} COMMITTEE ON CORPORATE GOVERNANCE, REPORT OF THE COMMITTEE ON CORPORATE GOVERNANCE (London, Gee Publishing, 1998) [hereinafter HAMPEL REPORT].
\textsuperscript{74} The “box-ticking” approach refers to a corporate practice by which “shareholders are only interested in whether the letter of the rule ha[s] been complied with.” See HAMPEL REPORT, supra note 73, at paras. 1.11–1.14. See also Unpacking Hampel, The Committee’s Preliminary Report, INTELLIGENCE (July/Aug. 1997).
\textsuperscript{75} HAMPEL REPORT, supra note 73, at para. 1.21.
\textsuperscript{76} Id. at paras. 2.1-2.2.
\textsuperscript{77} See Unpacking Hampel, supra note 74 (also stating that “one auditor told the Financial Times, ‘it’s all pretty confusing.’”).
\textsuperscript{78} The Combined Code is included in the appendix to the Listing Rules, which are administered by the U.K. Financial Services Authority in its capacity as the U.K. Listing Authority (“UKLA”). See Financial Services Authority, Listing Rules, § 1, paras. B1–B3, Schedules A, B (June 1998).
shareholders, financial reporting, auditing and transparency. The Combined Code is unique among its predecessors, whereas the other codes were voluntary, it is made mandatory to publicly listed companies by Rule 12.43A of the Listing Rules for the LSE. Although it technically has the force of law, a company may choose not to comply with the Combined Code, which is conditioned on the company explaining the reasons for its noncompliance — often called “comply or explain.” Unfortunately, “in many cases the companies’ explanations for non-compliance are either weak or non-existent.”

In addition, “while compliance has improved [since the Code was promulgated], only around one in three listed companies (34%) fully complies with the existing Combined Code.” Therefore, despite the fact that the Combined Code leads to greater transparency of corporate governance practices, it loses some of its “bite” since a company still has a choice not to comply as long as it justifies its reasons. Recently, the Code was amended to incorporate recommendations regarding non-executive directors and audit committees.

In January 2003, a report entitled “Review of the Role and Effectiveness of Non-Executive Directors” was published by a committee led by Derek Higgs. This report is more widely known as the Higgs Review or the Higgs Report. The review focused on issues such as the role of non-executive directors, attracting and recruiting non-executive directors, the ways in which the effective performance of non-executive directors could be enhanced and the relationship between shareholders and

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79. PIRC, supra note 37.
80. Id.
83. See Higgs Report, supra note 35. It should be noted that on the same day, the Smith Report was also published, which clarified and expanded the roles and responsibilities of audit committees. Clearly, the Smith Report was a “response to issues raised by the major corporate failures in 2002.” Michael Hammill, Corporate Governance — Proposed Changes in the U.K., INT’L COMPANY & COMM. L. REV., 2003, 14(9), N102-104, at N102 (also summarizing the main key recommendations of the Smith Report). While noteworthy, the Smith Report is beyond the scope of this Note.
non-executive directors.\(^\text{84}\) The report made proposals with regard to each of these topics, including a proposal that quoted company boards should be comprised of a majority of non-executive directors and only these non-executive directors should comprise the remuneration board.\(^\text{85}\) In general, the report “envisages a more demanding and important role for non-executive directors.”\(^\text{86}\) Higgs was generally met with favorable reviews, which included an endorsement from Patricia Hewitt, Secretary of State of the U.K. Department of Trade and Industry (hereinafter “DTI”).\(^\text{87}\) The Higgs Report was incorporated into the amended Combined Code in July 2003.\(^\text{88}\)

Indeed, the DTI has been very active in making recommendations to the U.K. government regarding directors’ remuneration. The DTI has published three consultative documents and has made many noteworthy proposals to the U.K. government to enhance corporate governance in the area of executive pay.\(^\text{89}\)

In July 1999, the DTI published its first consultative document on the topic of directors’ remuneration.\(^\text{90}\) In its foreword, the Secretary of State for Trade and Industry noted the importance of British companies offering remuneration packages that attracted the “best executives to run their businesses” while simultaneously linking pay to performance.\(^\text{91}\) This document focused principally on the following issues: 1) the independence and effectiveness of the board’s remuneration committee; 2) the way in which rewards are linked to performance to encourage enhanced performance by directors; 3) companies’ reporting to

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\(^{84}\) See Higgs Report, supra note 35, at 5–10 (Summary of Recommendations).

\(^{85}\) Id.

\(^{86}\) Hammill, supra note 83, at N102 (summing up the main key recommendations of the Higgs Report).

\(^{87}\) Press Release, DTI and Her Majesty’s Treasury, Government Welcomes Reports on the Role and Effectiveness of Non-Executive Directors and on Audit Committees (Jan. 20, 2003), available at http://www.dti.gov.uk. But see Alistair Alcock, Higgs — The Wrong Answer, COMP. L. 24(6), 161 (2003) (arguing that the Higgs proposals will lead to increased domination of the CEO).

\(^{88}\) Alcock, supra note 87, at 161.

\(^{89}\) See infra notes 90–102 and accompanying text.

\(^{90}\) See DTI CONSULTATIVE DOCUMENT, DIRECTORS’ REMUNERATION (July 1999).

\(^{91}\) See id. at Foreword.
shareholders of their general policy on executive remuneration, particularly with regard to linkage to performance; 4) compensation payments to directors on loss of office; and 5) the board’s accountability to shareholders on remuneration policy. DTI recommended that all quoted companies should have a remuneration committee composed of independent non-executive directors, that executive pay should be linked to performance, and that the disclosure for individual directors’ remuneration should be simplified for easier comprehension. In addition, the DTI recommended strengthening the disclosure provisions on service contracts and compensation arrangements improving accountability by requiring quoted companies to ask shareholders to vote on the board’s remuneration every year, as well as voting on its remuneration policy. Other proposals included requiring directors of quoted companies and the chairman of the remuneration committee to stand for election or re-election every year and for the creation of special procedures by which shareholders could move a remuneration resolution at the AGM.

In December 2001, the DTI published its second consultative document on executive pay. This document recommended that companies: (1) publish a report on directors’ remuneration as part of the company’s annual reporting cycle; (2) disclose within the report details of individual directors’ remuneration packages, remuneration policy, the remuneration committee, the policy on the duration of directors’ contracts, and the payments made upon severance; (3) display a line graph showing company performance; and (4) put an annual resolution to shareholders on the remuneration report.

In June 2003, the DTI published a third consultative document on directors’ remuneration, entitled “Rewards for Failure’
Directors’ Remuneration — Contracts, Performance and Severance” which focused mainly on severance payments to directors. Patricia Hewitt, the Secretary of State for Trade and Industry, stated in the foreword to this document that the “increase in the level of shareholder activism on the issue of directors’ remuneration...is very much a result of the new requirements on disclosure and a shareholder vote which the Government has introduced.” Despite progress, DTI recognized that further reforms were necessary. For example, they made the following suggestions: (1) amending the Companies Act of 1985 to require compensation payments to be fair and reasonable and (2) amending section 319 of the Companies Act of 1985 to reduce the statutory contract period. The U.K. government should soon be responding to this latest consultative document by announcing how it proposes to proceed.


99. Id.

100. A bill entitled “Company Directors' Performance and Compensation,” published on December 11, 2002 and now withdrawn, was introduced by Archie Norman in Parliament and suggested the insertion of a new section 316A into the Companies Act of 1985. This new section would require that upon a director’s termination from office or employment, the amount of compensation paid to such director should be “fair and reasonable having regard to any failure by the director in the performance of his duties either in his office as director or as an employee or both.” The full text of the bill is available at http://www.publications.parliament.uk/pa/cm200203/cmbills/022/2003022.htm. For a brief discussion of the proposed bill, entitled the “Company Directors’ Performance and Compensation Bill,” see Mike Woodley, Big Rewards for Big Failures, COMPANY L. 2003, 24(8), 247–48 (2003).

101. Currently, § 319 allows companies to enter into contracts with executives in excess of five years if shareholders give their approval. See Companies Act 1985, § 319. The DTI proposes lessening this five year period to three years. See REWARDS FOR FAILURE, supra note 98, at paras. 3.16–3.20.

102. The consultation period, during which commentary on the report is received, closed on September 30, 2003. The next step is for the U.K. government to publish a summary of the responses and announce its own actions. See Hammill, supra note 83, at N122. Hammill has noted that “[c]ommentaries on the Consultative Document and responses published to date show a polarization of opinions.” Id.
III. IS EXECUTIVE COMPENSATION EXCESSIVE?

Before embarking on a discussion regarding how shareholders can “fix” the problem of excessive executive compensation, the question must first be asked: Are executives being paid too much?103

There are two classes of people arguing the issue of executive compensation: those who believe that executive compensation is excessive and those who do not.104 Those who believe that executives are overpaid argue that there is little relationship between executive compensation and executive performance.105 Indeed, “pay for performance” has caustically been referred to as “pay-for-attendance.”106 This group argues that the substantial pay differential between executives and rank and file employees (especially in the U.S.) is a justification for lowering executive compensation.107 Indeed, the pay differential between executives and rank and file employees is spiraling out of control.108 For example, in 1980, executives in the U.S. earned approximately 40 times that of the average production worker.109 This figure rose to 85 in 1990, and today it is approximated that executives earn about 400 times more than the average production workers.110 Recently, the chairman of the Catholic Funds, a

104. Id. at 2.
105. Id. For example, executives of utility companies in the U.K., that were privatized under Margaret Thatcher’s Conservative Government, were awarded substantial increases in pay despite the fact that profits were a result of “privileged access to markets” and not executive performance. Cheffins & Thomas, supra note 3, at 279.
106. Useem, supra note 9, at 59 (quoting Matt Ward, an independent pay consultant).
110. Id. A study conducted in 2000 by Towers Perrin found that the pay differential between CEOs and lower-level employees was closer to 531 to 1.
$30 million fund company in Milwaukee, submitted a proposal to seven companies which would limit CEO pay to a figure that is 100 times that of the average worker.\textsuperscript{111} As of 2000, in the U.K., it was estimated that executives earned only twenty-five times more\textsuperscript{112} than rank and file employees.\textsuperscript{113} “According to a recent Incomes Data Services report, the total earnings of FTSE 100 chief executives rose 89% in the five years [leading up] to 2001, while full-time employees received a 28.7% rise.”\textsuperscript{114}

Those who argue that executive pay is not excessive suggest that a “free market fixes compensation.”\textsuperscript{115} In other words, this group believes that executive compensation can be rationalized due to the combination of a “large pool of potential executives,” “companies bidding for their services,” and a “wealth of information available about compensation.”\textsuperscript{116} Others argue that it would be too difficult to link executive pay to performance because the company cannot “distinguish between those achievements stemming from the CEO’s contribution versus those that are a result of favorable economic conditions or other factors.”\textsuperscript{117}

In the same vein, it is too difficult to link the success or failure

\textsuperscript{111} See Morgensen, Explaining (or Not) Why the Boss is Paid So Much, supra note 108, at sec. 3 at 1.
\textsuperscript{112} See Morgensen, Explaining (or Not) Why the Boss is Paid So Much, supra note 108, at sec. 3 at 1. The seven companies included Cendant, Compuware, Delta Air Lines, the El Paso Corporation, International Paper, Sun Microsystems, and Viacom. The SEC must determine whether the proposal will be allowed to be included in the companies' proxy materials. \textit{Id.}
\textsuperscript{113} Another study has stated that the pay differential in the U.K. is closer to 20 to one. See Cheffins & Thomas, supra note 3, at 279.
\textsuperscript{114} See Morgensen, Explaining (or Not) Why the Boss is Paid So Much, supra note 108, at sec. 3 at 1. The study was conducted by Towers Perrin in 2000. It also found that in Brazil the pay gap is 57 to 1; in Mexico it is 45 to 1; in Canada it is 21 to 1; in France it is 16 to 1; in Germany, it is 11 to 1; and in Japan, it is approximately 10 to 1. \textit{Id.}
\textsuperscript{116} Loewenstein, supra note 103, at 2.
\textsuperscript{117} Id. Cf. Joshua A. Kreinberg, Reaching Beyond Performance Compensation in Attempts to Own the Corporate Executive, 45 Duke L.J. 138 (1995) (arguing that the pay-for-performance method of compensation is inadequate to address the concerns of excessive compensation and that the courts should focus on equity ownership as a solution).
\textsuperscript{116} See Morgensen, Explaining (or Not) Why the Boss is Paid So Much, supra note 108, at sec. 3 at 1.
of a corporation to the performance of one individual. Some among this group believe that executive compensation is not a matter for public debate — it is simply “a matter for the company and shareholders.” Indeed, “by and large, [even] governments are reluctant to intervene in the private matter of employment contracts.” Yet, there is substantial commentary and evidence finding that the market for executives is simply inefficient. This has come to be known as the Lake Woebegon effect — taking its title from the novel by Garrison Keillor entitled “Lake Woebegon Days,” wherein all of the children in Lake Woebegon are “above average.” A market has developed for corporate executives in which all executives are considered “above average” and, consequently are paid at “above average” prices — thus causing “bosses’ pay to spiral[] upwards.” CEO pay has ratcheted upward because “[n]o [executive] selection committee wants to award their new [executive] less than the industry average.” Others have referred to the free-market system for corporate executives as “the Golden Rule gone wrong, CEOs do unto others as they would have [the executives] do unto them.” Further adding to the Lake Woebegon effect is the globalization of the market for executives. With the market for executives becoming increasingly global (in 2002, a study found that 10% of CEOs on the FTSE 100 were non-

118. Id.
120. Fat Cats Feeding, supra note 10, at 64.
121. See Bosses for Sale, ECONOMIST, Oct. 5, 2002, at 57 (suggesting that the market for executives is secretive, restricted, bad at price-settings and generally run by the head hunter firms). See also Where’s the Stick?, supra note 109, at 13; Useem, supra note 9, at 58.
123. Id.
125. Useem, supra note 9, at 64 (quoting Harvard Business School Professor Rakesh Khurana).
126. Therese Raphael, Hunting Fat Cats, Shooting Wild, WALL ST. J. (Europe), June 26, 2002, at A9 (stating that the global market for executives has increased executive pay in the U.K.). See also Evelina Shmukler, HBOS Girls to Approve Executive-Pay Schemes, WALL ST. J. (Europe), May 14, 2002, at M6 (stating that since the market for executives is international, U.K. banks must increase salaries to attract executive talent and “keep up with the compensation offered across the ocean”).
British),\textsuperscript{127} countries must increase salaries in order to attract talented executives.\textsuperscript{128}

There are also those that agree that compensation is substantial, but find that it is justified by a variety of factors. For example, some argue that, empirically speaking, “[m]uch of the increase in CEO pay is directly attributable to the increase in stock prices over the past two decades, as the portion of CEO pay in stock options has risen dramatically in the past several years.”\textsuperscript{129} Moreover, this group justifies the substantial pay differentials between executives and rank and file employees by arguing that the figures should not be taken at face value.

Perhaps the U.S.’ pay differential is not as bad as it appears at first glance.\textsuperscript{130} For example, “certain valuable and traditional components of an American compensation package take the form of benefits that are governmentally provided in other countries.”\textsuperscript{131} In addition, since tax rates in many other countries are higher than in the U.S., executives in other countries may receive a “significant amount of nontaxable compensation, far in excess of the types of fringe benefits most American executives are accustomed to receiving.”\textsuperscript{132} Lastly, they argue that CEOs in the U.S. actually have a more substantial job description, and thus have a “high level of responsibility and direct

\textsuperscript{127} Raphael, \textit{supra} note 126, at A9.

\textsuperscript{128} \textit{Id.} See also Shmukler, \textit{supra} note 126, at M6. But see Nick Isles, \textit{Life at the Top: The Labour Market for FTSE-250 Chief Executives}, The Work Foundation, \textit{available at} http://www.theworkfoundation.com/pdf/Life_atthe_Top.pdf (last visited Feb. 4, 1004) (arguing that “the FTSE-250 market is very home-grown…[and] [c]ompanies are behaving rationally by grooming talented members of staff to take over the top job when it becomes available.”).

\textsuperscript{129} Loewenstein, \textit{supra} note 103, at 4–5.

\textsuperscript{130} \textit{Id.} at 5 (“Had the stock market declined over this period [of the past two decades], the change in the differential between CEO and average worker compensation would look quite different, as the average worker is not paid in stock options.”). Others argue that U.S. culture is simply more accepting of greater pay differentials than other countries. \textit{See Norma Cohen, Britain Points Up Cultural Divide}, \textit{FIN. TIMES}, May 5, 2003, at 9 (quoting Stuart Bell, research director at PIRC: “The main difference is that U.S. society is more encouraging of, and tolerant of, a high-earning culture.”).

\textsuperscript{131} My Executive Makes More than Your Executive, \textit{supra} note 107, at 66.

\textsuperscript{132} \textit{Id.} at 65. For example, “[g]enerous housing allowances are not uncommon and it is not unheard of for bonuses to be paid outside of the executive’s country to avoid the imposition of income tax.” \textit{Id.} at 65–66. In Germany, a company may pay its executives a “second salary in a tax haven, which is not reported.” Loewenstein, \textit{supra} note 103, at 66–67.
involvement in managing the corporation." Indeed, although CEO compensation in the U.S. has risen faster than that of the average employee, it "has risen much slower than the pay of professional athletes."

Still, when comparing the U.S. and the U.K., the empirical data is undeniable: CEOs in the U.S. earn 45% higher cash compensation and 190% higher total compensation. One study found that salary levels for U.S. CEOs can be up to ten times higher than their U.K. counterparts. For example, Disney's CEO, Michael Eisner, nicknamed the "Prince of Pay," exercised options in 1997 that were worth more than the aggregate salaries of the top 500 CEOs in the U.K. More recently, when Eisner failed to meet the requirements that would entitle him to a bonus two years in a row, "his board lowered the performance bar" so he could receive a bonus. In fact, Britain's highest-paid executive in 1999, Sam Chisolm (of British Sky Broadcasting), "would only [have] rank[ed] as the 97th highest among U.S. chief executives." Mark Swartz, former Chief Fi-

134. Loewenstein, supra note 103, at 5 ("During the period 1980-95, the pay of the average worker increased 60%, that of CEOs 380%, National Basketball Association players 640%, National Football League players 800%, and Major League Baseball players 1000%. ").
136. Isles, supra note 128.
138. Id.
139. Useem, supra note 9, at 59.
140. In 2002, Bart Becht, Chief Executive of Reckitt Benckiser, an Anglo-Dutch household products conglomerate, was the highest paid executive in the U.K., earning £9 million — approximately $14 million (which includes £5.7 million — about $10.4 million — in stock options). Richard Wray, Low Profile of Highest Paid Boss, Guardian, Oct. 4, 2002.
141. Conyon & Murphy, supra note 135, at F640–41. Since U.S. companies are larger, more successful, or in faster growing industries, the empirical study accounted and controlled for firm size, industry, growth opportunities, and CEO's individual skills and abilities. Id. The current CEO of BSkyB, Tony Ball, earned £7.8 million in 2001 even though the company performed
nancial Officer of Tyco, won the prize for top-paid executive at an S&P 500 company in 2002 — “pull[ing] in a whopping $136 million.” Swartz’s cohort, Dennis Kozlowski, former CEO of Tyco, was the second-highest-paid executive with $82 million. In fact, a study by Equilar, an independent provider of compensation data, found that the median compensation of CEOs of the 100 largest companies in the U.S. rose 14% in 2002, while the Standard & Poor’s 500 plunged 22.1% that same year. Un-doubtedly, the recent scandal over the $140 million lump-sum cash payments given to Richard Grasso, chairman of the New York Stock Exchange (“NYSE”), which were in addition to his base salary of $1.4 million and bonus of at least $1 million, sparked the most controversy of all U.S. compensation payouts in 2003. Part of the outcry related to the fact that the NYSE is not a publicly traded entity and, as the world’s largest stock exchange, serves as a “quasi-public institution with an important regulatory function.” Accordingly, these payments were “more in line with what chief executives of public corporations are paid and are far above the pay of top officials at the Securities and Exchange Commission, NASD and even Nasdaq, a primary competitor to the Big Board.” Under a cacophony of calls for resignation from the NYSE, institutional investors, and even politicians, Grasso resigned from the NYSE in September 2003.

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142. Useem, supra note 9, at 57.
143. Id.
144. Id. at 58. The study also found that average CEO compensation dropped by 23% in 2002, but Fortune magazine attributed this decline to the significant pay decrease of a few “mega-earners.” Id.
145. Landon Thomas, Jr., Big Board Chief Will Get a $140 Million Package, N.Y. TIMES, Aug. 28, 2003, at C1; Landon Thomas, Jr., A Pay Package That Fat Cats Call Excessive, N.Y. TIMES, Aug. 29, 2003, at C1; Susanne Craig & Kate Kelly, Large Investors Call for Grasso to Leave NYSE, WALL ST. J., Sept. 17, 2003, at C1.
146. Thomas, supra note 122, at C6.
147. Id.
148. Kate Kelly & Susanne Craig, Grasso, Who Wanted to be a Cop, In the End Showed that he Knew When It Was Time to Surrender, WALL ST. J., Sept. 18, 2003, at C1.
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This is not to suggest, however, that executive remuneration in the U.K. is not excessive. In fact, one study reported that “from 1993 to 2002, the median salary of the highest paid director in FTSE 100 companies rose 92% from £301,000 to £579,000.” In addition, “[t]he maximum level of annual bonuses [] significantly increased” — in 1999, annual bonuses were the equivalent of 40-60% of an executive’s salary, while in 2000, they were the equivalent of 100% or more. The study also found “[a] similarly inflationary trend…for share-based incentive schemes.” “A recent poll in Britain found that 80% of people believe that top directors are overpaid.” Comparatively, “British executives earn more than their European counterparts on average, but less than Americans.” Indeed, “the U.K. is second only to the U.S. in terms of the global league for CEO pay.” Unfortunately, these pay standards are on the rise.

149. See British Solutions to ‘Fat Cat’ Pay, PAY FOR PERFORMANCE REPORT, Oct. 1, 2001, available at www.ioma.com/mr/uploads/pfp2_smp.pdf (“Although executive compensation in the U.K. takes different forms from that in the U.S., ‘the politically charged issue of boardroom pay continues to hit the headlines’….”) (citation omitted). See, e.g., Kreinberg, supra note 116, at 139 (suggesting that the collapse of Barings PLC, a 233-year-old British banking institution, may have been caused by Barings’ excessive incentive compensation plan, which “led to the payment of 50% of gross earnings in the form of bonuses”).


151. Id.

152. Id.


155. Isles, supra note 128.

156. Raphael, supra note 104, at A9. Raphael attributes the rise of salaries of British executives to the globalization of British companies and the fact that the market for executives has become more global. She states that 10% of CEOs on the FTSE 100 are non-British, compared to 2% a decade ago. She also states that greater transparency “has made CEOs more aware of what their peers are earning.” Id. See also Crystal, supra note 136 (stating that “CEO pay in the U.K., which seriously lagged behind the pay of American CEOs for years, is on its way to catching up” and finding that the gap between pay in the two countries has narrowed from U.S. CEOs earning 3.2 times that of U.K. counterparts in 1993, to only 1.1 times in 2002).
Regardless, these extravagant executive salaries have not gone unnoticed by shareholders in the U.K. For example, shareholders of Vodafone were quite vocal when Vodafone “proposed making a £10 million\(^{157}\) ‘one-off’ bonus payment to the chief executive [Christopher Gent] who had orchestrated acquisitions that resulted in the company becoming the world’s largest mobile telephone concern.”\(^{158}\) Despite heavy criticism following these events in 2000, Gent only recently volunteered to step down as chief executive.\(^{159}\) Termination contracts, to reward executives leaving a corporation, are also a problem in the U.K. These “golden goodbyes”\(^{160}\) have caught the eye, and voice, of shareholders. For example, when Ken Berry, music industry veteran, was paid £6.1 million (approximately $11.2 million U.S. dollars) last year upon leaving the corporation, shareholders were outraged and, subsequently, there was “a redesign of the company’s pay structure.”\(^{161}\) The DTI’s third consultative document, published in June 2003, focused specifically on severance packages of executives and made recommendations to

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157. This is the equivalent of approximately $18.6 million U.S. dollars (as of February 9, 2004).
158. Cheffins & Thomas, supra note 3, at 281. Oliver Burkeman, You’d be Smiling Too, GUARDIAN, Dec. 15, 2003, available at http://www.guardian.co.uk/mobile/article/0,2763,1107234,00.html (describing how Gent was rewarded with a £10 million “transaction bonus,” in addition to his £1.2 million salary after negotiating the takeover of Mannesmann, a German telecom giant, which shareholders felt was “obscenely overvalued.”). In 2000, Gent was paid nearly £6 million, despite the fact that shareholders lost nearly 20%. John Duckers, Time to Stop These Fat-Cats Running Away With Cream, BIRMINGHAM POST, Sept. 11, 2001, at 26. After criticism from institutional investors and several publications, Gent “was persuaded to take half the sum in shares.” See Burkeman, You’d be Smiling Too, supra note 158.
159. Burkeman, You’d be Smiling Too, supra note 158. Notably, however, on June 19, 2002, Vodafone issued a press release stating that it had engaged in extensive consultation over its new remuneration policy with shareholder groups.
160. See Jill Treanor, Multimillion Deals Give a Golden Goodbye to Ousted Executives, GUARDIAN, Oct. 4, 2002 (Seven directors in the U.K. were given more than £1 million to leave their executive positions in 2001).
161. See id. Mr. Berry had made his reputation by signing the Spice Girls, but then lost it after signing Mariah Carey to a contract for an album that flopped. As a result of Berry’s poor judgment, EMI paid almost £38 million to terminate the contract with Mariah Carey. Id. See also Finch & Treanor, Executive Pay Leaps Ahead 17%, supra note 114.
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the U.K. government.\textsuperscript{162} Regardless of whether the company is located in the U.S. or the U.K., there is guaranteed to be lively debate and outright criticism regarding the sometimes outrageous compensation paid to executives.

IV. SETTING EXECUTIVE COMPENSATION AND DISCLOSURE RULES

Aside from the issue of whether CEOs are being paid too much, there is also the issue of why CEOs are being so well compensated.\textsuperscript{163} This question is intertwined with yet another question: Who sets remuneration figures and policies, and how much do they have to disclose about such issues?

In fact, in public companies in the U.S. and the U.K. “executive pay is set in much the same way.”\textsuperscript{164} In both countries, the board is empowered not only to appoint executives, but also to set their compensation. However, “the prevailing orthodoxy is that directors of a publicly quoted company should delegate decisions concerning executive pay to a remuneration or ‘compensation’ committee made up of outside directors.”\textsuperscript{165} Ironically enough, both countries are concerned that the “outside directors” are not truly “outside” and are thus influenced in their decision-making by the directors who appointed them.

A. By what methods or financial instruments are executives paid?

Beside the difference in the amount of executive payment between the U.S. and the U.K., there is also a difference in the manner of payment. Executive compensation can take the form of annual salary, bonuses, share/stock options, and long-term incentive plans (LTIPs).\textsuperscript{166} In fact, both U.S. and U.K. execu-

\begin{itemize}
  \item \textsuperscript{162} See generally DTI, Consultative Document, Directors’ Remuneration (Dec. 2001).
  \item \textsuperscript{163} See Loewenstein, supra note 103, at 4 (“Overlaying all of these arguments [that CEOs are paid excessively] is the structural argument — corporate boards are ‘captured’ by the CEO and thus incapable of bargaining with the CEO.”).
  \item \textsuperscript{164} Cheffins & Thomas, supra note 3, at 298.
  \item \textsuperscript{165} Id.
  \item \textsuperscript{166} In the U.K., LTIPs are usually grants of shares of stock that become vested (ownership is transferred) upon attainment of specified performance objectives by the executive. In the U.S., LTIPs take the form of either (1) “re-
tives are paid through a combination of these financial instruments. However, the percentage of each that comprises the executive’s overall salary differs from one to the other.

In the U.S., an executive’s annual base salary comprises approximately 18% of his total compensation; whereas, in the U.K., an executive’s annual base salary is closer to 40%. On average, stock options comprise 61% of executive compensation in the U.S., whereas they compromise only 45% payment of executive compensation in the U.K. Thus, U.S. corporate executives rely less on salary and more on stock options; whereas, U.K. executives rely more on fixed salary. However, restricted stock, is becoming more popular as a form of executive pay in the U.S.

Both U.S. and U.K. executives are paid annual bonuses, as well. In a 2000 study, it was found that 17% of U.S. executives compensation was in the form of an annual bonus; whereas, in the U.K., approximately 18% of executives compensation is through an annual bonus. Although these percentages are close, in the U.K. an increasing amount of executive compensation is being paid as bonuses. Generally speaking, however, U.S. executives are awarded annual bonuses that are approximately three times more than their U.K. counterparts.

It is important to note that the manner of payment can affect the link between executive pay and share performance.

stricted stock’ grants that vest with the passage of time” (and are unrelated to pre-stated performance objectives), or (2) multi-year bonus plans, which are usually based on “rolling-average three or five-year cumulative accounting performance.” Conyon & Murphy, supra note 135, at F644.

167. Id.
169. Id.
170. Id.
171. Id.
173. Conyon & Murphy, supra note 135, at F640–41.
174. Isles, supra note 128 (citing statistics that five years ago, the upper limit for annual bonuses was 40% to 60% of an executive’s base salary, but by 2003 that upper limit rose to 100% of base salary).
175. See Conyon & Murphy, supra note 135, at F648.
176. Susan J. Stabile, Viewing Corporate Executive Compensation Through a Partnership Lens: A Tool to Focus Reform, 35 WAKE FOREST L. REV. 153,
would seem that CEOs with a greater percentage of their total pay in the form of stock options would have a greater incentive to increase the price of those shares. However, the grant of large stock options can have one of two results: it will either make the CEO work harder to increase the value of the company and its shares, or it will give the CEO incentive to manipulate the stock price (because of his or her own stake in the price of the shares). 177

B. The Law Regarding Setting Executive Compensation in the U.S.

In a U.S. corporation, the articles of incorporation empower the board of directors to appoint executives. 178 In addition, the board of directors is generally responsible for setting executive compensation. 179 In most publicly-listed U.S. corporations, however, the board of directors delegates the job of determining compensation to a compensation committee. 180 The corporation’s human resources department submits pay proposals for compensation committee considerations, with the help of an independent, outside compensation consultant. 181 The compensation committee will then make a recommendation to the board of executives, which routinely approves such recommendations

177. The details of such arguments are beyond the scope of this Note, but it should be noted that both consequences exist. Id.
178. See DOUGLAS M. BRANSON, supra note 24, §1.01, at 1–2; VARALLO & DREISBACH, supra note 23, at 14–15.
181. Id. at 1026–27. “Most of these experts come from a handful of well-known consulting firms specializing in executive compensation matters, many of which provide a wide variety of other consulting services to the company.” Id. This practice of hiring a high-paid compensation consultant has been criticized by Warren Buffet, the chairman of Berkshire Hathaway and an outspoken proponent of strong corporate governance. Buffet has stated that “when the compensation committee — armed as always with support from a high-paid consultant — reports on a mega-grant of options to the CEO, it would be like belching at the dinner table for a director to suggest that the committee reconsider.” Fat Cats Feeding, supra note 10, at 64 (quoting Warren Buffet).
“without much inquiry.” It is important to note that “[s]hareholders have no direct input in this process...They can voice their opinions to the board of directors in a variety of ways before and after the package is approved, but this only indirectly affects the outcome of the process.”

Disclosure is one aspect of U.S. corporate governance law that has a profound effect on compensation policies since “there is reason to believe that disclosure might have a restraining effect on the level of compensation.” Some argue, however, that disclosure “encourages better compensation plans (in terms of aligning managers’ interests with shareholders”). Unsurprisingly, the SEC, with regard to disclosure of executive compensation and compensation policies, favors heightened disclosure by companies.

In the early 1990s, the SEC tightened its disclosure regulations regarding executive compensation. Although it does not limit or cap executive compensation, the SEC enacted rules affecting corporate disclosure of executive compensation for proxy and information statements. For example, corporations are required to produce and disclose a “Summary Compensation Table,” which shows annual and long-term compensation in a single comprehensive form. In addition, the board’s Compensation Committee must report the corporate performance factors it relied on in making specific compensation awards, and must also report the corporation’s general compensation policies. Finally, the corporation must prepare a “Performance Graph,” comparing shareholder return over the past five years

182. Thomas & Martin, supra note 180, at 1027.
183. Id. (but noting that boards will take shareholders' views into consideration to insure the passage of any proposed stock option plan).
184. Loewenstein, supra note 103, at 23.
185. Id.
189. See id.
to shareholders in the Standard & Poor’s 500 index, and to a group of peer companies chosen by the corporation. 190

Setting compensation is an area that is mainly left to the good judgment of the corporation and is thus an area that the judicial system usually declines to examine. 191 Courts generally leave compensation questions to the business judgment of a corporation or the SEC. 192 For example, in Lewis v. Vogelstein, a leading case on the issue of shareholder derivative suits for excessive executive pay, the Delaware Chancery Court held that plaintiff’s complaint did not state a claim for breach of the duty of disclosure (regarding executive stock options plans which were approved by shareholder vote) primarily because the company’s failure to disclose the value of the stock options was more a result of uncertainty in valuing stock options than intentional manipulation on the part of the board. 193 Although the court did not dismiss the complaint entirely, it did note that the plaintiffs would face the large burden of overcoming Delaware’s high waste standard in order to proceed. 194 In order to determine that the stock options constituted waste of the corporation’s assets, the plaintiffs would have to show that the stock options were “in effect a gift” and that no substantial consideration was received by the corporation in exchange for the grant. 195 The court noted that the corporation gets the benefit of a “good faith judgment that in the circumstances the transaction is worthwhile.” 196 More recently, however, the Delaware Court of Chancery allowed a shareholder derivative action to go forward, basing their decision on the Disney Company’s lack of due care in granting a $140 million severance package and

190. Id.
191. See Viewing Corporate Executive Compensation Through a Partnership Lens, supra note 176, at 181–82.
192. See Lewis v. Vogelstein, 699 A.2d 327, 332–33 (Del. Ch. 1997) (“Judgments concerning what disclosure, if any, of estimated present values of options should be mandated are best made at this stage of the science, not by a court under a very general materiality standard, but by an agency with finance expertise…. [such as] the Securities and Exchange Commission.”).
193. Id.
194. Id. at 336.
195. Id.
196. Id.
other employment perks to Michael Ovitz.\textsuperscript{197} The court found that the facts alleged, if true, “belie any assertion” that Disney’s directors “exercised any business judgment or made any good faith attempt to fulfill the fiduciary duties they owed to Disney and its shareholders.”\textsuperscript{198} In particular, the court pointed to the plaintiff’s allegations that the board and the compensation committee both spent less than an hour reviewing Ovitz’s qualifications to serve as president of Disney, that neither the board nor the compensation committee reviewed the actual employment agreement or salary and severance provisions therein, and that no expert was hired to evaluate the terms of Ovitz’s employment package.\textsuperscript{199} While this decision may signal the beginning of more litigation in this area, such a conclusion is merely speculative at this point.\textsuperscript{200}

C. The Law Regarding Setting Executive Compensation in the U.K.

According to the DTI, compensation of U.K. executives should be linked to performance.\textsuperscript{201} Article 82 allows directors “such remuneration as the company may by ordinary resolution determine.”\textsuperscript{202} Moreover, Article 84 provides that directors may appoint a managing director or other executive officer and remunerate such person as they see fit.\textsuperscript{203} Generally speaking, a public company’s articles of association will empower the board to set executive remuneration.\textsuperscript{204} Since the early 1990s, most publicly traded U.K. companies have established remuneration committees, pursuant to the disclosure-oriented guidance out-

\textsuperscript{197} See generally In re The Walt Disney Co. Derivative Litigation, 825 A.2d 275 (Del. Ch. 2003).
\textsuperscript{198} Id. at 287.
\textsuperscript{199} Id.
\textsuperscript{200} For a general discussion of the recent success of shareholder litigation in the area of corporate governance, see John Gibeaut, Stock Responses, 89 A.B.A. J. 38, 38 (2003). See also Gretchen Morgensen, Shareholders Win in Effort to Alter Pay, N.Y. TIMES, Aug. 27, 2003, at C1 (discussing corporations settling lawsuits with shareholders by agreeing to change offensive corporate governance practices).
\textsuperscript{201} See generally REWARDS FOR FAILURE, supra note 98.
\textsuperscript{202} Companies Act, 1985, c. 6, art. 82.
\textsuperscript{203} Id. art. 84.
\textsuperscript{204} Cheffins & Thomas, supra note 3, at 286–87.
The Combined Code gives guidance on other remuneration-related issues. For example, the Code suggests that the level of remuneration should only be sufficient to retain directors with the competence to run the company, but not higher, and should be structured to link compensation awards to performance. The Code also suggests that grants under option and other incentive plans be parceled out over time, rather than awarded in one large block. The Combined Code also addresses the appropriate composition of remuneration. It suggests that annual bonuses and long term incentive schemes be supplemental to a director’s salary and that any such deferred remuneration or options not be exercised for at least three years. A one-year limit on service contracts, especially for newly recruited directors, is also recommended. By suggesting that directors remain uninvolved in setting his or her own compensation, the Code maintains its focus on independent and transparent remuneration-setting procedures. In addition, director performance should be factored into bonuses and criteria such as the company’s status and success in relation to other similarly-situated companies should factor into incentive schemes. Disclosure is another keystone of the Combined Code. In its annual report, the Code suggests that companies disclose the membership of the remuneration committee, the remuneration policy, and details of each individual director’s remuneration package (and reasons for such remuneration). The Code also recommends that shareholders have a vote at the AGM to

206. Id. at para. B.2.1.
207. Id. at para. B.1.
208. Id. at schedule A, para. 4.
209. Id. at schedule A, paras. 1–2.
210. Id. at paras. B.1.7–1.8.
211. Id. at para. B.2.
212. Id. at schedule A, paras. 1–2.
213. Id. at schedule A, para. 4.
214. Id. at para. B.2.3.
215. Id. at paras. B.3.1–3.2.
216. Id. at schedule B, paras. 1–3.
approve the board’s annual remuneration report\textsuperscript{217} and that shareholders vote to approve any new long term incentive schemes.\textsuperscript{218}

Unfortunately, a large portion of listed companies do not comply with the Code and, indeed, have at least one senior executive on the remuneration committee.\textsuperscript{219} Indeed, a recent study by the Pensions Investment Research Consultants suggests that less than 40\% of the average remuneration committees in the U.K. is comprised of fully independent directors.\textsuperscript{220} Interestingly enough, even one member of the remuneration committee of the London Stock Exchange’s (a publicly listed company) is not independent.\textsuperscript{221} However, even if such committees were truly “independent” bias would remain an issue. This is because “[i]n most listed companies, a nominating committee will work together with the chairman of the board to select the individuals who ultimately serve as non-executive directors.”\textsuperscript{222} These individuals “have been chosen on the basis that they ‘fit-in’ with the company, in the sense that they identify with its goals and are compatible with the management team.”\textsuperscript{223} Exacerbating this potential bias is the fact that CEOs often attend such meetings. The PIRC studied compliance with the Combined Code in 1999 (the year it first became effective) and determined that director’s pay was one area where compliance was poor.\textsuperscript{224} With regard to one-year contracts for executives,

\textsuperscript{217} Id. at para. B.3.5 & schedule A, para.3.
\textsuperscript{218} Id. at paras. B.2.4, B.3.2, B.3.5.
\textsuperscript{219} See Pensions Investment Research Consultants, Corporate Governance Annual Review (2002). See also Press Release, PIRC, Boards Dominated By Executives And Connected Directors (Dec. 12, 2002) (“After four years of operation, 34\% of companies state that they fully comply with the Combined Code on Corporate Governance.” More than 75\% of company boards in the UK are controlled by executives and no-executives who are not independent.)
\textsuperscript{221} London Stock Exchange Annual Report 34 (2002).
\textsuperscript{222} Cheffins & Thomas, supra note 3, at 285.
\textsuperscript{223} Id. at 285.
voting on remuneration reports, and fully independent remuneration committees, the PIRC found that only 51% of companies had one year contracts for executive directors, only 27% of companies disclosed that their board had considered voting on remuneration committee reports at their annual meeting, and approximately 77% of companies had a wholly independent remuneration committee. In addition, in 1999, the DTI commissioned PricewaterhouseCoopers (“PWC”) to monitor compliance by listed companies with both the Greenbury best practice framework and the Combined Code. PWC found that only 7 out of 270 companies (3%) complied with the Greenbury Report recommendation that shareholders should have a vote at the AGM on remuneration policies. PWC also found that in 81 out of 298 companies (27%), the board chairman was also the chair of the remuneration committee; in only 17 of 298 companies (6%) the majority of the members of the remuneration committee were non-independent, non-executive directors. These numbers show poor compliance with the Combined Code’s recommendation that “[r]emuneration committees should consist exclusively of non-executive directors who are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment.”

Traditionally, U.K. shareholders, specifically institutional shareholders, have been hesitant to bring derivative lawsuits relating to corporate governance issues because of procedural, financial, and substantive hurdles. In addition, U.K. judges have been, and continue to be, reluctant to interfere with executive compensation. Legislation is one area where sharehold-
ers can turn for support since executive remuneration in the U.K. is somewhat regulated through the Companies Act of 1985. For example, under section 311 of the Companies Act, a company is prohibited from paying a director remuneration that is not subject to income tax.

With sparse procedural safeguards for concerned U.K. shareholders, the issue becomes whether such shareholders have their own voice in the remuneration debate. As Cheffins and Thomas observe, “[w]hile the general rule in the U.K. is that shareholders do not have a direct say over executive pay, the pattern is subject to exceptions.” Some sections of the Companies Act give shareholders a voice in setting remuneration. For instance, sections 312 through 314 of the Companies Act of 1985 provide that a company’s shareholders have the right to vote by resolution on employment contracts for executives. Section 312 specifically proscribes that a company first obtain shareholders’ approval before it may compensate a director for leaving the corporation. A company cannot enter into an employment contract with a director for a term of more than five years without the shareholders consent by such resolution.

Finally, section 232, a disclosure provision, requires that the company disclose, in the notes to the accounts, payments and other benefits given to directors. In the U.K., shareholders can attempt to challenge executive remuneration as constituting “unfair prejudicial conduct” under section 459 of the Companies Act. Although the phrase “unfair prejudicial conduct”

whether the amount [of directors’ remuneration] is too large or too small: the directors of the company know a great deal [more] about these matters than [a judge] can possibly do); In Re Saul D. Harrison & Sons, [1994] B.C.C. 475 (C.A.) (holding that the directors did not violate their fiduciary powers despite the fact that the petitioner alleged that the directors had kept the struggling company going for the sole purpose of paying themselves compensation).

232. Companies Act, 1985, c. 6, § 311.
233. Cheffins & Thomas, supra note 3, at 287.
234. Companies Act, 1985, c. 6, § 312.
235. Id. §§ 312–14.
236. Id. § 232. In 2002, the U.K. government made it mandatory that shareholders give an advisorial vote at the AGM on remuneration packages and policies. See infra Part VI.
237. Companies Act, 1985, c. 6, § 459. See also In Re Saul D. Harrison & Sons, [1994] B.C.C. 475 (C.A.), (petitioner arguing that directors engaged in “unfair prejudicial conduct,” violating section 459, when they paid themselves excessive salaries despite the fact that the business was operating at a loss).
is not defined in the statute, “various meanings have been attributed to it including from ‘oppression,’ ‘discrimination,’ or ‘incompetence.’”

Another place shareholders can look to for rights is the U.K. Listing Authority Listing Rules. The Listing Rules give shareholders in a listed company the right to approve executive share option schemes and LTIPs.

Although some commentators have debated about the shareholders’ role in setting compensation in the first instance, the next section of this Note focuses on how shareholders can challenge compensation after it has been set.

V. CHALLENGING EXECUTIVE COMPENSATION

There are three basic methods by which a shareholder can challenge executive compensation: suing, selling, and voting.

As previously mentioned, suing is not usually a viable option for shareholders in either the U.S. or the U.K. because courts apply a “hands off” approach when it comes to compensation issues, preferring to leave such decisions to the corporation. In addition, at least in the U.S., the procedural and economic hurdles to bringing a derivative suit for excessive compensation are immense. Of course, shareholders can always sell their shares or refuse to invest in companies that they feel overpay

239. Financial Services Authority, Listing Rules, supra note 49, at para. 13.13. For long term incentive plans, see para. 13.13A, defining “long-term incentive scheme.” A listed company that does not obtain shareholder approval in accordance with these Rules can be censured or delisted. See also Cheffins & Thomas, supra note 3, at 287.
240. Viewing Corporate Executive Compensation Through a Partnership Lens, supra note 175, at 187–201.
242. Cheffins & Thomas, supra note 3, at 300 (“In the U.K., this course of action has only rarely been pursued.”).
244. “Historically, shareholders unhappy with the management of a company simply ‘vote[d] with their feet’ by selling their shares.” Viewing Corporate Executive Compensation Through a Partnership Lens, supra note 175, at 187–88.
their executives. However, selling does not necessarily guarantee a change in remuneration policy. This Note focuses on challenging executive compensation through shareholder voting.

A. Challenges by Proposal

There are three main avenues by which shareholders may choose to challenge pay practices by proposal: (1) proposals that restrict or cap executive pay; (2) proposals that would alter corporate compensation policy so that shareholder approval of pay is required; and (3) proposals that would restrict repricing of stock options without first securing shareholder approval.

In the U.S., SEC Rule 14a-8 (federal proxy rules) gives shareholders the option of putting forth a proposal to be voted on at the annual meeting. Such proposals are not self-executing, but rather serve as mere recommendations to the board. However, if the proposal consists of an amendment to the corporation’s bylaws, it can become part of the governance structure of the corporation. While this may sound like an idyllic solution for a concerned shareholder, “[b]ylaw amendments, especially those dealing with pay issues, are a relatively rare phenomenon.” In 1998 the SEC recognized this problem and suggested that “shareholders could use Rule 14a-8 to propose bylaw amendments related to pay practices.” To be eligible to submit a proposal, a shareholder “must have continuously held at least $2,000 in market value, or 1% of the company’s securities entitled to be voted on the proposal at the meeting for at

245. See Loewenstein, supra note 103, at 25–26 (noting that “[i]f one believes that excessive pay is pervasive in corporate America, then exiting one company would logically mean exiting the market.”).
246. Id. at 26–27.
least one year by the date you submit the proposal.\textsuperscript{251} Each shareholder may submit only one proposal per meeting\textsuperscript{252} and the burden is “on the company to demonstrate that it is entitled to exclude the proposal.\textsuperscript{253}

Another limitation on shareholder proposals is that there is a deadline by which the proposal must be sent to the corporation. Pursuant to Rule 14a-8, if the proposal is to be included in the proxy materials for the annual meeting, it must be “received at the company’s principal executive offices not less than 120 calendar days before the date of the company’s proxy statement released to shareholders in connection with the previous year’s annual meeting.”\textsuperscript{254} For proposals that are submitted for special meetings (any meeting other than the annual meeting), the materials must be received by the corporation “a reasonable time before the company begins to print and mail its proxy materials.”\textsuperscript{255}

When a corporation disagrees with a shareholder proposal and wishes to exclude the proposal, it will usually advise the SEC and attempt to justify its position.\textsuperscript{256} If the SEC agrees with the justification, it will issue a “no-action” letter, advising the shareholder not to pursue the proposal further.\textsuperscript{257}

Regardless of whether shareholder proposals relating to executive pay take the form of non-binding recommendations or bylaw amendments, historically such “shareholder proposals in

\textsuperscript{251} 17 C.F.R. § 240.14a-8(b)(1) (1998). The shareholder must hold the securities through the date of the meeting.
\textsuperscript{253} 17 C.F.R. § 240.14a-8(g) (1998). However, many corporations regularly exclude proposals based on the grounds that the proposal is within the ordinary business operations of the company. See 17 C.F.R. § 240.14a-8(i)(7) (1998).
\textsuperscript{254} 17 C.F.R. § 240.14a-8(e)(2) (1998).
\textsuperscript{255} 17 C.F.R. § 240.14a-8(e)(3) (1998).
\textsuperscript{256} 17 C.F.R. § 240.14-8(g) (1998) (“The burden is on the company to demonstrate that it is entitled to exclude a proposal.”). See also 17 C.F.R. § 240.14-8(j)(1)-(2) (1998).
\textsuperscript{257} While shareholders who receive such letters may not submit their proposals to a shareholder vote, they may still pursue the matter in court. See generally Donna M. Nagy, Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework, 83 CORNELL L. REV. 921, 923–46 (1998).
this area generally have not fared well.\textsuperscript{258} Indeed, “[i]t is true that shareholder proposals on executive compensation issues frequently do not succeed.”\textsuperscript{259} In 1998, the Investor Responsibility Research Center conducted a study which calculated the percentage of votes for shareholder proposals regarding remuneration.\textsuperscript{260} The 1998 survey results demonstrated that, not only had voting decreased on shareholder proposals to limit compensation, but that the number of proposals had also decreased.\textsuperscript{261} Moreover, the study concluded that “[s]hareholder support for executive compensation proposals is not as high as with most other types of shareholder proposals.”\textsuperscript{262} Encouragingly, in 2002 there were “275 shareholder proposals to rein in executive pay” — a record number.\textsuperscript{263} Only two of the proposals, however, received majority votes, and regardless, “management is free to ignore those mostly nonbinding resolutions and routinely does.”\textsuperscript{264}

Similar to Rule 14a-8, section 376 of the Companies Act of 1985 allows shareholders to submit proposals to be voted on at the AGM. Unlike Rule 14a-8, however, shareholders submitting proposals in the U.K. have more freedom regarding the substance of the proposal, mainly because the Companies Act takes a hands-off approach to the matter.\textsuperscript{265}

There are some obstacles for shareholders wishing to utilize section 376. First, unlike Rule 14a-8 of the U.S. federal proxy rules, which allows proposals at both annual and special meetings of shareholders, section 376 limits shareholder proposals to annual meetings.\textsuperscript{266} Despite a more flexible approach to the sub-

\begin{itemize}
\item \textsuperscript{258} Loewenstein, supra note 103, at 26.
\item \textsuperscript{259} Viewing Corporate Executive Compensation Through a Partnership Lens, supra note 175, at 195.
\item \textsuperscript{260} See INVESTOR RESPONSIBILITY RESEARCH CENTER, SUMMARY OF 1998 U.S. SHAREHOLDER RESOLUTIONS 2 (Feb. 3, 1999).
\item \textsuperscript{261} See id.
\item \textsuperscript{262} Id. It is possible that as a result of the Enron debacle and consequent corporate governance reforms (and increased shareholder activism), shareholder proposals in this area could become more widespread.
\item \textsuperscript{263} Useem, supra note 9, at 64.
\item \textsuperscript{264} Id. (Hewlett-Packard and Tyco were the only two companies where shareholder proposals regarding executive pay received a majority of votes).
\item \textsuperscript{265} There is no exception in the Companies Act for “ordinary business operations” as in Rule 14a-8. See Companies Act, 1985, c. 6, §§ 376–81.
\item \textsuperscript{266} Id. § 376.
\end{itemize}
Challenging Executive Compensation

267. Id. § 377.
268. Id.
269. Id. § 377(1)(b).
270. Id. § 376(2).
271. See, e.g., Tony Tassell, Investors Push For Cap on Executive Pay-offs: Pension Funds Move to Stem Rising Compensation Tide, NAT. POST, Apr. 18, 2002, at FP16 (“Leading investor groups are holding talks about stemming the rising tide of pay-offs for sacked executives.”).
273. In New York, shareholders used to get a vote on such plans under New York Business and Corporations Law, § 505(d). However, this section was changed, and shareholders of New York corporations no longer have this right. Under New York, if the stock exchange rules require voting, then New York will also. See N.Y. BUS. CORP. LAW § 505(d) (McKinney 2003).
274. See REV. MODEL BUS. CORP. ACT § 624(a) (2003).
rations approach in not allowing shareholder votes regarding stock options. This is unfortunate since, as noted above, share options constitute a substantial percentage of an executive’s pay in the U.S. and therefore a vote on stock options could increase shareholder involvement in setting executive pay. In addition, corporations can benefit from tax deductions if they put executive compensation plans to a shareholder vote.

The NYSE, the NASDAQ Stock Market, and the American Stock Exchange all have listing rules that require shareholder votes on option plans, with certain exceptions. However, “the New York Stock Exchange and NASDAQ are contemplating changing their listing rules to address a loophole which allows companies to bypass the shareholder approval process where plans include a substantial number of employee participants as well as corporate executives.” In addition, as discussed in Part VI (Recent Developments) infra, the NYSE has just proposed a new rule which would require that shareholders approve equity-compensation plans within twelve months for adoption by the board of directors, as per the Internal Revenue Code.

In both the U.S. and the U.K. executive compensation may potentially be challenged based on breach of fiduciary duties.

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277. A provision of the Internal Revenue Code (“IRC”) provides that a corporation that pays an executive more than $1 million annually, may receive a tax deduction, but only if the amount was paid pursuant to a “performance-based plan.” See 26 U.S.C. § 162(m)(4)(C) (1998). According the IRC, a plan is only considered “performance-based” if it is ratified by shareholders.
279. Cheffins & Thomas, supra note 3, at 300.
280. See infra Part VI.
281. There is some evidence to conclude that shareholder derivative suits challenging breach of fiduciary duties are more successful in the U.S. and
In derivative litigation in the U.S., the board will typically have the burden of proving the fairness of the compensation award if it is a self-interested transaction, and might therefore have incentive, from a litigation perspective, to allow a shareholder vote on share option plans.

C. Challenges at the Annual Meeting

It has been suggested that shareholders should have a right to a non-binding, advisory vote at the annual meeting on executive compensation matters. Some argue that there is support for the fact that management will pay attention to shareholder votes on remuneration issues at the annual meeting, the U.K., recently amended the Companies Act to grant shareholders this right.

Aside from voting directly on compensation, shareholders can exercise other voting rights. For example, shareholders of publicly listed companies in both the U.S. and the U.K. are given the right to elect directors. Thus, such shareholders may vote not to re-elect directors on the remuneration committees whom they feel either pay excessive compensation or promulgate compensation policies that are too flexible. In the U.K., the National Association of Pension Funds (“NAPF”) did just this. In 2001, the NAPF (whose members own almost 25% of the UK stock market), reacting to excessive pay given to the Royal Bank of Scotland’s executives, “urged shareholders to register a protest in this fashion.” In the U.S., the SEC has recently proposed that shareholders have greater power to nominate and therefore serve as a better check on excessive executive remuneration. See Cheffins & Thomas, supra note 3, at 300–01.

283. See Loewenstein, supra note 103, at 28; see also Thomas & Martin, The Effect of Shareholder Proposals supra note 180, at 1046–48.
284. Id.
285. See infra Part VI.
286. See Douglas M. Branson, supra note 24, §1.01, at 1–2 (1993) (“Most central to shareholders’ role then is their power to elect directors, and statutes typically refer to that shareholder power expressly.”); Charkham, supra note 22, at 182; Companies Act, 1985, c. 6, § 303.
287. Viewing Corporate Executive Compensation Through a Partnership Lens, supra note 176, at 191.
288. Cheffins & Thomas, supra note 3, at 289.
289. Id.
appoint directors. At the annual meeting, U.K. shareholders are given a vote on the company’s accounts. Shareholders that choose to vote against the accounts are making a statement — that they object to the corporation’s pay policies.

Unfortunately, neither voting against the re-election of directors nor voting against the company accounts are all that meaningful. For one, questionable directors may not be up for vote at the time the shareholder votes. Also, many shareholders will choose not to vote against a remuneration committee director if that shareholder feels that the director provides useful skills for other aspects of running the corporation. Moreover, there is a strong argument that many shareholders do not even vote — that “shareholders are apathetic and often fail to open their proxy materials, much less take the time to complete a proxy card and mail it back to the company.”

Indeed, the most recent figures from a study conducted by Pensions Investment Research Consultants suggest that voting turnout, while showing an improvement during 2001-2002, did not improve during 2002-2003.

VI. RECENT LEGAL DEVELOPMENTS

There have been recent developments in both the U.S. and the U.K. regarding shareholder voting on executive pay. At the

292. This is because directors must prepare a remuneration report as part of the company’s accounts. Id. § 3.
293. Viewing Corporate Executive Compensation Through a Partnership Lens, supra note 176, at 200.
294. See Loewenstein, supra note 103, at 27.
295. See Press Release, PIRC, Growing Voting Opposition at UK Listed Companies (Oct. 9, 2002) (finding that average voting levels for FTSE 350 companies rose from 51% to 55% and for FTSE All Share companies there was a rise from 50% to 53%). The study also found that “[d]irectors’ pay remains important but is not the main issue which has attracted dissenting votes during the year.” Id. Remuneration issues such as excessive share schemes and remuneration policies attracted an increasing number of dissenting votes. Id.
end of 2002, the U.K. Parliament implemented a new voting policy for shareholders at the AGM and the NYSE just amended its listing rules to give shareholders a right to vote on equity compensation plans—both of which should have positive effects for shareholder voting rights. In addition, the SEC has weighed in with proposals related to important issues in this area. The U.K. Parliament passed an amendment to the U.K. Companies Act, which went into effect on August 1, 2002. The new amendment requires that shareholders vote at the AGM on the directors’ remuneration report. Schedule 7A of the new regulations provides that the directors’ remuneration report must contain several disclosures to the voting shareholders.

Pursuant to Part 2 of Schedule 7A, the report must contain information regarding four areas of compensation. First, the report must disclose “the circumstances surrounding the consideration by the directors of matters pertaining to directors’ remuneration.” Second, the report must contain “a statement of the company’s policy on directors’ remuneration for the following financial year.” Third, the report must contain a performance graph “which sets out the total shareholder return of the company on the class of equity share capital, if any, which caused the company to fall within the definition of ‘quoted company.’” Lastly, the report must include certain information regarding each director’s service contract. Part 3 of Schedule 7A sets out other areas of compensation which must be disclosed in the remuneration report, including share options, long

298. See NYSE LISTED COMPANY MANUAL, supra note 278, § 303A; Viewing Corporate Executive Compensation Through a Partnership Lens, supra note 176, at 188–91.
300. See id. § 7. The new shareholder voting requirement has been inserted as § 241A of the Companies Act.
301. Schedule 7A is now inserted after the already existing Schedule 7 of the Companies Act. Id. § 9.
302. Id. at sched. 7A.
303. See id. at “Explanatory Note.”
304. Id.
305. Id.
306. Id.
term incentive plans, pensions, and compensation and excess retirement benefits of each director.\textsuperscript{307}

Although much of this disclosure is already required by the SEC in the U.S.,\textsuperscript{308} the mandatory shareholder vote at the AGM is not required in the U.S.\textsuperscript{309} Despite the fact that the new U.K. shareholder vote is only advisory, it seems as though, at the very least, shareholders now have an opportunity to voice their opinion. In fact, the new legislation basically codifies the suggestions from the voluntary codes.\textsuperscript{310} Indeed, the new voting amendment, albeit merely advisory, is preferable to the former voluntary scheme. Under the voluntary scheme, whereby companies had the option of putting the remuneration packages up for shareholder vote, few companies allowed such votes.\textsuperscript{311}

However, the U.S. is not standing idly by with regard to excessive executive compensation. On June 30, 2003, the SEC approved a proposal by the NYSE which requires that shareholders approve executive equity-compensation plans.\textsuperscript{312} The text of the new rule, codified in Section 303A(8) of the Exchange's Listed Company Manual, reads as follows: “Shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exceptions.”\textsuperscript{313} The Exchange commented that such equity-compensation plans (which would include plans under which directors pay less than fair market value for shares and which are not available to shareholders generally), “can help align shareholder and management interests.”\textsuperscript{314} In addition, the Ex-

\textsuperscript{307} Id.
\textsuperscript{310} See discussion supra Part II.C.
\textsuperscript{312} See NYSE LISTED COMPANY MANUAL, supra note 278, § 303A.
\textsuperscript{313} Id. § 303A.08 (Shareholder Approval of Equity Compensation Plans). The new rule is also referenced in § 312.03(a) of the Exchange's Listing Rules (Shareholder Approval). “Equity-compensation plan” is defined broadly to include a “compensatory grant of options or other equity securities that is not made under a plan.” Id.
\textsuperscript{314} Id.
change noted that part of the purpose of this stockholder approval was “to provide checks and balances on the potential dilution resulting from the process of earmarking shares to be used for equity-based awards.” The commentary also mentions that there are exceptions to the voting requirement — some plans are exempt from the requirement of shareholder approval. For example, employment inducement awards are not subject to such a vote in the context of mergers and acquisitions. The NYSE’s most recent corporate governance standards, as set forth in the Exchange’s Listing Company Manual, Section 303A, and approved by the SEC on November 4, 2003, also require that listed companies have a compensation committee composed entirely of independent directors. In addition, the compensation committee “must have a written charter that addresses the committee’s purpose and responsibilities...to review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO’s performance in light of those goals and objectives and...determine and approve the CEO’s compensation level based on this evaluation.” The compensation committee must also have a written charter that addresses “an annual performance evaluation of the compensation committee.”

VII. LOOKING AHEAD — A FOCUS ON SHAREHOLDER RESPONSIBILITIES

Unfortunately, “[e]nthusiasts for corporate governance do not spend much time discussing the shareholders’ responsibilities, preferring to concentrate on shareholders’ rights instead.” Perhaps a paradigm shift is necessary to avoid the almost ironic inevitability of investors who are passive regarding corporate governance, but then become irate when executives pillage the very companies the investors own, in which they have little in-

315. Id. It is important to note here that “material revisions” to such plans (i.e., a material increase in the number of shares available under the plan) are also subject to shareholder vote under this new rule. Id.
316. Id.
317. Id.
318. See NYSE LISTED COMPANY MANUAL, supra note 278, § 303A.05(a).
319. Id. § 303A.05(b)(i)(A).
320. Id. § 303A.05(b)(ii).
volvement. One author has noted that “[s]omewhere along the line, managers – who are, after all, just hired hands — started behaving as if they owned the place. And the real owners — mostly mutual funds and pensions — starting behaving as if they didn’t.”

This same author, somewhat cryptically began an article critiquing CEO pay with a quotation from George Orwell’s novel “Animal Farm”: “But the pigs were so clever that they could think of a way round every difficulty.”

Is this then, the destiny of the regulations regarding executive greed — to be one-step behind clever corporations and over-paid executives at all times? As per the “Law of Unintended Compensation,” “any attempt to reduce compensation has the perverse result of increasing it.” Indeed, one need look no further than the scandal involving Richard Grasso to see that regulations cannot be the sole impetus to curtail excessive executive pay.

While the NYSE was in the process of proposing new amendments to its Listing Manual, which have since become the amended voting rules on equity compensation plans, the NYSE was paying Grasso amounts which made some Wall Street CEOs blush.

Perhaps, the answer is not through regulation, as discussed previously, but activism from below. In 2002, the CEO of Cendant Corp., a corporation which has been “revamping its corporate governance since its 1998 accounting scandal” to include such provisions as shareholder approval of executive stock options, stated: “I think the real impetus [for reform] will not be the NYSE, the President, or Congress — it will be the reality of

322. Useem, supra note 9, at 57, 64.
323. Id. at 57.
324. Useem also notes in his article: “Regulation is a spur to innovation, and in the pay arena innovation always means “more.” Id. at 59.
325. Id. at 59. (Citing examples from 1989, 1992, and 1993, wherein Congress attempted to place hurdles in the way of rising executive compensation only to have the perverse effect of compensation skyrocketing as a result).
326. See Thomas, Big Board Chief Will Get a $140 Million Package, supra note 145, at C1; Thomas, A Pay Package That Fat Cats Call Excessive, supra note 145, at C1; Craig & Kelly, supra note 145, at C1; Kelly & Craig, supra note 148, at C1.
327. See Thomas, Big Board Chief Will Get a $140 Million Package, supra note 145, at C1; Thomas, A Pay Package That Fat Cats Call Excessive, supra note 145, at C1; Craig & Kelly, supra note 145, at C1; Kelly & Craig, supra note 148, at C1.
the marketplace.”

Shifting the focus from government regulation to shareholders, “the ostensible owners of companies,” to play a larger role in setting executive pay would “play to capitalism’s strength — its flexibility.” The SEC has taken just this stance by passing a new disclosure-oriented rule, which will take effect in the summer of 2004, requiring mutual funds to disclose the way they vote their shares. Until recently, only a handful of mutual funds have disclosed how they voted proxies. In the U.K., mutual funds are not obligated to reveal how they vote. Part of the problem with mutual funds and other institutional investors may stem from conflicts of interest — “banks, insurance companies and mutual funds all want a company’s banking, insurance or pensions business, so they will hesitate to cast the proxy votes of their investment arms against the management.” Indeed, “some company directors are known to meet the institutional shareholders privately to make presentations or discuss with them the future of the company.”

When this scenario occurs, institutional investors are not flexing their “financial muscles” on behalf of those they have a fiduciary duty to represent. CalPERS, one of America’s largest investment funds, is a role model for other institutional investors.

328. Lavelle, supra note 2, at 112.
330. See SEC Proposed Rule: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 17 C.F.R. Parts 239, 249, and 274 (One of the goals of this proposed rule is “increased transparency” to “enable fund shareholders to monitor their funds’ involvement in the governance activities of portfolio companies, which could have a dramatic impact on shareholder value.”). See also Useem, supra note 9, at 64.
331. See John Wasik, Speak Loudly — Or Lose Your Big Stick, FIN. TIMES, July 24, 2002, at 26 (only eight retail mutual fund groups openly disclose how they vote on proxies).
332. Polly Toynbee, Starve the Fat Cats, GUARDIAN, May 16, 2003, available at http://www.guardian.co.uk/comment/story/0,3604,957194,00.html (urging that a change in the law which does not require disclosure of mutual fund voting in the U.K. is necessary).
333. Id.
335. Id.
336. Craig & Kelly, Large Investors Call for Grasso to Leave NYSE, supra note 145, at C1, C3.
fronting companies whose governance it questions,” such as Walt Disney Co., eBay Inc., Time Warner, and most recently, the NYSE.\footnote{337}

In addition, private shareholders are often uninterested in exercising their ownership privileges, such as voting, because they merely “want a financial product.”\footnote{338} But what worth does a \textit{right} have when it remains unexercised? For example, the U.K. Parliament passed an amendment to the U.K. Companies Act, which went into effect on August 1, 2002, requiring that shareholders vote at the AGM on the directors’ remuneration report.\footnote{339} Yet, in just over one year since its inception, institutional shareholders have only voted against one existing pay package — at GlaxoSmithKline.\footnote{340} At the very least, shareholders should take advantage of their right to vote in order to embarrass executives. Indeed, in the U.S., embarrassed executives have returned at least a portion of their astronomical pay. For example, in 2002, the CEO of E*Trade Group, Inc., Christos M. Cotsakos “returned $21 million in pay after shareholder anger over his $80 million pay package boiled over.”\footnote{341} In July 2002, the CEO of Dollar General Corp., Cal Turner, Jr., returned $6.8 million which “he received as the result of financial results that were later restated.”\footnote{342} A spokesperson for the board of the NYSE recently stated that it plans to recommend that federal and state regulators pursue legal action against Richard

\footnote{337}{Id.}
\footnote{338}{Toynbee, supra note 332.}
\footnote{339}{See generally Directors’ Remuneration Report Regulations, (2002) SI 2002/1986. The shareholder voting requirement has been inserted as § 241A of the Companies Act. Id. § 7.}
\footnote{340}{Where’s the Stick?, supra note 109. Shareholders voted down a financial package that would have given chief executive Jean-Pierre Garnier £22 million for leaving the company before his contract had expired, despite a significant fall in the company’s share price. See DTI Consults Over Compensation for Termination of Directors’ Contracts, COMPANY L. 24(9), 271–72 (2003). For more information, see also Glaxo Bows to Pressure over Executive Pay, GUARDIAN, Dec. 15, 2003, available at (discussing the revised pay policy put forth by Glaxo seven months after its pay package was voted down at the AGM).}
\footnote{342}{Lavelle, \textit{supra} note 2, at 108–09.}
Grasso, the former chairman of the NYSE, unless he agrees to return a substantial portion of his pay.\textsuperscript{343}

The SEC also recently proposed “an increase in the power of shareholders to nominate and appoint directors.”\textsuperscript{344} In effect, this would allow shareholders to break through the “pay-for-attendance” model of corporate leadership and put a stop to the “you-scratch-my-back-I’ll-scratch-yours” phenomenon of executive remuneration.\textsuperscript{345} Such a proposal would be especially important in the U.K. where the reality is that “the non-executive directors in an audit committee are appointed by the executive directors who fix their salary.”\textsuperscript{\textsuperscript{346}} In addition, it is a model for the U.K. in the sense that the proposal shows a burden shift, albeit a small one, towards placing the responsibility for controlling corporate governance in the hands of the shareholder-owners.\textsuperscript{347} The U.K. government has not yet focused on the shareholder’s responsibility. For example, in its 1999 Consultative Document, the U.K. Department of Trade and Industry looked principally at the activities of U.K. companies, their remuneration committees, and their accountability to shareholders.\textsuperscript{348} Moreover, despite the 2002 Amendment to the Companies Law, which gave shareholders the right to vote at the AGM on executive pay packages, GlaxoSmithKline is the sole example of shareholders taking advantage of the new amendment.\textsuperscript{\textsuperscript{349}}

\textsuperscript{343} Landon Thomas, Jr., Exchange Said to Want Move on Grasso Pay, N.Y. TIMES, Jan. 8, 2004, at C1 (“John S. Reed, the interim chairman of the stock exchange, has said that he expects Mr. Grasso to return as much as $150 million of his compensation.”).

\textsuperscript{344} SEC Proposal Rule, \textit{supra} note 244. \textit{See also Where’s the Stick?}, \textit{supra} note 109.

\textsuperscript{345} Hemraj, \textit{supra} note 334, at 345–46. \textit{See also Fat Cats Feeding}, \textit{supra} note 10, at 66 (“The ‘you scratch my back, I’ll scratch yours’ atmosphere of company boardrooms has been recognized for decades.”).

\textsuperscript{346} \textit{Id.} \textit{See also} Press Release, Boards Dominated By Executives And Connected Directors, \textit{supra} note 219. (“Over 75% of UK company boards are dominated by executives and non-executives who are not independent, according to PIRC’s Annual Review of Corporate Governance published today.”).

\textsuperscript{347} \textit{See, e.g.}, Toynbee, \textit{supra} note 332.

\textsuperscript{348} \textit{See DTI CONSULTATIVE DOCUMENT, DIRECTORS’ REMUNERATION} (July 1999), \textit{supra} note 90.

\textsuperscript{349} Heather Timmons, \textit{Glaxo Shareholders Revolt Against Pay Plan for Chief}, N.Y. TIMES, May 20, 2003, at W1 (noting that the pay package was voted against “by a slim margin of 50.72 percent to 49.28 percent”). Two large institutional investors who voted against the proposal included Isis Asset
Increased regulation regarding exorbitant pay is only the first step toward curbing it. The next step is to place responsibility in the laps of shareholders to be instrumental in ensuring that such regulations succeed. Thus some of the focus of the U.S. and the U.K. should be shifted toward the responsibility of the shareholder.

In the end, it is evident that “a combination of a bear market, some muted shareholder activism, and negative media commentary difficult to dismiss as mere Schadenfreude, [are necessary] to effect change at the top.” Then, in a bull market, will executive compensation be a moot issue? There is a strong argument that in times of financial stability, apathy toward excessive compensation will increase. Some commentators are hopeful that change is afoot and that the balance in power between executives and investors is changing. For instance, Carol Bowie, director of governance research services at the Investor Responsibility Research Center in Washington was optimistic due to the success of recent shareholder lawsuits: “The shareholder-management relationship is going through a sea change, with shareholders asserting their prerogative as owners of the company. We went through a long period where shareholders didn’t interfere with management. These lawsuits are not just to recoup money anymore — they involve forcing companies to change their practices.”

At least one thing is clear, however, “[i]ncome inequality in society has damaging effects. It reduces overall levels of well-being, creates a well-spring of resentment and helps trigger antisocial behaviors and outcomes.” In addition, a large pay differential between executives and lower-level employees is “bad for the long-term performance of a company because it breaches the trust between top management and the people who work for

Management, which manages £58.8 billion in assets ($95.4 billion) and California Public Employees’ Retirement System (known as CalPERS), one of the world’s largest investors. Id.

350. Isles, supra note 128.
351. See generally Gibeaut, supra note 200; Morgensen, Shareholders Win in Effort to Alter Pay, supra note 200, at C1, C10.
352. Morgensen, Shareholders Win in Effort to Alter Pay, supra note 200, at C10.
353. Isles, supra note 128.
them.’”\textsuperscript{354} If “[o]rganizations are microcosms of wider society”\textsuperscript{355} it will be necessary to continue compensation reforms even in a bull market and during times of increased profitability. Another thing is also clear – increased regulations are the first step in equalizing the playing field. The next step is for shareholders to exercise their ownership status and get in the game.

In both the U.S. and the U.K. it seems as though there is an obvious inconsistency between “the outrage expressed in the popular press and the lack of shareholder voice.”\textsuperscript{356} This can be attributed to shareholder apathy or a penchant for simply selling one’s shares instead of fighting to substantiate change. In addition, it is possible that the “free market system” for executives just does not work all that well.\textsuperscript{357} Most people are familiar with the age-old saying: “to the victor, go the spoils.”\textsuperscript{358} By applying this tenet to the present day pay controversies, it is possible to reach the conclusion that perhaps, performance aside, executives have \textit{earned} a right to substantial compensation by the nature of simply \textit{getting to be an executive}. Perhaps this way of thinking has remained ingrained in our corporate governance models — though recent developments show a shift away from such shareholder apathy. Clearly, the governments and regulating agencies in the U.S. and the U.K. are making strides toward fixing the problem of astronomical executive pay.

\textsuperscript{354} Morgensen, Explaining (or Not) Why the Boss is Paid So Much, supra note 108, at section 3, at 1.
\textsuperscript{355} Isles, supra note 128.
\textsuperscript{356} Loewenstein, supra note 103, at 28.
\textsuperscript{357} See generally Bosses for Sale, supra note 121, at 57 (noting that the market for executives is secretive, restricted, bad at price-settings and generally run by the head hunter firms).
\textsuperscript{358} Bartlett’s Quotations attributes this quote to William L. Marcy (1786-1857) during a speech in the United States Senate in January, 1832 (“They see nothing wrong in the rule that to the victors belong the spoils of the enemy.”). See John Bartlett, Bartlett’s Familiar Quotations 419 (17th ed., Justin Kaplan ed. 2002).
Yet, until shareholders speak with one, loud, unified voice, pay will continue to spiral upward, despite increased government regulation. Institutional investors, generally the largest and most powerful owners of corporations in the U.S. and the U.K., have begun to flex their muscles and demand that executives perform in accordance with how they are paid. However, at least for now, it is still good to be the king.

Jaclyn Braunstein*

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LICENSING INTELLECTUAL PROPERTY: COMPETITION AND DEFINITIONS OF ABUSE OF A DOMINANT POSITION IN THE UNITED STATES AND EUROPEAN UNION

I. INTRODUCTION

At the crux of antitrust policy is the effort to ensure that companies do not maintain a monopoly over their respective markets by unacceptable means. However, where intellectual property rights are at odds with competition law, the European Commission (“Commission”) favors maintaining access to European Union (“EU”) markets over protecting the intellectual property rights that may block market access. Notwithstanding the fact that a company endowed with a particularly effective intellectual property right may make entry into a market difficult for competitors, it seems intuitively wrong to include legitimate means — especially regarding the use of a valid intellectual property right — under the umbrella of abusive behavior. In fact, to a great extent, an intellectual property right that results in market dominance is only performing its

1. Markets are variously defined, and the definition chosen has enormous implications when examining the use of an intellectual property right in relation to competition law in the European Union.
3. The European Commission is the executive body of the European Union. It “embodies and upholds the general interest of the Union,” through initiating draft legislation and along with the European Court of Justice, enforces Treaty and Community law while ensuring its proper application. See EUROPA, GATEWAY TO THE EUROPEAN UNION, at http://www.europa.eu.int/institutions/index_en.htm (last visited Feb. 10, 2004).
4. The EU was created under the Treaty of Rome in 1957 and includes the United Kingdom, Greece, Sweden, Denmark, Austria, Finland, Republic of Ireland, Spain, Portugal, France, Germany, Italy, Belgium, Luxembourg, and the Netherlands. New Member states include the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia, and Slovakia. See EUROPA, GATEWAY TO THE EUROPEAN UNION, at http://europa.eu.int/abc/index_en.htm (last visited Feb. 10, 2004). See also Terence Prime, EUROPEAN INTELLECTUAL PROPERTY LAW 5 (2000).
job. To consider it abusive when a dominant company refrains from licensing intellectual property to competitors is to undermine the foundation of the intellectual property right, which is in itself the right to exclusivity. Moreover, to undermine the property right via forced licensing is to obliterate that right, for what is an intellectual property right if not an assurance of exclusivity? Essentially, the intellectual property right is a mechanism for eliminating competition regarding a specific good or service. Therefore, at the outset, intellectual property law appears to conflict with competition law.

II. FOUNDATIONS OF INTELLECTUAL PROPERTY PROTECTION

At the most fundamental level, intellectual property rights are designed to reward the author or innovator with the fruits of his or her labor — a notion which derives from the Lockean concept of a person’s ownership over his or her labor. In a sense, the author of intellectual property is provided the legal

5. Paul D. Marquardt & Mark Leddy, Articles and Responses: The Essential Facilities Doctrine and Intellectual Property Rights: A Response to Pitofsky, Patterson, and Hooks, 70 ANTITRUST L.J. 847, 848 (2003). The authors note:

In particular, intellectual property rights acquired through productive investment in research and development are not forfeited simply because they may result in a decisive competitive advantage for the innovative product. The fundamental (and procompetitive) rationale for intellectual property protection is to foster innovation whether or not it creates a market advantage — or even market power — for the lawful duration of the right.


6. James B. Kobak Jr., Antitrust Treatment of Refusals to License Intellectual Property: Unilateral Refusal to License Intellectual Property and the Antitrust Laws, 566 PLI/PAT 517, 616–20 (2001) [hereinafter Kobak, Antitrust Treatment of Refusals] (citing Continental Paper Bag Co. v. Eastern Paper Bag Co., 210 U.S. 405, 429 (1908) holding that, in reference to patents, that the exclusive use of the patent “may be said to have been of the very essence of the right conferred by the patent, as it is the privilege of any owner of property to use or not use it, without question of motive”).

7. GUY TRITTON, INTELLECTUAL PROPERTY IN EUROPE 565 (2d ed. 2002).

8. Id.

right to exclude others from reaping the benefits from his work in exchange for giving the public access to the work in the first instance. The incentive to disclose a created work obviously benefits the public and encourages other members of society to learn and build on the ideas of others. The modern policy elements behind intellectual property rights specifically consider that those who invest time and resources into the development of a new technology, system or device should be rewarded with the exclusive right to profit from their investment. Without the right to exclusivity, there would be no incentive to continue expending these resources because the return on the investment would be minimal. Furthermore, without the exclusive opportunity to “exploit the invention” via intellectual property rights, there would be no mechanism through which the owner of the intellectual property right could guard against free riders taking advantage of the innovator’s research and development. In the United States (“U.S.”), the aim of the Copyright Act is to “encourage the investment in the creation of desirable artistic and functional works of expression.”

Intellectual property owners will often readily license their works due to the tremendous expense attributed to manufacturing, marketing and distributing a product on the market. Through licensing, the innovator without the means to independently profit from the protected innovation can reap finan-

10. Id.
11. Id.
12. Tritton, supra note 7, at 565. See also Marquardt & Leddy, supra note 5, at 856. In particular Marquardt & Leddy state that:

If innovation did not carry the promise of potential economic return, there would of course be much less of it. For this reason alone, the essential facilities doctrine is, in Professor Areeda’s words, ‘an epithet in need of limiting principles.’ It cannot be used to force firms to surrender assets in which they have invested simply because those investments resulted in a significant competitive advantage.

Id.
17. Tritton, supra note 7, at 563.
cial benefits. Thus, licensing is also an incentive to innovate.\textsuperscript{18} The motivation behind the decision to license, therefore, is to achieve optimal financial gains from the good or service.\textsuperscript{19} Those who make the decision to abstain from entering into licensing agreements share this motivation, and yet the refusal to deal triggers competition law scrutiny.\textsuperscript{20} In analyzing the licensing of intellectual property rights, it is important to understand the effect that an intellectual property right has upon competition in a market.\textsuperscript{21} This effect is the focus of the inquiry.\textsuperscript{22}

III. MARKET DEFINITIONS TODAY

The nature of competition has changed in that competition within a given market has been replaced in many spheres by competition for the market.\textsuperscript{23} Although this new state of affairs may appear to warrant more stringent application of antitrust law, it is deceiving. There may be less competition within markets because the composition and definitions of a “market” have changed.\textsuperscript{24} True, certain behemoth companies have emerged from globalization to vie with each other for domination of markets.\textsuperscript{25} However, in many instances, particularly involving new technologies and services, the market itself is new and, perhaps for this reason, the EU tends to define them more narrowly.\textsuperscript{26}

\begin{itemize}
  \item \textsuperscript{18} ANDERMAN, EC COMPETITION LAW, supra note 14, at 6.
  \item \textsuperscript{19} TRITTON, supra note 7, at 563.
  \item \textsuperscript{20} Id.
  \item \textsuperscript{21} Id.
  \item \textsuperscript{22} Id. See also Kobak, Antitrust Treatment of Refusals, supra note 6, at 616 (“Generally, an intellectual property owner with market power is under no obligation to license that property to others. This will generally be true even where a firm has achieved a monopoly position in a market as a result of its ownership of intellectual property.”).
  \item \textsuperscript{23} Steve Anderman, EC Competition Law and Intellectual Property Rights in the New Economy, ANTITRUST BULL., June 22, 2002, at 285 [hereinafter Anderman, New Economy].
  \item \textsuperscript{24} Id. See also Charles T. Compton & Scott A. Sher, Technology Mergers, INT'L FIN. L. REV. 1923, July 1, 2002, available at 2002 WL 14932920.
  \item \textsuperscript{25} Id.
  \item \textsuperscript{26} By narrowly defining the market, the European Union increases the chances that a market participant is dominant because there are fewer players in narrowly defined markets. See Anderman, New Economy, supra note 23, at 4 (explaining that “[o]nce the markets are narrowly defined, a finding of
In defining whether competition has been inhibited or abusive conduct has occurred, the scope of the market must first be defined. In the EU, the Competition Directorate General of the European Commission ("DG Comp") is charged with determining which market is "relevant" in the context of establishing whether a company is dominant in that market. This process involves either determining whether a certain good is interchangeable with others in a given market or applying a "test of sustainability," which determines whether a change in price would result from the absence of other products in the market. The potential result of requiring access to a newly drawn market is two-fold: there is the possibility that participants will free ride, taking advantage of the innovations that savvy competitors have achieved through expensive research and development programs, and there is the possibility that the high volume of participants in the market will make it difficult to achieve the profit margins and growth necessary to sustain market participants without considerable resources.

The speed at which innovation moves forward is to some extent determined by the nature of the market in which it is developed. Along these lines, it is important to strike a balance with respect to the amount of companies that are encouraged to enter the market. This is important to ensure that the money available to support research and development is not spread too thin. Today, an array of new issues come to the fore regarding dominance can be reinforced where intellectual property rights operate as real barriers to entry.

27. Id. at 3. The DG Comp of the European Commission is charged with measuring the dominance exhibited in a particular market under EU law. Id.


29. Id.

30. Id.

31. Id.

32. DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS, COMMITTEE ON COMPETITION POLICY, COMPETITION POLICY AND INTELLECTUAL PROPERTY RIGHTS, available at http://www.oecd.org/dataoecd/34/57/1920398.pdf (last visited Feb. 10, 2004) [hereinafter COMPETITION POLICY] (discussing the fact that "Shumpeter was the first to show that market structure has an effect on the pace of innovation. He went on to say that large monopolistic firms are ideally suited for introducing technology innovations that benefit society.

33. Id.

34. Id.
market definitions: “[a]ntitrust economists and enforcers have long struggled with the policy articulations appropriate to deal with perceived or actual potential competition — particularly in the technology age where products and markets change so quickly, new competitors may spring up overnight and innovation plays such a critical competitive role.”

There are further temporal considerations when considering the effects of too much or too little competition within a market. Along with the broad notion that the U.S. tends to sanctify intellectual property rights used within their statutory framework, it is important to consider that the incentive to innovate, which underlies this approach, is also tied to notions about market participation and its long run effects on competition and innovation.

The previous “short-run” view of competition authorities has been replaced by a longer-run view, which acknowledges that technological progress contributes at least as much to social welfare as does the elimination of allocative inefficiencies from non-competitive prices. There is, therefore, a growing willingness to allow restrictions on competition today in order to promote competition in new products and processes tomorrow.

Just as it is essential to create standards of conduct by which companies can gauge their behavior, it is equally vital that market definitions be clear and consistent. It is also important for markets to not be defined in a way that would facilitate easy

35. Compton & Sher, supra note 24.
36. U.S. DEPARTMENT OF JUSTICE & FEDERAL TRADE COMMISSION, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY (1995), available at http://www.usdoj.gov/atr/public/guidelines/ipguide.htm (last visited Feb 10, 2004). “If a patent or other form of intellectual property does confer market power, that market power does not by itself offend the antitrust laws. As with any other tangible or intangible asset that enables its owner to obtain significant supracompetitive profits, market power (or even a monopoly) that is solely ‘a consequence of a superior product, business acumen, or historic accident’ does not violate the antitrust laws. Nor does such market power impose on the intellectual property owner an obligation to license the use of that property to others.” Id.
37. Willard K. Tom, Background Note, COMPETITION POLICY, supra note 32, at 274.
38. Id.
determinations of abusive behavior.\footnote{Id.} An example of such a situation is where complex products are broken down into component parts.\footnote{Id. at 4. See also Mark D. Powell, \textit{Competition Law and Innovation: The Interface between Competition Law and Intellectual Property}, 708 PLI/PAT 57 (2002) [hereinafter Powell, \textit{Competition Law and Innovation}]. Using IBM as an example, the author explains that “[p]rior to the Commission intervention, IBM supplied an integrated family of products (i.e. printers, storage devices, disk drives, software applications) which could work on its dominant System/370 platform for microcomputers. Arguably each component represented a separate market.” \textit{Id.}} This narrow definition of a market makes it difficult — particularly where component parts are protected by intellectual property rights — to avoid an “abusive” characterization.\footnote{Id.} The U.S. position is that “market power does not by itself offend antitrust law.”\footnote{Id. See also U.S. Department of Justice & Federal Trade Commission, \textit{Antitrust Guidelines for the Licensing of Intellectual Property} (1995), available at http://www.usdoj.gov/atr/public/guidelines/ipguide.htm (last visited Feb 10, 2004). \textit{See also} Kobak, \textit{Antitrust Treatment of Refusals}, supra note 6, at 639 (commenting on the Guidelines “lack of a mandatory duty to license” intellectual property as it contradicts certain recent enforcement actions, such as a 1998 FTC action against Intel).} Even when huge profits are reaped and the intellectual property owner establishes a near monopoly on the market, this result is legitimate where it stems from the valid use of an intellectual property right.\footnote{U.S. \textit{DEPARTMENT OF JUSTICE & FEDERAL TRADE COMMISSION, ANTITRUST GUIDELINES FOR THE LICENSING OF INTELLECTUAL PROPERTY} (1995), available at http://www.usdoj.gov/atr/public/guidelines/ipguide.htm (last visited Feb 10, 2004). \textit{See also} Kobak, \textit{Antitrust Treatment of Refusals}, supra note 6, at 639 (commenting on the Guidelines “lack of a mandatory duty to license” intellectual property as it contradicts certain recent enforcement actions, such as a 1998 FTC action against Intel).}

The methods used by EC competition can be attacked on the grounds that their choice of markets is sometimes arbitrary, their findings of dominance is sometimes suspect and their definitions of abuse ignore the full entitlement of IPR holders to obtain what the market will bear.

\textit{Id.}

41. \textit{Id. at 4. See also} Mark D. Powell, \textit{Competition Law and Innovation: The Interface between Competition Law and Intellectual Property}, 708 PLI/PAT 57 (2002) [hereinafter Powell, \textit{Competition Law and Innovation}]. Using IBM as an example, the author explains that “[p]rior to the Commission intervention, IBM supplied an integrated family of products (i.e. printers, storage devices, disk drives, software applications) which could work on its dominant System/370 platform for microcomputers. Arguably each component represented a separate market.” \textit{Id.}

42. \textit{Id.}

IV. GOALS OF COMPETITION: COMPETING PERSPECTIVES

The EU’s fundamental perspective on the nature of competition, as a means to an end instead of as an end in itself, diverges from U.S. policy. At its core, the different approaches exhibited by the EU and the U.S. stem from differing views of what constitutes “economic freedom,” how it is valued, and how it should be facilitated. The U.S. espouses keeping an eye on the ultimate goal of reducing interstate barriers, facilitating market participation and enhancing the consumer benefits that competition may spawn. The U.S. seems to view competition as a goal in itself. Therefore U.S. policy allows markets to correct themselves, assuming that the benefits down the line will accrue based on the survival and demise of competitors according to the strength of their products and the related public demand for them.

Along these lines, the U.S. requires proof that a substantial decrease in competition will result from an entity’s inability to


If a patent or other form of intellectual property does confer market power, that market power does not by itself offend antitrust law. As with any other tangible or intangible asset that enables its owner to obtain significant supra-competitive profits, market power (or even monopoly) that is solely a consequence of a superior product, business acumen, or historic accident does not violate the antitrust laws. Nor does such market power impose on the intellectual property owner an obligation to license the use of that property to others. As in other antitrust contexts, however, market power could be illegally acquired or maintained, or even if lawfully acquired and maintained, would be relevant to the ability of an intellectual property owner to harm competition through unreasonable conduct in connection with such property.

Id.


47. Id.
enter the market.\footnote{Everett, supra note 45, at 118. “In sum, European competition policy is satisfied that an arrangement should be prohibited upon proof that it may significantly restrict one or more competitors’ ability to access or expand its operations in a market; U.S. antitrust law goes a step further, requiring proof that such harm is also likely to lessen competition substantially.” Id. (discussing competing policy in the context of vertical arrangements).} The EU stops short of this analysis by favoring the restriction of those who block the access of individual competitors, regardless of any proof of a substantial impact on competition in a broader sense.\footnote{Id.} Even more, the U.S. policy considers evidence that the lack of competition in a market offsets “efficiency benefits.”\footnote{Id. at 124 (discussing the Commission regulation on vertical agreements). The author comments that the EU approach to competition policy “reveals the Commission’s continuing concern to prohibit arrangements simply because they may significantly restrict competitors’ access to a market along with a new receptivity to a more strictly competition-oriented test.” Id.} In the interest of economic freedom, the EU has been more likely to favor broadening the participation in each market as much as possible: “[h]istorically, the concern of Community competition law was to prohibit restraints of any form on a person’s economic freedom, i.e., the right of that person to choose how he behaves in a particular market.”\footnote{Tritton, supra note 7, at 566.}

The U.S. places emphasis on the integrity of the intellectual property right by granting owners total discretion regarding the licensing of their protected intellectual property right.\footnote{In re Indep. Serv. Orgs., 203 F.3d 1322, 1327–28 (Fed. Cir. 2000), cert. denied, CSU, L.L.C. v. Xerox Corp., 121 S. Ct. 1077 (2001). The court held: In the absence of any illegal tying, fraud in the Patent and Trademark Office, or sham litigation, the patent holder may enforce the statutory right to exclude others from making, using or selling the claimed invention free from liability under the antitrust laws. We therefore will not inquire into his subjective motivation for exerting his statutory rights, even though his refusal to sell or license his patent invention may have an anti-competitive effect, so long as that anti-competitive effect is not illegally extended beyond the statutory patent grant. Id.} This is chiefly the case in patent law, where allowing exclusivity and preserving the incentive to innovate is particularly important because of the relatively large amount of capital committed by companies to research and development.\footnote{Tritton, supra note 7, at 571.} The U.S. patent
statute testifies to this position by expressly providing that refusal to license is not a misuse or illegal extension of the patent right.\textsuperscript{54} This position is also evident throughout the antitrust enforcement agencies’ Guidelines for the Licensing of Intellectual Property, which states that the owner will not be required “to create competition in its own technology.”\textsuperscript{55}

The Federal Trade Commission holds the view that “great respect for and concern about protecting incentives to innovate” is the U.S. priority when considering the practical application of intellectual property rights and antitrust principles.\textsuperscript{56} This is important in part because it is difficult to gauge just how the incentive to innovate is effected through governmental policy and legislation.\textsuperscript{57} Evidence is presently emerging that the EU has begun to embrace the goals of encouraging investment and preserving the incentive to innovate; however, these are recent developments.\textsuperscript{58} Whereas in the U.S., focus on the preservation of incentives shaped its antitrust policy and resulting statutory construction and application, in the EU “the need to avoid free riding and to encourage investment had limited influence on competition law until, with the creation of the merger task force in 1989, the competition department of the Commission of the EU began to respect economists more.”\textsuperscript{59} As the competition law in the EU evolves, therefore, the values at the forefront of the

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56. See Pitofsky, supra note 2, at 924.

57. Id. at 3 (responding to the argument that “[b]ecause effects on incentives to innovate are hard to measure, government should pursue a cautious or even hands-off policy” with the contention that the combination of antitrust law’s protection of innovation and intellectual property right protection’s rewards for innovation can “create incentives to introduce new products.”).

58. Valentine Korah, Symposium, The Federal Circuit and Antitrust: The Interface between Intellectual Property and Antitrust: The European Experience, 69 ANTITRUST L.J. 801, 803 n.10 (2002). “There have always been a few officials who were concerned about incentives to investment...until the last decade or so, however, they were in the minority and there was little evidence of their influence over the treatment of intellectual property rights.” Id.

59. Id. at 803.
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U.S. competition policies are beginning to find a place in EU law.

The motivating factors behind the Commission’s approach include a focus on policy concerns regarding protection for smaller, less powerful and less global businesses and ostensibly the consumer, as well as the nature of the antitrust and intellectual property legislation itself, or lack thereof. The EU’s divergence with the U.S. approach to intellectual property rights and competition policy has its roots in the history of antitrust and intellectual property laws themselves. In the U.S., intellectual property rights and antitrust law derive from the common foundation of federal law. In the EU, intellectual property rights stem from the domestic laws of member states, while competition law is rooted in the Treaty of Rome (“Treaty”). At this stage, there are only community-wide intellectual property rights in the realm of trademarks, biotechnological inventions, and plant variety rights. These disparate legal constructions are largely the result of the historical basis for the respective systems of law.

60. Id.
61. Id.
62. Korah, supra note 58, at 804.

Admittedly, in the absence of Community standardization or harmonization of laws, determination of the conditions and procedures for granting protection of an intellectual property right is a matter for national rules. Further, the exclusive right of reproduction forms part of the author’s rights, so that refusal to grant a license, even if it is the act of an undertaking holding a dominant position, cannot in itself constitute an abuse of a dominant position.

Id. The position the Court of Justice takes here is obviously at odds with that of the DG Comp in its attempt to force IMS to license its copyrighted database. The European Union does not have a system of stare decisis — prior decisions are merely persuasive and are not formally precedentual. Id.


66. Id.
While the U.S. enjoyed economic integration during the inception of the Sherman Act, the EU was wary of isolating states from one another via intellectual property right protection: “Intellectual property rights were seen as the way by which companies might partition the common market to prevent free movement of goods between the 6 (and latterly the 9) Member States.” In response, the EU applied competition law in a way that risks impairing the integrity of intellectual property rights. Along these lines, nationally rooted intellectual property rights are preempted by the Treaty to the extent that they conflict with the terms of the Treaty.

V. STATUTORY STRUCTURE OF COMPETITION LAW

In the EU, intellectual property rights are considered in two ways — in one sense they are evaluated based on their function of maintaining the integrity of the protected innovation, and in another sense they are considered according to their use. The former is the subject of national law, but the latter is governed by the Treaty’s competition laws and could therefore be challenged under rules related to the free movement of goods throughout the EU. This distinction was developed through case law in the EU to reconcile the conflict that arose when a nationally vested right is threatened with nullification by community-wide law. In the Centrafarm cases in particular, the European Court’s method of analysis regarding the use of intellectual property rights as it relates to the unhindered movement of goods evolved to create this “existence” and “use” distinction. At the same time, the court attempted to ensure that

67. Id.
68. Forrester, Abuse of Intellectual Property, supra note 65.
69. “When Congress passed the Sherman Act, the United States was largely economically integrated: it enjoyed a single currency and federal intellectual property rights. None of these characteristics applied in Europe in the 1960’s and 1970’s when the law was being developed.” Korah, supra note 58, at 804.
70. COMPETITION LAW, supra note 32, at 275.
71. Id.
72. Id.
73. Forrester, Abuse of Intellectual Property, supra note 65, at 39 (discussing the evolution of the existence and exercise distinction).
benefits from rights did not extend indefinitely at the expense of the integrity of the market. Although the “core of the intellectual property right” was immune from challenge, the adjoining rights were not. This paradigm raises the question that if an intellectual property right is not the right to exploit the discovery or development exclusively by placing the protected product or service on the market, then what is it? Is it an intellectual property “right” at all without exclusive use?

Articles 81 and 82 are the competition provisions of the Treaty that govern the use, and potential abuse, of intellectual property rights. Article 81 of the Treaty bars agreements that adversely affect trade between member states through the restriction of competition. In regulating agreements between


Centrafarm v. Sterling Drug first held that national patent rights were exhausted with respect to products marketed in another member state by the patentee or with its consent. The issue before the court was whether the policy in favor of the free movement of goods in Article 30 of the EEC Treaty prohibited the use of Dutch patent law to prevent parallel imports of Negram originally marketed in Britain by Sterling’s subsidiary. The ECJ reiterated the distinction between the existence and exercise of IPR, noting that only the specific subject matter of the IPR was safeguarded by Article 36.

Id.


77. J AY DRATLER, JR., INTELLECTUAL PROPERTY LAW: COMMERCIAL, CREATIVE, AND INDUSTRIAL PROPERTY § 1.07 (2003). “The term ‘infringement’ has a distinct meaning for each type of intellectual property. Each form of intellectual property protection confers certain exclusive rights upon the intellectual property owner, and anyone else’s unauthorized exercise of those rights constitutes infringement.” Id.


80. Korah, supra note 58, at 823.

81. Treaty of Amsterdam Amending the Treaty on European Union, The Treaties Establishing the European Communities and Certain Related Acts,
companies, Article 81 is a relatively broad restriction that speaks to the free market policy of the EU, and endeavors to prevent alliances that may preclude the entrance or viability of other market participants. In analyzing the competitive effects of intellectual property licensing, EU law includes an inquiry into the effect of the intellectual property right itself, and its licensing, simultaneously.

Article 82 of the Treaty prohibits the abuses associated with those who have already achieved dominant positions in the market. Although market dominance is allowed under the Treaty, those that do dominate the market are called upon to remain acutely aware of the effects this position has on the rest of the market. Both of these provisions, and indeed the Treaty in a broad sense, aim to encourage the free movement of goods and services among the member states, preventing their isolation from one another, while Article 82 more specifically governs the licensing of intellectual property rights.


83. Tritton, supra note 7, at 564.

In combining the two stages, Community law has implicitly considered the competitive effect of intellectual property laws themselves as well as their licensing. In doing so, they have historically tended to take a restrictive view as to the procompetitive effects of licensing by questioning the validity of intellectual property rights themselves with regard to competition.

Id.

84. Europa, Gateway to the European Union, Article 82 (formerly Article 86) of the EC Treaty, available at http://europa.eu.int/eur-lex/en/treaties/selected/livre218.html#anArt1 (last visited Jan. 5, 2004). “Any abuse by one or more undertakings of a dominant position shall be incompatible with the common market insofar as it may affect trade between member states.” Id.

85. Anderman, New Economy, supra note 23, at 2, 12.
86. Anderman explains:

The examples of abuse given in article 82 include unfair pricing, discriminatory pricing and tie ins. However, article 82 also extends to such abuses as exclusive dealing, predatory pricing, refusals to supply and license. The latter two, which are particularly applicable to
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Article 36 of the Treaty governs the interplay between the community-wide competition law and national intellectual property rights by balancing the protection of intellectual property and the preservation of free competition in the community:

[T]he reconciliation between the requirements of the free movement of goods and the respect to which intellectual property rights were entitled had to be achieved in such a way as to protect the legitimate exercise of such rights, which alone was justified within the meaning of that article, and to preclude any improper exercise thereof likely to create artificial partitions within the market or pervert the rules of governing competition within the Community.

VI. THE FUTURE OF BLOCK EXEMPTIONS

Intellectual property licensing is governed by the Technology Transfer Block Exemption Regulation (“TTBE Regulation”) established in 1996. The regulation is essentially a formal mandate, which provides that those with intellectual property rights use them in accordance with the competition articles in the Treaty, especially Article 81. Although the regulation ostensi-
bly applies specifically to the licensing of “pure patents, pure know-how, or both,” there are existing ancillary provisions relating to other intellectual property rights.\footnote{Korah, supra note 58, at 832.} However, there are no provisions meant expressly for the licensing of trademarks or copyrights.\footnote{Id.}

Pursuant to Article 12 of the TTBE Regulation, the Commission is required to draw up a report regarding the effectiveness of the regulation and to propose appropriate changes.\footnote{EUROPA, GATEWAY TO THE EUROPEAN COMMUNITY, TRANSFER OF TECHNOLOGY BLOCK EXEMPTION REGULATION No. 240/96, available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31996R0240&model=guichett (last visited Jan. 5, 2004).} In the December 2001 report, it was proposed that trademarks and designs should be included, and that a move towards a more “economic” approach that is more broad than the original regulation,\footnote{EUROPA, GATEWAY TO THE EUROPEAN COMMUNITY, ANNEX 1, SUMMARY OF SUBMISSIONS ON TTBE REVIEW REPORT, available at http://europa.eu.int/comm/competition/antitrust/technologytransfer/summaryofcomments.pdf (last visited Jan. 5, 2004) [hereinafter ANNEX 1].} and more “user friendly,” would be appropriate.\footnote{Korah, supra note 58, at 832.}

Nevertheless, as it stands the TTBE Regulation does not cover copyright and trademarks standing alone, and therefore exemption from Article 81 scrutiny is often a “long and laborious process” for many companies whose technology is not protected by patent.\footnote{Anderman, New Economy, supra note 23, at 10.} It is possible to maneuver outside of this mandate by petitioning the Commission, but exception to the transfer block exemption is extremely difficult to achieve.\footnote{Id.} The response to comments submitted regarding the December 2001 report describe the various arguments for and against including copyright, trademark and design rights in the TTBE Regulation.\footnote{ANNEX 1, supra note 93, at 2.} Arguments for including a wider array of intellectual property rights include the suggestion that it would make application easier and that would allow companies to avoid complicated inquiries into which intellectual property rights are ancillary and which stand alone.\footnote{Id. See also Korah, supra note 58, at 832.}

\footnotesize
\begin{itemize}
\item \footnote{Korah, supra note 58, at 832.}
\item \footnote{Id.}
\item \footnote{EUROPA, GATEWAY TO THE EUROPEAN COMMUNITY, TRANSFER OF TECHNOLOGY BLOCK EXEMPTION REGULATION No. 240/96, available at http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31996R0240&model=guichett (last visited Jan. 5, 2004).}
\item \footnote{EUROPA, GATEWAY TO THE EUROPEAN COMMUNITY, ANNEX 1, SUMMARY OF SUBMISSIONS ON TTBE REVIEW REPORT, available at http://europa.eu.int/comm/competition/antitrust/technologytransfer/summaryofcomments.pdf (last visited Jan. 5, 2004) [hereinafter ANNEX 1].}
\item \footnote{Korah, supra note 58, at 832.}
\item \footnote{Anderman, New Economy, supra note 23, at 10.}
\item \footnote{Id.}
\item \footnote{ANNEX 1, supra note 93, at 2.}
\item \footnote{Id. See also Korah, supra note 58, at 832.}
\end{itemize}
tual property rights to the regulation believe that each intellec-
tual property right has a different antitrust implication and
therefore should be treated differently.\footnote{100}

Defining markets is again important in considering the appli-
cation of the TTBE Regulation.\footnote{101} The Commission acknowled-
ges that it becomes difficult to define the market, particularly
in the realm of intellectual property rights which are tied to
 technological innovations.\footnote{102} Particularly where licensing occurs
with new products and technologies, “market share thresholds”
could be deceiving — possibly stifling licensing and innovation.\footnote{103}

The competition laws in the Treaty mirror the Sherman Act
in construction, but the practical application of the articles in
the EU differ from the way in which antitrust statutes are util-
ized in the U.S.\footnote{104} The Commission monitors the effects a domi-
nant company has on its markets for the purpose of ensuring
that other companies are able to engage in competition along-
side dominant market members.\footnote{105} In contrast, the U.S. more
readily employs a \textit{laissez faire} approach where the focus is on
maintaining a system of competition for the benefit of consum-
ERS and the encouragement of innovation, instead of looking out

\begin{footnotes}
\footnote{100}{ANNEX 1, supra note 94, at 2.}
\footnote{101}{Id.}
\footnote{102}{Id.}
\footnote{103}{Id. at 3.}
\footnote{104}{James B. Kobak, Jr., Running the Gauntlet: Antitrust and Intellectual
Property Pitfalls on the Two Sides of the Atlantic, 64 ANTITRUST L.J. 341, 344–
47, 354 (1996). Kobak explains:

\begin{quote}
Even though the prima facie elements to finding antitrust liability
under the essential facilities doctrine are similar in the EU and U.S.,
the elements have been applied differently in their respective jurisdic-
tions. Notwithstanding this difference, in both the EU and U.S. it
is difficult to rely on the essential facilities doctrine to force a domi-
nant owner to license its IPRs.
\end{quote}

\textit{Id.} See also Sergio Baches Opi, The Application of the Essential Facilities Doc-
trine to Intellectual Property Licensing in the European Union and the United
PROP. MEDIA & ENT. L.J. 409, 414 (2001).}
\footnote{105}{The European Commission has historically aimed to protect small and
medium sized firms in particular, but recently the Commission has begun to
recognize the long term benefits not just for these small or medium sized com-
panies, but for consumers and the economy in a broader sense. Korah, supra
note 58, at 804.}}
for market participants individually.\textsuperscript{106} Along these lines, the Commission will go so far as to mandate the licensing of intellectual property rights where a dominant company’s refusal to license is deemed abusive and results in the restriction of competition.\textsuperscript{107} However, absent fraud and illegal tying, the “statutory right to exclude others” in the U.S. is not conditioned upon a company’s effect on the market.\textsuperscript{108}

VII. COMMON LAW EXPRESSIONS OF STATUTORY POLICY

Two recent cases, one in the U.S. and one in the EU, demonstrate just how bipolar the two approaches can be. Generally, the U.S. takes the view that an intellectual property owner is not required to license that intellectual property right to other companies.\textsuperscript{109} This is true regardless of whether the right has caused the company to gain a monopoly in the market.\textsuperscript{110} In Independent Services Organizations Antitrust Litigation (“Xerox”), Xerox refused to license its patented parts and copyrighted software to independent service organizations, effectively eliminating them from the service market.\textsuperscript{111} The Supreme Court held that, even though “refusal to deal impacts competition in more than one market,” Xerox could retain its right to refuse to license to competitors. This decision, although considered extreme by some,\textsuperscript{112} highlights the relative power of intellectual

109. Kobak, Antitrust Treatment of Refusals, supra note 6, at 616.
110. Id.
111. In re Indep. Serv. Orgs., 203 F.3d at 1327.
112. See Pitofsky, supra note 1, at 919–20. Pitofsky, concerned that the invocation of intellectual property rights would become a facile response to challenges of a refusal to deal, comments on the Xerox case, “[T]he court reached its decision in sweeping language that exalts patent and copyright rights over other considerations and throws into doubt the validity of previous lines of authority that attempted to strike a balance between intellectual property and antitrust.” Id.
property rights in the U.S., and the disinclination courts have to equate market power with the duty to license.\footnote{In re Indep. Serv. Orgs., 203 F.3d at 1326, (citing Intergraph Corp. v. Intel Corp., 195 F.3d 1346, 1362 (Fed. Cir. 1999) as demonstrating that “market power does not impose on the intellectual property owner an obligation to license the use of that property to others”).}

In an apparent move in the opposite direction, in 2002, the Commission forced IMS, a pharmaceutical marketing company, to license its copyrighted database to participants in the narrowly defined market\footnote{“The Commission defined the relevant market as the market for ‘German regional sales data services’ and found that IMS, by virtue of its large market share, occupied a dominant position in this market.” David W. Hull et al., Compulsory Licensing, THE EUR. ANTITRUST REV., 36–39 (2002).} of pharmaceutical sales data services in Germany.\footnote{Case COMP D/338.044, NDC Health/IMS Health: Interim Measures (July 3, 2001); Case T-184/01 R, IMS Health Inc. v. Commission (Aug. 10, 2001), confirmed after oral hearing, Oct. 26, 2001.} The case\footnote{As of October of 2002, the Court of First Instance has closed its investigation of IMS Health Inc.’s “pharmaceutical sales and prescriptions data collection practices.” AFX Financial News, EU Drops Inquiry into US’ IMS Health Sales Practices, available at http://www.afxnews.com (last visited Jan. 5, 2004).} demonstrates the relatively extreme measures the Commission is willing to employ in an effort to protect smaller, less powerful market participants.\footnote{Julian Epstein, The Other Side of Harmony: Can Trade and Competition Laws Work Together in the International Marketplace?, 17 AM. U. INT’L L. REV. 343, 360 (2002): The underlying policies of European Commission competition law are distinctly different from those of the United States, and other non-European countries. U.S. antitrust laws are concerned largely with optimizing marketplace efficiencies by protecting against concerted actions to increase prices or reduce output (as stated \textit{infra}, for example, dominant firms in the U.S. are free under antitrust laws to “compete hard,” and to engage in such schemes as “refusals to deal” and other exclusionary practices so long as there are legitimate efficiency rationales.) The Europeans have rejected many of the U.S. competition paradigms in favor of greater protections for smaller and mid-sized firms requiring, for example, that market share as low as forty percent can trigger “must deal” requirements with horizontal or vertical competitors.} It is true, however, that although even in the realm of copyright the U.S. policy refrains from forced licensing, the Commission may have more aggressively handled IMS Health’s refusal to deal because
it involved copyright instead of patent.\textsuperscript{118} Keeping in mind the “creative effort of the rightholder and the economic advantages flowing from the exercise of the right,” there may be less incentive for the Commission to protect those rights that do not directly spur investment in research and development.\textsuperscript{119}

There is no need to make a “definitive finding that an infringement has occurred” for the Commission to impose interim measures.\textsuperscript{120} However, in temporarily suspending the decision to force IMS to license its copyright, the Court of First Instance demonstrated wariness at the notion of such a harsh remedy without further investigation of the facts and legal issues.\textsuperscript{121} Ultimately, in the EU the facts of each case are determinative of which way the Commission and courts will lean — where the “creative effort” is not there, the view is that there is no need to give incentive for innovation.\textsuperscript{122}

The Court of First Instance invoked Article 295 of the Treaty, which guarantees that the Treaty will not interfere with the property ownership of member states:\textsuperscript{123}

In the present case, it is first appropriate to recall that Article 295 EC provides that ‘This Treaty shall in no way prejudice the rules in the Member States governing the system of property ownership’. It follows from Article 295 EC that a judge hearing an application for interim measures should normally treat with circumspection a Commission decision imposing, by way of interim measures taken in the course of a pending investigation under Article 3 of Regulation No. 17, an obligation upon the proprietor of an intellectual property right recognized and protected by national law to license the use of that property right.\textsuperscript{124}

Although the court temporarily reigned in the decision to impose interim measures, the Commission’s move to force IMS to license its intellectual property demonstrates an expansion of

\textsuperscript{118} Powell, \textit{Competition Law and Innovation}, supra note 41, at 52.
\textsuperscript{119} Id.
\textsuperscript{121} Id. at 176.
\textsuperscript{122} Powell, \textit{Competition Law and Innovation}, supra note 41, at 52.
\textsuperscript{123} Id.
\textsuperscript{124} Case T-184/01 R, IMS Health Inc., 173–74.
the scope of Article 82 that eclipses intellectual property rights exercised in the EU.\textsuperscript{125}

The relevant case law illustrates that EU courts are called upon to balance the interests of protecting the nationally-endowed intellectual property right with the policies espoused and enforced by competition law found in the Treaty.\textsuperscript{126} When examining the relationship between a company’s intellectual property right and its position in the market, the courts frequently invoke the “essential facilities doctrine.”\textsuperscript{127} This doctrine is applied to determine whether a company has control over a facility essential to competing in the market and, if so, whether the company has prevented competitors from using the facility to block access to the market.\textsuperscript{128} An intellectual property right owner is ripe for “essential facilities” analysis when the company refuses to license the right and/or is reaping tremendous economic benefits by virtue of its exclusive use of the intellectual property protected technology.\textsuperscript{129} Both the U.S. and the

\textsuperscript{125} Hull et al., \textit{supra} note 114, at 37 (“the decision in \textit{IMS Health} raises significant concerns for intellectual property owners because the Commission expanded third parties’ rights of access to proprietary information under Article 82”).

\textsuperscript{126} There are national competition law systems which complement the EC Treaty provisions. Julian M. Joshua & Donald C. Klawiter, \textit{The UK ‘Criminalization’ Initiative}, \textit{ANTITRUST MAG.}, Summer 2002, at 68. “While some national competition regimes are similar to that of the EU, the relationship between the EC and the national systems has never been seamless...No general jurisdictional rule defines a bright line between those agreements subject to EC competition rules and those covered by national laws.” \textit{Id.}


The contradictions inherent in any effort to reconcile intellectual property rights and competition law are exemplified by the “essential facilities” doctrine, one of the analytic tools invoked by the Commission and the EC Courts to enhance market competition. This doctrine provides that “a company which has a dominant position in the provision of facilities which are essential for the supply of goods or services on another market abuses its dominant position where, without objective justification, it refuses access to those facilities.”

\textit{Id.}

\textsuperscript{128} Badal & Ware, \textit{supra} note 46, at 2.

\textsuperscript{129} \textit{COMPETITION POLICY}, \textit{supra} note 32.
EU use the doctrine as a way of measuring whether abusive conduct has taken place however their application differs.\textsuperscript{130} The EU uses the doctrine to assess a duty to license the intellectual property deemed essential to participation in the market. Conversely, the U.S. has resisted this application.\textsuperscript{131} “Even where the intellectual property right is alleged to be an essential facility...courts have held that the owner of the intellectual property does not violate the antitrust laws by unilaterally refusing to license to a competitor....”\textsuperscript{132} In the EU, the essential facilities doctrine is grounded in Article 82 of the Treaty of Amsterdam\textsuperscript{133} in its proscription against abuse of a dominant position.\textsuperscript{134} The essential facilities doctrine applied to intellectual property rights reflects the tendency in the EU to devalue these rights in favor of “competition” principles, which may ultimately result in disincentives for achieving market dominance in the EU by virtue of these rights.\textsuperscript{135}

In \textit{IMS Health}, the essential facilities doctrine was utilized and the licensing of intellectual property was called a “a prerequisite for effective competition” in the market.\textsuperscript{136} The court in \textit{IMS Health} drew upon the standards set in \textit{Oscar Bronner}, calling for a determination of whether (1) “the refusal of access to the facility is likely to eliminate all competition in the relevant market; (2) such refusal is not capable of being objectively justified; and (3) the facility itself is indispensable to carrying on business, inasmuch as there is no actual or potential substitute in existence for that facility.”\textsuperscript{137}

\begin{itemize}
  \item \textsuperscript{130} Id.
  \item \textsuperscript{131} Id. This differing approach between the European Union and the United States “has substantial ramifications for companies possessing a dominant position in the market, even if they have achieved that position lawfully by way of copyright.” Id.
  \item \textsuperscript{132} Kobak, \textit{Antitrust Treatment of Refusals}, supra note 6, at 619.
  \item \textsuperscript{134} Gitter, \textit{supra} note 127, at 227.
  \item \textsuperscript{135} Marquardt & Mark Leddy, \textit{supra} note 5, at 848–50.
\end{itemize}
In Volvo v. Veng, the Court of Justice was presented with the first case dealing with whether the refusal to license an intellectual property right could be considered abusive.\textsuperscript{138} Volvo was the owner of a registered design of the front wings of the automobile.\textsuperscript{139} Veng manufactured and imported the panels in the United Kingdom without permission and Volvo contended that Veng was therefore infringing their exclusive right to manufacture and sell the parts.\textsuperscript{140} The court held that refusal to grant third parties a license on these parts was not, in itself, an abuse of a dominant position.\textsuperscript{141} The court’s holding was based upon the particular factual circumstances, namely that Veng had no intention to innovate. Additionally, the court considered the related policy consideration that “free riding” should not be facilitated through the invocation of community antitrust law.\textsuperscript{142} Notwithstanding this holding, however, the court chose to leave the opportunity open for attacking a company’s refusal to license via antitrust law by stating that in some circumstances this type of conduct could be considered abusive.\textsuperscript{143}

Magill established the standards according to which intellectual property ownership and refusal to license may constitute an abuse and breach of competition laws.\textsuperscript{144} The case involved a broadcast company’s refusal to license program schedules to a publishing company interested in publishing a television guide. Based on the impact the refusal to license had on a secondary market and that it had prohibited the entrance of a new product on the market, the European Court of Justice held that compulsory licensing was an appropriate remedy.\textsuperscript{145}

In Magill, the court stressed that in “exceptional circumstances” the refusal to license would not be justified by a valid intellectual property right.\textsuperscript{146} The holding, however, left open

\begin{itemize}
\item \textsuperscript{138} Case 238/87, AB Volvo v. Erik Veng (UK) Ltd., ECR 6211, 4 C.M.L.R. 122 (1988). See also Forrester, Abuse of Intellectual Property, supra note 65, at 40.
\item \textsuperscript{139} Id.
\item \textsuperscript{140} Id.
\item \textsuperscript{141} Id.
\item \textsuperscript{142} Forrester, Abuse of Intellectual Property, supra note 65, at 41.
\item \textsuperscript{143} Id.
\item \textsuperscript{145} Id.
\item \textsuperscript{146} Id.
\end{itemize}
the question of whether the exceptional circumstances necessarily involved restriction of secondary markets and of new products, or whether one of the two circumstances would suffice to fall under the rubric of abusive conduct. Unlike the situation in *Magill*, the court in *Tierce Ladbroke* found in part that a secondary market was not snuffed out by the refusal of the makers of horse racing videos to grant a license of the video recordings to a betting chain because the chain was already present on the secondary market. In *Tierce Ladbroke*, the fact that the failure to license did not preclude the development of a secondary market was discussed in the court’s decision alongside the finding that the refusal to license was not abusive enough to meet the “exceptional circumstances” standard necessary for the court to force the defendants to issue a license.

In the early 1970’s, the European Court of Justice began using the “doctrine of Community exhaustion” in deciding its cases involving the abuse or exclusive use of intellectual property rights. Under this doctrine, once an intellectual property owner produces the protected good and it enters the market, the right is exhausted and therefore a parallel right in another member state cannot exclude the good from entering the member state. This approach again illustrates the way in which EU law emphasizes the need for integration, instead of protecting investments and the incentive to innovate through the protection of intellectual property rights. The doctrine of exhaustion as it applies to intellectual property rights continues to hold sway in certain cases in the EU. However, there have been certain cases where the doctrine of exhaustion has been diffused, as in *Tierce Ladbroke*, where it was held that the

147. Hull et al., supra note 114, at 37.
149. “The CFI in *Ladbroke* did not find an abuse of a dominant position, primarily because the dominant firms were not present on the relevant market and the intellectual property at issue was not indispensable for competition on that market.” Hull et al., supra note 114, at 37.
150. Korah, supra note 58, at 805–06.
152. Korah, supra note 58, at 806.
licensing of an intellectual property right does not exhaust the right.  

**VIII. FASHIONING EU INTELLECTUAL PROPERTY RIGHTS**

A possible solution to the impasse between EU-wide competition law and state-endowed intellectual property rights would be to form EU-wide intellectual property rights. This would provide uniformity and would at the very least afford more clarity and notice for companies doing business in the EU. Depending on the nature and scope of the intellectual property protection, companies may still be reluctant to expose their technology or services where their success, and consequent market dominance, may mean susceptibility to scrutiny under competition laws. However, in the climate of the EU, more narrowly tailored intellectual property rights would have the dual effects of easier compatibility with competition laws — which would perhaps encourage the abandonment of policies like forced licensing — and the public policy benefit of facilitating technological advancement by allowing innovation to build upon predecessors. Where the intellectual property right is too broad, there is little incentive or room for advancement of the relevant technology or service.

154. Id.

155. Badal and Ware, supra note 46, at A15. “Licensing or refusal-to-license decisions that are likely to be permissible under U.S. law may not be approved by the E.C., which then presents the difficult question of how to proceed — indeed, whether to proceed at all — in light of the different legal status of the same licensing action.” Id.


157. See Pitofsky, supra note 1, at 919. Pitofsky explains:

    Indeed, competition may be especially important where innovation is concerned, in order to preserve a diversity of approaches which will often prove essential to advance knowledge and discovery. The history of innovation since the monolithic AT&T was broken up is some evidence that innovation is more likely to thrive in the presence of competition than in its absence.

Id.

158. Korah, supra note 58, at 830 (stating that “[i]n Magill, the intellectual property rights were wider than are usually granted in Europe or elsewhere. In Oscar Bronner, Advocate General Jacobs suggested that this may be the reason why a compulsory license was in effect granted”).
There are also temporal considerations involved in deciding whether to narrow or broaden the scope of intellectual property rights. If the intellectual property right is more broadly drawn, perhaps it should protect the innovation for a shorter period, and if it is narrowly drawn, it would extend for a longer period. Striking a proper legislative balance between the scope of the right and the time limits surrounding the exclusivity of the right would serve a number of interests. First, it would provide exclusivity in the interest of enhancing the incentive to innovate while clearly delineating where the intellectual property right will be open to competition law scrutiny. Additionally, it would satisfy the interests of providing the amount of exposure and opportunity to market participants that is necessary to encourage the continued development of the product or device. This is particularly true in the realm of rapidly developing, nascent technologies.

159. *Id* at 811. Korah states:

Economists cannot tell us how strong protection of intellectual property rights should be. Whatever the law dictates, there may be insufficient inducements to investment in research and development. If patent protection is too strong, the incentives to derivative research and development are insufficient. A license under the basic patent will have to be negotiated and any reward will have to be shared with its holder. The holder of the basic patent may not be under competitive pressure to improve the technology. If protection is less strong and the holder of an improvement patent is entitled to a compulsory license, the incentive to invest in the basic technology may be insufficient.


161. *Id*.


It is essential that EC legislators address the intersection between intellectual property rights and competition law in order to attract foreign direct investment. U.S. firms in particular are loath to pursue investment opportunities in the face of insecure intellectual property rights, especially in light of the traditional antipathy inherent in U.S. law toward compulsory licensing. Due to several economic and socio-political factors, however, the EC is unlikely to abandon the compulsory licensing remedy in competition cases involving intellectual
Tightly bound to the notions of encouraging competition while protecting intellectual property rights and the incentive to innovate is the EU approach to research and development. The Commission acknowledges the “important role in the knowledge economy” of state aid to research and development.\(^{164}\) Along these lines, the Commission seeks to raise total European investment in research and development to 3% of the EU’s gross domestic product, which would constitute an approximately 1% rise from the current allotment.\(^{165}\) The Commission seeks to affect this increase by exempting smaller companies from competition rules and providing state aid to research and development.\(^{166}\) These values, of encouraging research and development, and the ostensible goal of encouraging innovation, exist alongside the EU’s priorities of making certain that these technological innovations are accessible to consumers.\(^{167}\) This latter goal is effected by enforcing strict adherence to competition laws.\(^{168}\)

Just as an innovator needs incentive to create the technology or product that will be protected by an intellectual property right, the Commission needs incentive to actually do the protecting.\(^{169}\) This incentive is found in the conclusion that the nature of the right and its holder are such that other innovations will stem from the right.\(^{170}\) In this way, there is incentive, for example, to protect an innovator who can most efficiently continue to develop the already protected technology or product.\(^{171}\)

property, though certain European scholars and practitioners question the wisdom of applying the essential facilities doctrine in such circumstances.

\(^{163}\) Gallini & Trebilcock, supra note 160.
\(^{165}\) Id. Investment in research and development has been 1.9% in the European Union, while it has been about 2.7% in the U.S. Id.
\(^{166}\) Id.
\(^{167}\) COMPETITION POLICY, supra note 32, at 273.
\(^{168}\) Id.
\(^{169}\) Id.
\(^{170}\) Id.
If the intellectual property right owner is not, however, in a position to most efficiently enhance the innovation or to disseminate it, the Commission will be more likely to find that it has less incentive to ensure the protection of that right.\textsuperscript{172} Instead, the right will be considered more flimsy and vulnerable to the attack ofcompetition law.\textsuperscript{173} It is this subjective evaluation of the intellectual property right in light of competition law — arguably exhibited in IMS — that presents a problem.\textsuperscript{174} This subjective approach can "create uncertainty" about the enforceability of an intellectual property right, while forcing an evaluation of whether one right is protected while another equally valid right is not.\textsuperscript{175} In Xerox, the court also addresses the danger of investigating the subjective motivation of the owner who refuses to license through refusal to apply a rebuttable presumption.\textsuperscript{176}

\textsuperscript{172} Id.

It is also argued (Deffains) that the protection of the original innovator will be also the most efficient solution in cases where its holder is anyway the best suited to fully develop the follow-on developments. In such a case, a high degree of protection will induce him to actually engage in the development of those further innovations. The patent will allow him to monitor future developments and, at the same time, will help to reduce wasteful duplication of R&D efforts.

\textsuperscript{173} Id.

\textsuperscript{174} Marquardt & Leddy, supra note 5, at 848. Marquardt and Leddy discuss the application of the essential facilities doctrine wherever an intellectual property right results in substantial market power in the U.S.:

Such amorphous standards threaten to underminethe basic rights of intellectual property holders and the procompetitive system of incentives and rewards created by Congress and the Constitution. How does one distinguish a legitimate refusal to license based upon a strategy to exploit the right exclusively from an illegitimate refusal to license based upon 'anticompetitive' intent?

\textsuperscript{175} Id.

\textsuperscript{176} U.S. FTC CHIDES E.C. EFFORTS TO DODGE IMS RESEARCH PATENT, EUROPE DRUG & DEVICE REPORT (June 3, 2002) (Deputy Assistant Attorney General for International Antitrust and Policy Enforcement for the Antitrust Division of the U.S. Department of Justice William Kolasky comments that the Commission bases competition policy on "whether it thinks the intellectual property rights in question are worth protecting.").

\textsuperscript{176} Howley, supra note 54, at sec. 12, col. 1.
IX. CONCLUSION

Market dominance by a company can be intimidating to those vying to participate in the market, but it is never indefinite. Although this is small consolation for companies interested in immediate participation in the market, too much judicial and legislative intervention in market forces, in terms of the long run disincentive to innovate, could be pernicious. This is because it often takes time to “undo” what the judiciary or legislature does, whereas the market can correct itself fairly rapidly if left untouched.

177. See Pitofsky, supra note 1, at 915–16.
178. Id. See also Opi, supra note 104, at 450 (citing Ronald W. Davis, The FTC’s Intel Case: What Are the Limitations on “Throwing Your Weight Around?” Using Intellectual Property Rights?, 13 ANTITRUST 47 (1999)). (“Any legal rule, either based on the essential facilities doctrine or the leveraging theory, that may decrease the value of IPRs by limiting or qualifying an IP owner’s right to the exclusive use of its own property, risks drastically reducing the incentive to innovate.”).
179. Frank H. Easterbrook, The Limits of Antitrust, 63 Tex. L. Rev. 1, 15 (1984) (“[T]he economic system corrects monopoly more readily than it corrects judicial errors. There is no automatic way to expunge mistaken decisions of the Supreme Court. A practice once condemned is likely to stay condemned, no matter its benefits.”).
180. See Pitofsky, supra note 1, at 915–16.
In an ideal statutory system, a company should be able to exercise the right to the exclusive control granted by intellectual property without concern regarding infringement of competition laws. As the holding in Xerox highlights, as long as companies remain within the statutory bounds of the intellectual property right, the exercise of that right should not conflict with antitrust law. It is possible that the conflict between the two bodies of law in the EU stems from the combination of intellectual property rights that are too broadly drawn and antitrust law that is too narrowly applied. Ultimately, the enforcement of a statutory right should not be capable of triggering the antitrust law, and if it does, the statutory right should be re-drawn so that it does not come into conflict with the antitrust law, or vice versa.

Meg Buckley

181. Certainly, in exceptional cases where fraud or frivolous infringement suits are involved, an intellectual property right owner should not be immune from violation of competition laws.
183. Korah, supra note 58, at 811 (discussing Magill).
* I would like to thank my parents, all three of them, for their love, support and sense of humor throughout my law school career. This note is dedicated to Marc Ferro, without whom my computer and this note would be scattered on the sidewalk of West 15th Street, and to my Grandmom, who is a source of constant inspiration.
LOOKING BEYOND THE SUNSET: INTERNATIONAL PERSPECTIVES ON THE TERRORISM RISK INSURANCE ACT OF 2002¹ AND THE ISSUE OF ITS RENEWAL

“The willingness to take risk is essential to the growth of a free market economy.”²

– Alan Greenspan¹

I. INTRODUCTION

The terrorist attacks of September 11, 2001 caused severe loss of life and property,⁴ but the economic and legal ramifications of that day continue to plague the United States (“U.S.”). The U.S. legislation H.3210,⁵ known as the Terrorism Risk Insurance Act of 2002 (“TRIA”), serves as a perfect exam-


³. Alan Greenspan serves as the chairman of the U.S. Federal Reserve Board. When this man speaks, the nation listens, as he is arguably one of the most knowledgeable individuals in the world of economics and international finance. For more information on Alan Greenspan, see the Federal Reserve Board’s Biography website at www.federalreserve.gov/bios/greenspan.htm (last updated Oct. 3, 2003). See also Greenspan Warns of “Unexpected Events” as Risk to Markets, APP, Jan. 13, 2004, at http://www.business.com/search/ratl_default.asp?4=0&type=news (last visited Feb. 2, 2004).


ple of such late blooming economic consequences requiring close legal scrutiny. As of November 15, 2002, this Act requires all U.S. property insurers to cover terrorist risk in order to protect the nation from a hesitant insurance industry, which proved unwilling to bear the future risk of terrorism in light of the costs of September 11, 2001.\textsuperscript{6} TRIA presently offers U.S. insurers the financial security necessary for providing terrorism insurance, the only limitation being that the legislation also comes with an expiration date.\textsuperscript{7} On December 31, 2005,\textsuperscript{8} the U.S. government must again decide what is necessary for the nation: continued TRIA-provided terrorism reinsurance or deregulation.\textsuperscript{9}

As the U.S. government intends for TRIA to serve as a temporary insurance support mechanism,\textsuperscript{10} the legislation also mandates that the U.S. Treasury Department measure the program’s success through reports that indicate the program’s vi-

\textsuperscript{6} See infra Part II.A.1.


\textsuperscript{8} Id. However, the Secretary of Treasury still retains the authority to continue the government insurance’s program for the purposes of taking the actions “necessary to ensure payment, recoupment, reimbursement, or adjustment of compensation for insured losses arising out of any act of terrorism occurring during the period in which the Program was in effect...” Id. § 108(b).


\textsuperscript{10} The legislation’s main purpose, as indicated by the statute itself, is “to establish a temporary Federal program that provides for a transparent system of shared public and private compensation for insured losses resulting from acts of terrorism....” Terrorism Risk Insurance Act of 2002, Pub. L. No. 107–297, § 101(b), 116 Stat. 2322, 2323 (emphasis added).
The U.S. government’s Terrorism Risk Insurance Program (“TRIP”) has already invested in the assistance of the Westat corporation, which will provide the federal government with surveys and economic perspectives for the government’s insurance program. Since the U.S. insurance and reinsurance industries continue to shy away from fully covering terrorism in their policies, the situation’s gravity re-


13. The U.S. Treasury Department held a meeting on January 30, 2003 with insurance representatives in order to discuss the drafting of survey questionnaires and to select contractor bids for the undertaking. Id.

14. Insurers’ hesitations particularly rest on the issue of potential bankruptcy upon another terrorist attack. Dwight Jaffe & Thomas Russell, Extreme Events and the Market for Terrorism Insurance 4 (Feb. 1, 2002) (U.C. Berkeley paper presented at the Nat’l Bureau of Econ. Research Conf. on Ins., Cambridge, MA) (examining the reaction of markets after the occurrence of low “frequency/high cost” events), available at http://faculty.haas.berkeley.edu/jaffeepapers/drinsfeb02.pdf (last visited Feb. 12, 2003). “[T]he probability that an insurance firm would be made bankrupt by a particularly bad terrorist loss during one year is substantially higher than the probability that the same firm would be made bankrupt by a particularly bad run of, say, auto insurance losses during a year.” Id. The insurance industry remains uncomfortable with bearing the entire risk of insuring against terrorism arguably because of the absence of historical data on the matter. See Christian Gollier, Insurability 24 (Feb. 1, 2002) (paper prepared for the Nat’l Bureau of Econ. Research Conf. on Ins., Cambridge, MA), available at http://www.nber.org/~confer/2002/insw02/insurprg.html (last visited Oct. 17, 2002). For example, no one knows the likelihood of a “large terrorist attack next year.” Id. Interestingly enough, however, this ambiguity does not paint the entire picture, as insurance theorists claim ambiguity alone is not determinative. Id. Gollier explains that the insurance industry’s aversion to cover terrorist-related harm exemplifies the “weight of evidence dilemma.” Id. at 24–25. He provides
quires that the U.S. government quickly determine TRIA’s destiny, even if it means renewing the legislation again on a short-term basis. The legislation’s passage strongly rested on its temporary nature; yet with the continuing terrorist threat, the legislation may require either a strong alternative or some serious alterations. U.S. officials will need to carefully examine the program’s statistical data as well as other insurance and national safety considerations before selecting a national terrorism insurance coverage option.

This Note will serve to clarify the legal and economic concerns that surround the forthcoming issue of TRIA’s renewal through a comparison of the U.S. government’s terrorism insurance program with the parallel programs available in the United Kingdom (“U.K.”) and Israel. An international perspective brings to light both TRIA’s limitations and achievements. As this Note will reveal, TRIA still has much room for improvement. These issues can also potentially pose a significant

Keynes-Ellsberg’s “two color problem” in order to illustrate this evidentiary issue:

[T]here are two urns each containing red and black balls. Urn 1 contains 50 red balls and 50 black balls, whereas urn 2 contains 100 red balls and black balls in unknown proportion. A ball is drawn at random from an urn and receives 100 euros or nothing depending on the color of the ball. The fact that people are indifferent to bet on red or black is used to indicate that their subjective probability for each color is 0.5, as in urn 1. [One seeking to maximize their probabilities] should thus be indifferent to using urn 1 or urn 2 for gambling. However, most people prefer to gamble with the unambiguous urn 1, where the “weight of evidence” is larger.  

Id. at 25. The insurability problem arises when insurers are “systematically more adverse than consumers.” Id. But see John Hillman, Terrorism Insurer: Americans Forget the Lessons of Sep. 11, BESTWIRE, Dec. 10, 2003, available at LEXIS, Nexis News & Bus. Library (reporting that the vice president of ACE USA’s terrorism underwriting department claims that in the event that the U.S. government does not renew TRIA, ACE will still be able to offer clients “other type[s] of protection.”).


cost burden for taxpayers, making room for some improvement necessary. For this reason, this Note argues in favor of TRIA's renewal, but contingent on serious alterations that would make the legislation more meaningful and helpful to the nation.  

After this introduction, Part II provides background information necessary for understanding the reasoning behind the unavailability of insurance and reinsurance within the U.S. after-September 11, 2001 and also discusses TRIA's legislative details. Part III introduces the analogous insurance dilemma faced by the U.K. in England and in Northern Ireland from 1992 until today, explaining the nation’s most recent legal developments as well as the implications of government insurance assistance for the nation’s insurance industry. Part III also introduces Israeli legal intervention in terrorism insurance coverage, demonstrating widespread public insurance techniques used for involving the private sector in mandatory national terrorism coverage. Part IV then presents a critical analysis of TRIA and compares the U.S. government insurance program with the Note’s proffered international models. This comparison then provides a global backdrop for the legislation, allowing for a critical comparative analysis and policy direction in sup-

18. See generally Warshawsky, supra note 12.
port of TRIA’s renewal. Part V concludes with a summary of the alterations necessary for TRIA’s maximum effectiveness as a facilitator of terrorism insurance coverage.

II. TRIA’S LEGISLATIVE HISTORY

A. The American Insurance Dilemma — Changes After September 11th

As a result of the insurance industry’s realization of its immense underestimations of underwriting terrorism due to September 11, 2001,20 insurance contracts renegotiations quickly crumbled thereafter.21 In fact, although unknown to many, January 1, 2002 was a monumental day in the history of American insurance coverage. That day set the stage for TRIA’s passage, marking the date when most reinsurance and insurance companies refused to renegotiate practically all insurance contracts, including terrorism coverage.22

The reinsurance industry’s extensive refusal was devastating to insurance companies, since reinsurance serves as the prime insurance of insurers.23 Contractual agreements, also known as “treaties,”24 between reinsurers and insurers play a monumental

20. See Gordon Woo, Quantifying Insurance Terrorism Risk 1 (Feb. 1, 2002) (paper prepared for the Nat’l Bureau of Econ. Research Conf. on Ins., Cambridge, MA) available at http://www.nber.org/confer/2002/insw02/insurprg.html (last visited Oct. 17, 2002). See also Gollier, supra note 14, at 26. The occurrence of an “underestimated” risk effectively penalizes underwriters as such losses pose a direct threat to their company’s loss ratios. Id. For this reason, in such adverse situations, underwriters prefer to “overestimate” their risks instead. Id.

21. See infra Part II.


24. Reinsurance treaties usually apply to a large number of insurance policies that reinsurance companies underwrite for long terms on a “continual basis” with annual or quarterly cancellation provisions, allowing for insurance companies to include additional policies as long their portfolios meet original
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role in the viability of the insurance industry.\textsuperscript{25} Through the
dispersion of market-liability,\textsuperscript{26} reinsurers provide insurers with
financial protection.\textsuperscript{27} Reinsurance agreements allow insurance
companies to provide policyholder protection by transferring, or
ceding, a part of the insured risk to a reinsurance company.\textsuperscript{28}
At a later time, reinsurance companies can then choose to reas-
sign their own risk to other investors by “retrocession.”\textsuperscript{29} For
this reason, the reinsurance industry prevents the insolvency of
insurers by assisting in the apportionment of liability for a par-
ticular event.\textsuperscript{30}

agreement conditions and standards. \textit{Ross Phifer, Reinsurance

\textsuperscript{25} See \textit{id.} at 6–15; Michael A. Knoerzer, \textit{Reinsurance}, 690 PLI/LIT 719,
723 (2003) (offering general information on the reinsurance market’s role in
insurance).

\textsuperscript{26} Insurers find that instead of multiple insurers covering one asset the
most cost effect way to insure large risks, such as bridges and large buildings,
is through one insurer who then can cede their risk to a reinsurer. Knoerzer,
\textit{supra} note 25, at 743.

\textsuperscript{27} See \textit{id.} at 743.

\textsuperscript{28} No privity exists between the reinsurer and the reinsured, as the ceded
portion creates a relationship that only relates to the ceding insurer and rein-
surer. \textit{Id.} at 721; 44A AM JUR. 2d \textit{Insurance} §1812 (Reinsurance — Nature of
Reinsurer’s Relationship to Original Policy Holder).

\textsuperscript{29} See John S. Diaconis, \textit{Introductory Comments and Basic Overview in a
Changing Global Environment}, 778 PLI/COMM 7, 12 (1998) (explaining fund-
damental reinsurance terminology). \textit{See also Kendall, supra} note 22, at 579.
\textit{See generally Robert Riegel et al., Insurance Principles and Practices:

\textsuperscript{30} The following example elaborates on how reinsurance provides insur-
ance coverage for assumed risks:

Building B has a value of [$]10 million. It is insured by insurance
companies X and Y, with each insuring fifty percent of the total value
of the building. X and Y reinsure their risks with reinsurers R sub
[to R sub n], respectively, through reinsurance contracts while retain-
ing forty percent of their respective risks for their own accounts. If
the building is destroyed, the [$]10 million loss will no longer be
borne entirely by X and Y. X and Y will have to pay for the loss up
front but, ultimately, their net payout will be limited to [$]2 million
each.

William B. Bice, \textit{Comment, British Government Reinsurance and Acts of
icorporating an example from: I Klaus Gerathewohl et al., \textit{Reinsurance
Principles and Practice} 3–6 (John Milligan–Whyte eds., 1988). Note, how-
ever, reinsurance treaties for the most part serve as indemnity contracts,
which means that the reinsurer does not make any payments until the ceding
However, the September 11 attacks pushed the U.S.’ intricate insurance system to its limit, and led reinsurers to withdraw from such expansive liability for terrorist damage exposure, as reinsurers were reportedly liable for 60 to 80% of insurance payments.\textsuperscript{31} Reinsurance companies’ new policies and renewal options excluded terrorism liability and, therefore, severely limited insurers’ terrorism coverage.\textsuperscript{32} This overt exclusion led many property owners and developers to scramble to find pricey alternatives before TRIA’s enactment.\textsuperscript{33}

As a result of high insurance premiums and, in many cases, lack of coverage offered, nearly half of U.S. businesses had no terrorism insurance coverage before the legislation’s enactment.\textsuperscript{34} In fact, the property industry asserted that new building projects estimated at $15 billion\textsuperscript{35} were stalled due to the company pays a percentage of the reinsurer’s portion for each claim. See PHIFER, supra note 24, at 230.


32. See Kendall, supra note 22, at 581–87.

33. See, e.g., William Sherman, Putting a Premium on Disaster: Insurance Costs Skyrocketing after Attacks, DAILY NEWS, April 28, 2002, at 22. Several prominent insurance deals that took place after contract renewal either required much higher premiums or completely excluded terrorist harm: (1) After October 31, New York’s Metropolitan Transit Authority (“MTA”) faced an increase in insurance rates from $6 million for $1.5 billion coverage and now is paying $18 million for $500 million coverage, a 200% increase, and the MTA also needed to purchase separate coverage for terrorism coverage at a $7.5 million premium for $70 million worth of coverage; (2) San Francisco’s Golden Gate bridge’s new insurance policy doubled and did not cover terrorism; (3) Yankee stadium’s insurance premium increased 125%, but the team stated that it would not increase admission; (4) The Meadowland’s insurance premium significantly increased from $700,000 to $2.1 million; and (5) Co-op and condominium buildings’ premiums increased 30% to 50%. Id. In addition, Times Square’s Condé Nast building was found to be in default on its mortgage because of the building’s lack of terrorism insurance, creating a heated legal dispute between the mortgaging bank and property owners. Thomas J. Walsh, 4 Times Square Runs Into Terrorism Coverage Problem, May 13, 2002, at http://www.crnewspage.com/4_times_story.html; Michael Kercheval, A Policy on Terrorism Insurance: Who Will Pay Out if Terrorism Strike Malls?, CHAIN STORE AGE EXECUTIVE WITH SHOPPING CENTER AGE, May 1, 2002, at 92.

34. See Look, No Umbrella, ECONOMIST, Sep. 7, 2002, at Fin. & Econ. sec.

lack of terrorism insurance availability. As a result, insurance uncertainty was negatively affecting the U.S. economy. Had the U.S. government refrained from assisting in the reinstatement of terrorism insurance coverage, another terrorist attack could have easily driven many businesses into bankruptcy, destroyed existing bank loans secured by properties of which the underlying value would have significantly diminished, limited future project funding and damaged pension funds as property investments would fail to reap profitable reimbursements. Due to these devastating prospects, TRIA presently provides governmental support to the insurance industry as a reinsurer of “last resort.”

The primary burden of covering the costs of the attacks was carried by insurance and reinsurance companies under “all risk” insurance coverage for businesses and property owners in

house.gov/news/releases/2002/10/print/200210003-6.html (last visited Nov. 22, 2002)). But see Look, No Umbrella, supra note 34, (pointing to a total sum of $8 million).


37. Id.

38. For this reason, secured lenders and insurance company/relationship lenders took various approaches in handling the issue of terrorism insurance. Richard R. Goldberg, Real Estate Financing Documentation: Coping with the New Realities, SH004 ALI-ABA 537, 549 (2003). Securitized lenders required terrorism insurance coverage on new loans and also demanded similar insurance on existing loans and projects. Id. at 549. In contrast, insurance company and relationship lenders allowed for terrorism insurance waivers, but some of these companies waived the procurement of terrorism insurance until it was commercially available to other similarly situated property owners. Id. Cf. Bice, supra note 30, at 448 (noting the implication of lack of terrorism coverage in the case of the U.K.).


40. See HOLMES’ APPLEMAN ON INSURANCE 2d § 1.10. The standard definition of “all risk” insurance coverage is as follows:

[All risk coverage should be interpreted to be just that — “All Risks.” Once the loss is proven by the insured to be caused by some risk generally covered…other than normal depreciation or inherent vice or defect, the insurer should have the burden to prove that the loss does not fall within some specified exclusion or exception. That the insurer has the burden of proof to prove no coverage under an all risk
the downtown World Trade Center area. According to the insurance industry, insurance payouts for the attacks have marked the steepest financial burden for the U.S. insurance industry since Hurricane Andrew as well as the largest insurance catastrophe ever worldwide. Although the primary insurance industry could possibly have sidestepped the costs of the September 11 attacks through a “war exclusion” clause found in most “all risk” policies, the insurance industry refrained from using this legal backdoor.

policy is the American rule in all the states, with the possible exception of Texas. Id. See also Joseph P. Snyder & Susan A. McAllister, Risk Management; Keeping Abrace of Insurance Policies: Review of Available Property/Liability Coverages, 14 COMM. LEASING L. & S. 3 (2001). The insurance industry provides a multitude of coverage options that are slowly eroding the past popular “all risk” insurance coverage. Id. Snyder and McAllister elaborate this point:

Property insurance coverage…protects the owner of property and others who have insurable interest in the property against loss due to fire and other perils. There are two general types of property insurance coverage: (1) “Named Perils” coverage, which clearly identifies the specific risks or perils insured against..., and (2) “Special Form” coverage, which covers all direct physical loss or damage to the insured unless it is caused by a peril specifically excluded from coverage under the terms of the policy. Special form coverage is by far the most common type of coverage purchased. It is the successor to “All Risk” insurance and is more expansive than its predecessor because it more specifically limits the occurrences excluded from coverage. Though many leases still require “All Risk” coverage, it has disappeared from the titles of insurance companies. Id. For a list of items typically excluded in U.K. “all risk” insurance contracts, see DIGBY C. JESS, THE INSURABILITY OF COMMERCIAL RISK: LAW AND PRACTICE, 316–17 (Sweet & Maxwell 3rd ed. 2001).

41. However, the World Trade Center’s insurance coverage may have actually been higher than the national average due to the building’s previous experience from the 1993 attack.


44. See Stempel, supra note 43, at 817.
War exclusion clauses specify that insurance companies should not have to pay for the costs of damages inflicted by an enemy state.\(^{45}\) For example, in *Pan American World Airways, Inc. v. Aetna Casualty & Surety*,\(^{46}\) the Court of Appeals for the Second Circuit ruled that Aetna did not have recourse to the war exclusion clause in the aftermath of the Pan American commercial airplane hijacking.\(^{47}\) In this case, terrorists had forced a plane to land in Egypt in order to use the threat of harm as a bargaining tool for their cause, which ultimately led to the plane’s destruction. The Court reasoned that war can exist between “quasi-sovereign entities”\(^{48}\) and can also “exist between sovereign states,”\(^{49}\) but insisted that the Popular Front for the Liberation of Palestine’s (“PFLP”) actions were independent from other Palestinian entities and, therefore, unrelated to any type of sovereign’s act of war.\(^{50}\)

Despite this legal precedent, insurance companies could have made the claim that the September 11 events were acts of war in light of President Bush’s declaration to that effect and subsequent U.S. military intervention in Afghanistan. The insurance industry could have also pointed to the strong ties between the Taliban and Al Qaeda.\(^{51}\) Nevertheless, after carefully consider-

\(^{45}\) *See generally* Kendall, *supra* note 22, at 573 (explaining the history of war exclusion clauses).


\(^{48}\) *Pan American World Airways, Inc. v. Aetna Casualty & Surety*, 505 F.2d at 1009.

\(^{49}\) *Id.* at 1013.

\(^{50}\) *Id.*

\(^{51}\) *See Stamper, supra* note 46, at 152.
ing the public relations and cost ramifications of such action and the court’s probable leniency towards insured parties, the insurance industry chose not to pursue any possible “war exclusion” argument.

Before September 11, underwriters freely assumed the risk of terrorism under “all risk” insurance policies. At that time, insurers considered the chances of domestic terrorist attacks on the U.S. as reasonably miniscule in comparison to other insurance coverage costs. The costs of the September 11 World Trade Center attacks, however, were far from miniscule. The tragedy of September 11 cost insurers an estimated $100 billion. Although the insurance industry was able to pay for most of the damages, another terrorist catastrophe would, according to the industry, deplete their financial reserves and force many insurers into bankruptcy, potentially devastating the U.S. insurance business. In the case of the World Trade Center disaster, the insurance industry had not anticipated such major losses due to terrorism and this lack of foresight forced insurers and reinsurers to assume a substantial portion of the damages of September 11.

52. See Westchester Resco Co. v. New England Reinsurance Corp., 818 F.2d 2 (2d Cir. 1987) (holding that insurance policy ambiguities are “construed strictly against” the insurer). See also Thomas, supra note 43, at 420–23 (explaining the transaction costs associated with litigating terrorism exclusion from insurance and reinsurance coverage).
54. See Thomas, supra note 43, at 402.
57. The National Association of Insurance Commissioners (“NAIC”) noted that even a $25 million loss for a primary insurance property/casualty insurer would pose solvency issues for 886 companies, which represents 44% of companies providing for such insurance. Thomas, supra note 43, at 403.
58. See World Trade Center Attack — The Ramifications, Tyser Group Limited, (explaining and listing the monetary losses that insurance companies faced world wide due to the September 11 attacks), at http://www.tyseruk.co.uk/wtc.pdf (last visited Jan. 18, 2004). In fact, the World Trade Center’s bombing also changed the lender’s insurance requirements at closing, as one
In order to prevent this exorbitant cost exposure, reinsurers redrafted their insurance treaties to exclude terrorism. Primary insurers and reinsurers’ agreements involve a high level of contract negotiability, which allows for such reinsurance exclusions. Insurers and reinsurers draft sophisticated negotiation with regard to treaties as compared to the standard boilerplate policies that primary insurers provide to insured parties. The distinction poses significant legal implications. The inherent flexibility of treaties allows each party to include or exclude terms through negotiation. Moreover, reinsurance treaties usually maintain provisions requiring dispute resolution through private arbitration, which further limits judicial intervention. This freedom of contract limited the U.S. courts’ and government’s intervention in such insurance matters.

of the hotly litigated issues with respect to insurance coverage for the damages were the existence of the actual insurance policies themselves. Goldberg, supra note 38, at 548. The billion-dollar World Trade Center transaction was closed through the use of insurance binders placed with multiple carriers. Id. The use of these insurance binders or ACORD 27 certificates meant that insurance policies were never issued; nevertheless, the court used these binders in order to construe an applicable insurance policy. Id.


60. See also ROBERT MERKIN ED., WHAT IS REINSURANCE? A COMPARATIVE STUDY 2, 51 (AIDA Reinsurance Working Party, 1998).

61. See id.


63. See Kendall, supra note 22, at 584 (“Whereas state regulatory agencies exercise veto power over the specific terms of insurance policies intended for issuance to consumers by direct writers, they exercise little power over the terms of reinsurance treaties as a matter of longstanding practice.”). However, reinsurers still face regulation through their ceding companies, since state law limits the “ceding company’s ability to take credit on its statutory
Due to the cessation of contractual obligations after January 1, 2002, many reinsurers were free to abstain from providing terrorism insurance coverage and this was the option that most insurers chose to take.\(^{64}\) The few reinsurance companies that did provide such insurance post January 1, 2002 nearly doubled their premium rates while simultaneously decreasing their total coverage.\(^{65}\) As a result, the insurance industry was left on a tightrope without the assumed safety net of reinsurance. Despite this, however, the primary insurance industry needed to satisfy state regulation standards.\(^{66}\) Thus, in part, the lack of legal intervention forced the insurance industry to consider the discontinuation of terrorism related insurance.

1. The State-Level Domino Effect of Insurance Deregulation

As most reinsurance companies dropped terrorism coverage, the insurance industry struggled to provide terrorism policies for their clients. The National Association of Insurance Commissioners ("NAIC")\(^ {67}\) asked for each state to allow for the Insurance Services Office’s ("ISO")\(^ {68}\) exclusion modifications, which would exclude losses stemming from less costly acts of

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\(^{64}\) As reinsurers conduct business on an international scale with sophisticated insurance companies, reinsurers face limited government regulation. See Thomas, supra note 43, at 403. For this reason, reinsurers were easily able to subtract terrorism insurance coverage from their treaty negotiations with insurers. See id.

\(^{65}\) See supra note 33 and accompanying text.

\(^{66}\) See infra Part II.A.1.

\(^{67}\) The National Association of Insurance Commissioners ("NAIC") serves as an insurance regulation organization, representing all fifty states, the District of Columbia and the four U.S. territories. The NAIC provides a forum for uniform insurance policy development and assists state regulators in protecting the interests of insurance consumers for the provision of common financial objectives and conduct regulation. For more information, see the NAIC's website at http://www.naic.org/ (last visited Oct. 3, 2003).

\(^{68}\) For more information on the Insurance Services Office’s ("ISO") most current stance on terrorism insurance, see the ISO’s website at http://www.iso.com/filings/response.html (last visited Jan. 5, 2004). The ISO’s website also provides forms and policy writing rules in response to TRIA's requirements.
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terrorism. The ISO supplies hundreds of U.S. insurance companies with advice and standard forms of insurance policy provisions, and established licensed forms for terrorism exclusions. The ISO’s exclusionary clauses limited insurance companies’ exposure to a maximum of $25 million within a seventy-two hour time frame, or for the death of fifty or more people; furthermore, the threshold amount did not include terrorist activity using nuclear, chemical or biological weapons. Thus, terrorism coverage excluded properties and development projects requiring coverage greater than proscribed, especially trophy buildings and national landmarks.

While most states allowed for insurance deregulation, several prominent states such as New York, California, Texas, Georgia and Florida withheld approval. New York and California ardently opposed the ISO’s exclusionary clause. California re-

70. For more information, see the ISO’s website at http://www.iso.com (last visited Jan. 5, 2004).
71. Terrorism, as defined by the ISO, consisted of:
Activities against persons, organizations or property of any nature:
(1) That involve the following or preparation of the following: (a) Use or threat of force or violence; or (b) Commission or threat of a dangerous act; or (c) Commission or threat of an act that interferes with or disrupts an electronic, communication, information, or mechanical system; and (2) When one or both of the following applies: (a) The effect is to intimidate or coerce a government or the civilian population or any segment thereof, or to disrupt any segment of the economy; or (b) It appears that the intent is to intimidate of coerce a government, or to further a political, ideological, religious, social or economic objectives or to express (or express opposition to) a philosophy or ideology.

72. The adoption of the $25 million limit stemmed from insurers’ concerns that any higher amount would create a severe threat to the solvency of a substantial percentage of insurers of property and casualty insurance. See Thomas, supra note 43, at 404.
73. States Adopt Terror Exclusion Clauses in Absence of Any Federal Solution, INS. DAY, Mar. 5, 2002, at law sec. [hereinafter States Adopt Terror Exclusion Clauses].
74. See Look, No Umbrella, supra note 34.
75. Loubier & Aro, supra note 56, at 19.
76. MERKIN, supra note 60.
fused to accept the ISO’s terrorism exclusion since the state’s regulators found: the ISO’s definition of terrorism to be too broad; the $25 million threshold of national damage overwhelmingly low; and the seventy-two hour time period as plainly arbitrary.\textsuperscript{77} New York state regulators voiced similar grievances with the ISO’s exclusion clause, and further noted that the $25 million threshold would exclude practically every building in downtown Manhattan, especially buildings near the World Trade Center site.\textsuperscript{78}

Since insurance regulation primarily falls under state law,\textsuperscript{79} insurers who wished to follow the exception clause started writing property insurance policies through affiliated companies conducting business within insurance-friendly states.\textsuperscript{80} Despite a limited amount of insurers,\textsuperscript{81} who established their own terrorism insurance coverage in separate policies, terrorism insurance remained extremely expensive and scarce.\textsuperscript{82} Meanwhile, the insurance industry also significantly increased commercial property insurance premiums in order to assist covering September 11 costs.\textsuperscript{83} As the insurance industry limited its in-

\begin{itemize}
\item \textsuperscript{77} States Adopt Terror Exclusion Clauses, \textit{supra} note 73.
\item \textsuperscript{78} Id.
\item \textsuperscript{80} Loubier & Aro, \textit{supra} note 56, at 19.
\item \textsuperscript{81} According to one source, five carriers offered terrorism insurance coverage with limits of $200 million, charging premiums that “far outweighed the costs of regular casualty insurance.” Richard R. Goldberg, \textit{Real Estate Financing Documentation: Coping with New Realities}, SH004 ALI–ABA 537, 548 (2003). The list of such insurers was extremely limited, and included the following insurers: Lloyd’s, AIG and ACE. \textit{See Look, No Umbrella, supra} note 34.
\item \textsuperscript{82} \textit{Look, No Umbrella, supra} note 34.
\item \textsuperscript{83} Bob Howard, \textit{Commercial Real Estate; Tenants to Pay Increased Rents in 2002. See also Insurance: Fees for Commercial Property Will Jump, as Landlords Face Premiums Hikes of 30% to 100%, LOS ANGELES TIMES, Dec. 25, 2001, at 5} (This article indicates that the insurance industry hiked up premiums also due to years of under-pricing and a general decline in the equity market, which stemmed from insurance companies’ previous practice of investing premiums into the stock market for a profit that would in turn minimize premiums.).
\end{itemize}
B. U.S. Congressional Action: A Myriad of Changes Before TRIA’s Enactment

Due to the lack of insurance for properties and major building projects, the U.S. government moved to support the insurance industry in Congress’ first and second sessions. After countless deliberations, the legislature enacted the “Terrorism Risk Insurance Act of 2002,” which many now refer to as TRIA. The main difficulty in passing the bill was merging the House of Representatives’ plan, H.R. 3210 (the Terrorism Risk Protection Act), with the Senate’s plan, S. 2600 (the Terrorism Risk Insurance Act of 2002), in order to establish TRIA. Both plans entailed the federal government’s monetary support only after the insurance industry’s costs of terrorist-instigated damages exceeded an established monetary threshold; however, each house differed in terms of deductible amounts, government assumption of risk, limits on punitive damages and repayment arrangements.

The final version of the bill incorporated bits and pieces of both houses’ legislative plans. For this reason, an understanding of the final product requires some attention to the deliberation proceedings, since the Act provides no explanations or legislative history.

The House’s “Terrorism Risk Protection Act” structured a reinsurance scheme that would provide insurers a way to spread their losses after a catastrophic terrorist attack in a manner very different from the enacted legislation. Under the House’s plan, the federal government would assume 90% of the insur-
The insurance industry's losses when such losses amounted to over $1 billion within a year of the terrorist activity. The House's plan also provided assistance for smaller insurance claims, if such claims threatened the solvency of a participating smaller insurer. For example, the government could intervene even when an insurance claim for losses caused by terrorism exceeded 10% of an affected insurance company's surplus capital and net premiums. Therefore, a claim as relatively small as $100 million, under the House's plan, may have merited government support.

Despite the House's seeming cornucopia of reinsurance coverage, insurance companies would eventually have to repay the government for a large part of the financial assistance received. For losses under $20 million, insurers would have been liable to the government for three-quarters of the total amount the government paid. Within the first year, insurers would have been responsible for one-quarter of the repayment due. Under the House's plan, insurers would have to reimburse the government's financial assistance after an unstated number of years at a rate set at insurers' annual assessments, not exceeding 3% of their premiums. For claims over $20 million and under the budgetary cut off of $100 billion, policyholders' premiums would have faced governmental surcharges of up to 3% of their premiums, but the government would not have required insurers to pay interest.

Alternately, the Senate's reinsurance plan offered terrorism insurance coverage without requiring insurance companies to

90. Elaine S. Povich, House OKs Insurance Bill; Measure Would Allow Coverage Against Terrorist Acts, NEWSDAY (NY), Nov. 30, 2001, at A65 (noting that the White House endorsed the House's plan, but prefers the Senate's legislation).
91. CBO STUDY, supra note 88, at 25.
92. Id.
93. Id.
95. Id.
96. Id.
97. CBO STUDY, supra note 88, at 25.
99. H.R. 3210 § 8(c).
reimburse the government, similar to the law’s final version. After a series of unsuccessful House bills, the Senate enacted its own version of the Terrorism Risk Insurance Act. The Senate’s reinsurance initiative provided insurance funding without repayment, but only after the insurance industry first paid a certain deductible. Under the Senate’s plan, if a catastrophic event were to occur within the first year of the program’s implementation, the insurance industry would have been liable for the initial $10 billion in losses.

After the insurance industry had paid the $10 billion, the government would pay for 80% of all losses up to the maximum of $100 billion. Similar to the House’s strategy, the Senate’s bill allowed for government assistance for losses under $10 billion only when the solvency of an individual insurance firm was at stake. The deductible would have been the insurer’s market share percentage multiplied by the government’s $10 billion requirement. In this way, the Senate hoped to allow the federal government to assume terrorism risk funding only after the insurance industry had already assumed their initial responsibility to make payments after the occurrence of a terrorist act.

Regardless of the drastic differences between the House and Senate’s legislation, Congressional debates mainly involved dis-

100. The following bills were unsuccessful in the first session of the Senate’s 107th Congress: S. 1743, S.1744, S. 1748, and S. 1751.
101. See S. 2600.
102. See id. §§ 3(7) & 4(e).
103. If the treasury decided to extend the program for more than one year, then insurers would be responsible to pay a deductible of $15 billion in initial losses.
104. See S. 2600 § 4(e)(II).
105. See id. § 4(e)(I)(A).
106. See id. § 3(7)(A–B).
107. According to the Senate’s Terrorism Risk Insurance Act of 2002, an insurer’s market share would have been:

[C]alculated using the total amount of direct written property and casualty insurance premiums for the participating insurance company during the 2-year period preceding the year in which the subject act of terrorism (or during such other period for which adequate data are available, as determined by the Secretary [of the Treasury]), as a percentage of the aggregate of all such property an casualty insurance premiums industry-wide during that period.

Id. § 3(4)(A).
agreement on tort reform.\footnote{108} Although both Houses agreed that terrorism insurance assistance would require state preemption,\footnote{109} and that the Secretary of the Treasury should be appointed as final adjudicator of insurance claims,\footnote{110} the House’s bill also added prohibitions against claims seeking punitive damages, limited cases to federal courts, and sought to cap attorneys’ fees at 20% of awarded damages with penalties for disobedience.\footnote{111} However, the Senate refused to pass legislation minimizing the legal rights of litigants and their attorneys,\footnote{112} leading to a bipartisan debate that lasted the entire second session of Congress, and that went unresolved, ultimately leaving these sections out of the bill.\footnote{113} Interestingly enough, the issue of whether the U.S. government should assist in terrorism insurance coverage rested heavily upon attorneys’ fees.

C. The Terrorism Risk Insurance Act of 2002 (“TRIA”)

TRIA ended all debates with important concessions made by both Houses. The legislation now offers a version of insurance financial backing similar to the Senate’s bill, for a temporary three-year span.\footnote{114} TRIA specifically mandates that all property insurance companies must cover terrorism risk coverage,\footnote{115} ex-

\footnotetext[108]{108} See Loubier & Aro, supra note 56, at 21. \footnotetext[109]{109} H.R. 3210 § 12; S. 2600 § 10. \footnotetext[110]{110} H.R. 3210 § 3; S. 2600 § 4(a)(2). \footnotetext[111]{111} H.R. 3210 § 15(a)(7) (included in the Nov. 29, 2001 and Dec. 3, 2001 versions of the bill). \footnotetext[112]{112} In fact, many senators opposed the passage of such legislation, since many felt that the government’s contemplated reinsurance scheme and litigation reform would in effect act as a “sop to corporate America.” Povich, supra note 90. \footnotetext[113]{113} See id; CBO STUDY, supra note 88, at 25 (noting that the House and Senate differed on the matter of punitive damages). \footnotetext[114]{114} Terrorism Risk Insurance Act of 2002, Pub. L. No. 107–297, §§ 108(a), 102 (11)(D). \footnotetext[115]{115} TRIA requires that all insurance companies that fall under the Act’s provision must participate. See id. §§ 102(6), 103(a)(3). TRIA defines “insurer” to include: (1) any insurance entity licensed to conduct business in any state in the U.S.; (2) all eligible insurers under the NAIC’s listing of Alien Insurers; (3) federally approved insurers providing coverage for maritime, energy or aviation activity; (4) state residual market insurance entities or state workers’ compensation funds; and (5) any other entity that fall under section 103(f) of TRIA, which requires that an entity wishing inclusion in TRIA must apply before the occurrence of a terrorist act. Id.
cluding reinsurance,\textsuperscript{116} making all terrorism exclusions previously approved by various state commissions now void.\textsuperscript{117}

Legislative constraints have also created many compromises between the two extremes taken by the House and the Senate. TRIA permits suits for punitive damages, but excludes the government from suit, thus freeing the nation from potential liability.\textsuperscript{118} There is no language referring to attorneys’ fees and non-economic damages;\textsuperscript{119} however, the law limits suits for damages arising from terrorist attacks to a Congressionally designated federal court.\textsuperscript{120} This jurisdictional distinction might very well produce smaller awards in damages than pro-litigant state courts.\textsuperscript{121} However, the merging of pending legislation regarding

\textsuperscript{116} Id. § 108(a–b).
\textsuperscript{117} Id. §§ 102(6)(A–C), 105(a–c). Lorelie S. Masters et al., \textit{Overview of the Terrorism Risk Insurance Act}, 686 PLI/Lit 427 (2003). TRIA does not obligate reinsurers to provide insurance for terrorism related harm, as the U.S. government under the Act takes on this role. \textit{See} Terrorism Risk Insurance Act of 2002, Pub. L. No. 107–297, §§ 102(6)(A–C), 105(a–c). Section 105 simply states that: “Any terrorism exclusion in a contract for property and casualty insurance that is in force on the date of enactment of this Act shall be void to the extent that it excludes losses that otherwise be insured losses.” Id. § 105(a–c) (emphasis added). However, the amount of coverage that TRIA provides for the general public is questionable, as TRIA requires the availability of terrorism insurance coverage; it does not specify how much it should cost. \textit{See} Thomas, \textit{supra} note 43, at 404. Accordingly, terrorism insurance coverage remains expensive for most businesses, which means that insurers are not insuring terrorism in all of their property and casualty policies. \textit{Id.} Furthermore, the U.S. Treasury Department explains in an interim guideline that TRIA requires that insurers make terrorism insurance “available,” but the Act does not require that insurers cover all risks that relate to terrorism damage, such as nuclear, biological and chemical damages. Masters, \textit{supra} note 117, at 430–31. Furthermore, TRIA also has a provision that allows insurers to add their previous terrorism exclusions in their contracts after providing their insured notices of such or if the policy holder does not pay for the additional terrorism coverage. \textit{Id.} \textit{See also} Terrorism Risk Insurance Act of 2002, Pub. L. No. 107–297, § 105(c). For additional analysis of the ramifications of these provisions, \textit{see infra} Part IV.

\textsuperscript{119} \textit{See} id. § 107.
\textsuperscript{120} Id. § 107(a)(4).
\textsuperscript{121} \textit{See generally} RICHARD L. MARCUS ET AL., \textit{CIVIL PROCEDURE: A MODERN APPROACH} (West Group 3d ed. 2000). This jurisdictional limitation may also make it difficult for foreign individuals and companies to prosecute claims outside of the U.S. Aon Reed Stenhouse Corp., \textit{The U.S. Federal Terrorism Risk Insurance Act of 2002 Implications for Canadian Insureds}, AON STATUS
frozen terrorist assets ameliorates TRIA’s escape-valve with respect to punitive damages, although it remains questionable whether or not such a provision will have force.

The government’s terrorism insurance assistance scheme allows the Secretary of the Treasury to determine and provide insurance-loss coverage, up to $100 billion for commercial property and casualty insurers’ liabilities resulting from future terrorist attacks, excluding traditional acts of warfare. Only the Secretary of the Treasury, Secretary of State and Attorney General can determine whether a situation falls under the category of a terrorist attack, their determination being final without the option of judicial review.

Government assistance under TRIA covers insurance losses exceeding the amount of $5 million. At that point, insurers

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127. Id. § 102 (1)(C).

128. Id. § 102(1)(B)(ii). The $5 million threshold applies to the aggregate property and casualty insurance losses stemming from an act of terrorism, and not on a policy-by-policy basis. Ugoletti, Implementing TRIA, supra note 11, at 4. Ugoletti also provides the following illustrative example: “if $7 million in aggregate property and casualty losses from a certified act of terrorism
remain responsible for a deductible that is adjusted according to each year’s percentile incremental deductible increase.\textsuperscript{129} TRIA assesses insurers’ deductible as an amount equal to the value of insurers’ direct earned premiums over the calendar year multiplied by 7, 10 and 15% for each year the program progresses.\textsuperscript{130} Section 103(e)(6)(A–C) also requires insurance companies to hold aggregate retention amounts of $10 billion, $12.5 billion and $15 billion.\textsuperscript{131} Therefore, the federal government’s total possible exposure would be $90 billion for the first year, $87.5 billion for the second year and $85 billion for the program’s last year.\textsuperscript{132}

TRIA also sets requirements for insurance companies that were not previously established in either House’s proposed bills. It places a statutory limit on premium increases to a maximum of 3% of the premium charged for property and casualty insurance coverage under each policy.\textsuperscript{133} The legislation also requires that insurers send coverage notices to their insured stating the premium charged for claims that TRIA covers.\textsuperscript{134} This requirement attempts to serve as a mechanism for assisting property owners in deciding whether or not to purchase terrorism insurance in addition to their regular property and casualty insurance.\textsuperscript{135} TRIA, however, retains state commission’s regulatory authority over insurance companies,\textsuperscript{136} and signifies that con...
sumer waivers of terrorism insurance will not apply to states that have legislation requiring insurers to include standard fire provisions in their policies.\textsuperscript{137}

In addition, TRIA requires insurers to repay the difference between their marketplace aggregate retention and the aggregate amount that the federal government is not compensated for because of the amount being within insurers’ deductibles or within the portion that the government does not cover.\textsuperscript{138} However, this reimbursable amount can potentially have a diminished value, as the statute further provides that if the uncompensated losses exceed insurers’ aggregate retention, insurers are absolved of their recoupment requirement and in certain cases the Secretary of the Treasury has discretion to release insurers of their duty to reimburse the government.\textsuperscript{139}

Under TRIA, the Secretary of the Treasury has “sole discretion” over claim determinations, with no opportunity for judicial review.\textsuperscript{140} In fact, TRIA also bestows upon the Secretary of the Treasury complete power to carry out the government’s insurance program, including investigating and auditing claims, establishing rules for filing claims, employing personnel and contracting the government’s insurance program to other agencies.\textsuperscript{141}

Because of the U.S. Treasury Department’s role, TRIA now stands as the U.S.’ current legal mechanism for terrorism insurance coverage. However, as several Congressional reports


\textsuperscript{138} Terrorism Risk Insurance Act of 2002, Pub. L. No. 107–297, § 103(e)(7)(A). TRIA explains the recoupment of insurers’ “federal share” as follows:

\textit{Id.} See also id § 103(e)(1) (Paragraph (1) explains the government’s “federal share.”).

\textsuperscript{139} Id. §§ 103(e)(7)(D), 103(e)(1).

\textsuperscript{140} See id. § 102(1)(C).

\textsuperscript{141} Id. § 104(a–d).
have stressed the need for international templates concerning
government-established terrorism insurance,\textsuperscript{142} other interna-
tional examples of government implemented terrorism insur-
ance procedures offer insight into conceivable national expecta-
tions and differences. In a world where war has shifted from
national intervention to terrorist action, the realities of terror-
isim and its threat to a nation’s security and economy constitute
an issue of international magnitude.\textsuperscript{145} The U.K. has dealt with
terrorist activity in major British metropolitan areas and in
Northern Ireland. Meanwhile, Israel’s ability to function as an
economically viable state depends on its ability to withstand
frequent terrorist activity. The next section serves as a window
on these parts of the world that have faced similar insurance
challenges and have reached legal solutions of their own.\textsuperscript{144}

III. INTERNATIONAL TERRORISM INSURANCE PERSPECTIVES

“Men walk almost always in the paths trodden by others, pro-
ceeding in their actions by imitation.....so that if he does
not attain to their greatness, at any rate
he will get some tinge of it.”\textsuperscript{146}
– Niccolo Machiavelli\textsuperscript{146}

A. The U.K.’s Insurance Assistance Scheme: Has History Re-
peated Itself?

1. The U.K.’s Private/Public Terrorist Insurance Combination

Similar to the U.S.’ current reinsurance crisis, the U.K. faced
an insurance industry unwilling to assume the risks of terror-
isim in the early 1990’s.\textsuperscript{147} The U.K.’s insurance industry re-

\begin{footnotes}
101(a)(1).
144. See \textit{supra} note 19 and accompanying text.
146. Niccolo Machiavelli is considered as the “first commentator of power,”
and his work, \textit{The Prince}, serves as a complex treatise in political realism.
See \textit{id. xxvi–xxxi.}
147. The Association of British Insurers (“ABI”) announced in a press re-
lease made in November 1992 that British insurers decided to exclude terror-

quired minimal regulation in the past. However, in light of terrorist attacks on the British mainland throughout the 1990s, the government was faced with a potential economic crisis. In 1992, the U.K. resolved the issue of insurance and reinsurance coverage for terrorism through a pool reinsurance system (known as “Pool Re”). The British Parliament passed the Terrorism Reinsurance Act of 1993 in order to establish “Pool Reinsurance Co., Ltd.” This government action occurred in the wake of the Irish Republican Army’s (“IRA”) bombings of Bishopsgate and St. Mary Axe in the financial district of England. The nation’s damages for both bombings were around $2 billion dollars.


149. For an in depth analysis of the U.K.’s terrorism insurance issues in the 1990s, see Bice, supra note 30, 446–64.
154. For estimates of the costs the U.K. incurred in 1993 allegedly due to the IRA’s bombings, see Beatty, supra note 153, at 18 (noting that the costs of the St. Mary Axe explosion equaled to approximately $500 million) and Barnes, supra note 142, (estimating costs of the Bishopsgate explosion at $1.5 billions dollars).
Pool reinsurance differs from the usual insurance practice of subdividing risk by spreading a specific property's risk among many shareholders; rather, pooling creates a collection of numerous individual risks, not individually subdivided, which are grouped together. The program specifically covers the insurers of commercial properties, and residential properties in commercial ownership. Pool Re serves as a governmental insurance mechanism that joins insurers together under government supervision in order to financially prepare for any potential massive losses incurred as a result of terrorism. The government-established Pool Re system works as a mutual insurance company incorporated under the “Companies Acts,” after having gained authorization from Britain’s Department of Trade and Industry (“DTI”), providing reinsurance coverage under the regulations of the “Insurance Companies Act of 1982.” The British Secretary of State for Trade and Industry runs Pool Re as a quasi-governmental entity. However, a tribunal oversees any challenges to the Secretary of State’s decisions. Currently, a small staff runs Pool Re with an annual expense budget of £1 million (approximately $1.5 million).

Hence, the British Parliament intended to establish a reinsurance arrangement that would guarantee that Britain’s industry and commerce would continue to receive terrorism insurance coverage. In this way, the British Parliament felt that it could assist the nation’s injured insurance industry and

157. Munday, supra note 147.
158. Companies Acts, 1985, ch. 6, § 1 (Eng.).
159. For more information, see the U.K.’s Department of Trade and Industry web page at http://www.dti.gov.uk/ (last visited Nov. 16, 2003).
162. This tribunal consists of Pool Re representatives and government officials, and this tribunal holds the final say. Barnes, supra note 142.
164. See Beatty, supra note 153, at 18.
at the same time regain the ability to insure against terrorism in such a way that would also secure the State’s benefit. According to British legislative representatives, Pool Re’s establishment would also guarantee that Britain would incur “zero costs” for terrorism claims after several years of implementation. This assertion has proven accurate as Pool Re has met several claims without requiring any financial assistance from the U.K. government.

As a result of Pool Re’s financial soundness, the U.K. government’s reinsurance scheme allows for the accumulation of monetary funds that ultimately shelters the British government and Pool Re’s participant insurers from exorbitant liability exposure. In the program’s earlier stages, Pool Re even dispersed its remaining yearly profits among all its participating entities. Moreover, Pool Re has worked in the U.K.’s favor since the government only acts as “retrocessionaire” to its own pool reinsurance program. Only the complete depletion of Pool Re’s financial reserves would require the government to cover any remaining uncovered costs, and many argue that Pool Re could now easily handle a major catastrophe in the U.K.


166. The Way We Live Now, CONV. & PROP. LAW, Nov/Dec 1993, at 418–20 (noting that within its first year Pool Re was expected to have an income of £350 million, which shows that the government established reinsurance pool program could also be profitable).

167. See Barnes, supra note 142; HILLMAN, supra note 55, at 8.


169. As of Jan 1, 2003, Pool Re no longer provides insurers with surplus gains due to the program’s expansion of terrorism coverage, as the program now requires an increased amount of revenue in order to cover its increased exposure. See U.K. Treasury Announcement, supra note 165.

170. See Bice, supra note 30, at 453–56.

171. However, the British Pool Re system has not been tested in its full capacity, being that very few claims materialized after the early 1990s. See Andrew Cave, City — Companies Pay Double for Insurance Against Terrorism, DAILY TELEGRAPH, Jan. 4, 2003, at 31, available at 2003 WL 2831376.
Insurers in Britain wishing to offer terrorism insurance can group with other insurers in order to minimize the impact of any potential terrorist losses. However, Pool Re requires that reinsurers obtain terrorism coverage for all of their portfolio properties, not only for their high-risk properties.\textsuperscript{172} Thus, Pool Re spreads the volume of risky coverage onto less risky properties nationwide. Before gaining terrorism insurance, each insurer seeking terrorism coverage for their properties must be assessed according to three factors: (1) an insured's aggregate value of total properties insured; (2) the location of the property at risk;\textsuperscript{173} and (3) the property’s target risk.\textsuperscript{174} Pool Re divides the British mainland into four zones: the first covers the U.K.’s highest risk areas, which covers the heart of London and Westminster; the second covers the rest of London as well as major cities and their business districts; the third encompasses the rest of the England except Devon and Cornwall; and the forth covers the U.K.’s counties and towns in the outskirts of the towns of Scotland and Wales.\textsuperscript{175}

The U.K. government sets insurers coverage liability based on Pool Re’s “retention” requirements.\textsuperscript{176} Pool Re originally set U.K. insurers’ terrorism coverage retention at £100,000;\textsuperscript{177} however, as of January 1, 2003, Pool Re now implements a “per event retention” and “annual aggregate limit” model.\textsuperscript{178} This model was formulated as a result of the September 11 attacks in order to increase terrorism insurers’ retention rates in the event of multiple attacks on the U.K.\textsuperscript{179}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{172} Some property owners turn to alternatives for their “single location basis” properties that require terrorism insurance coverage. Pollack, \textit{supra} note 152, at S1.
\item \textsuperscript{173} \textit{See id.} Properties located in Central London, for example, have premium rates of “0.144 percent or $144 for every $1 million of coverage.” \textit{Id.}
\item \textsuperscript{174} \textit{See Bice, \textit{supra} note 30, at 451–53.}
\item \textsuperscript{175} Beatty, \textit{supra} note 153, at 18.
\item \textsuperscript{176} Pool Re’s retention requirements refer to the total costs that an individual insurer bears based on the “number of heads of cover affected.” U.K. Treasury Announcement, \textit{supra} note 165, at 2–5.
\item \textsuperscript{177} This amount totals to $157,000. Sarah Veysey, \textit{United Kingdom Expands the Scope of Pool Re Coverage}, \textit{Bus. Ins.}, July 23, 2002, \textit{available at} \textit{http://www.businessinsurance.com/cgi-bin/news.pl?newsId=1127} (last visited Jan. 30, 2004).
\item \textsuperscript{178} U.K. Treasury Announcement, \textit{supra} note 165, at 3.
\item \textsuperscript{179} \textit{Id.} The U.K.’s concern was based on the September 11 legal battles between insured owners and insurance companies with respect to the number
\end{itemize}
\end{footnotesize}
Insurance companies have a maximum industry-wide retention of £30 million per event and £60 million per annum. Furthermore, these retention rates will increase annually in a predetermined manner up until January 1, 2006, which the British government and private insurance industry hope will help reinsurers take a larger role in terrorism insurance coverage.


180. U.K. Treasury Announcement, supra note 165, at 3 (allowing insurers the security of knowing exactly how much they owe in any one given year and per number of terrorist attacks).

181. Id.

182. Id. at 3–4 (offering a chart that displays the per event and per annum requirements for year up until January 1, 2006, which reports the increases as follows: (1) January 1, 2003 — per event: £30 million, per annum: £60 million; (2) January 1, 2004 — per event: £50 million, per annum: £100 million; (3) January 1, 2005 — per event: £75 million, per annum: £150 million; and (4) January 1, 2006 — per event: £100 million, per annum: £200 million). Pool Re's new retention rates indicate the insurance industry's maximum retention, but these figures do not represent each insurer's liability, as this amount will bear heavily on the distribution of claims amongst insurers in the U.K. Id. at 4.
Although several property owners have decided to self-insure terrorism damages as a result of the program, the insurance industry has benefited from Pool Re overall.\textsuperscript{183} The program’s success sparked the British government to pass new legislation further extending the capacity and extent of Pool Re’s terrorism coverage.\textsuperscript{184} After the events of September 11, the British Parliament discussed the need to expand their reinsurance scheme in order to maximize the nation’s insurance protection, but at the same time create new incentives to increase commercial insurance competition.\textsuperscript{185}

Accordingly, the British Parliament has made monumental changes to the Terrorism Reinsurance Act of 1993. The definition of what actually constitutes an act of terrorism has been recently altered to comprise all destructive acts meant to terrorize the British people and government, including domestic acts of terrorism taken by extremist radical groups such as new wave environmentalists.\textsuperscript{186} The British government has also expanded Pool Re’s overall coverage. Now, Pool Re also encompasses destruction caused by biological contamination, aircraft attacks and damage by floods,\textsuperscript{187} the last of which is particularly necessary for Britain’s well being since any terrorist attack on

\begin{footnotes}
\footnote{183}{See William Glyon, Insurance Against Terrorism, L. Soc’Y Gazette, June 9, 1993, at 20.}
\footnote{184}{Katherine Griffiths, News Analysis: Insurers Call for Greater Government Aid to Meet Terrorism Bill; Evidence is Mounting that Lack of Terror Cover is Exacerbating the US Business Downturn, INDEP. (LONDON), Feb. 12, 2002, at 15 (commenting that the “U.S. is also grappling with [the issues of terrorism reinsurance coverage] but it is at a less advanced stage than the U.K.”).}
\footnote{186}{See Reinsurance (Acts of Terrorism) Act, 1993, ch. 18, § 2(2) (Eng.) (‘‘[A]cts of terrorism’ means acts of persons acting on behalf of, or in connection with, any organisation which carries out activities directed towards the overthrowing or influencing, by force or violence, of Her Majesty’s government in the United Kingdom or any other government de jure or de facto.’’). See also U.K. Treasury Announcement, supra note 165, at 5.}
\footnote{187}{Yvette Essen, Pool Re Offers Terrorism Cover, DAILY TELEGRAPH (LONDON), July 24, 2002, at 29. This expansive coverage, however, does not cover electronic hacking and virus damages, as the British government feels that it is difficult to prove that such damage actually results from a terrorist attack. U.K. Treasury Announcement, supra note 165, at 2.}
\end{footnotes}
London’s enormous dam could potentially flood a huge portion of the metropolitan area. In addition, the British parliament has made arrangements to further extend terrorism insurance coverage to cover nuclear contamination. These legal changes ensure the industry’s well-being and mark a savvy grasp of the ever expanding varieties of terrorist activity.

2. The U.K.’s Public Terrorism Insurance in Northern Ireland

In Northern Ireland, however, where damages from terrorist activity have become part of the region’s everyday reality, most insurers refuse outright to assume the risk of terrorist-caused property damage, and this tendency especially holds true in the case of commercial properties. The Reinsurance (Acts of Terrorism) Act of 1993 does not cover Northern Ireland under Section 3(2) of the statute. Rather, the British government directly takes responsibility for terrorism damage recovery, acting as the insurer itself.

Two pieces of legislation require the direct payment of terrorist insurance claims by the British government: the Criminal Injuries to Properties (Compensation) Act of 1971 and the

188. See id.
190. See Cave, supra note 171, at 31 (reporting that the U.K. has expanded it coverage in order to adapt to new terrorism concerns). C.f. Gregory Pressman, Attacks Require Fresh Look at Old Concepts, N.Y. L.J., Nov. 26, 2001, at S1 (discussing the changing concerns that exist with respect to terrorism).
193. Richard W. Stevenson, Britain to Help Insurers Cover Terrorism Risks, N.Y. TIMES, Dec. 22, 1992, at D2. Insurers presently provide normal insurance coverage for domestic property and automobiles in Northern Ireland; however, a governmental compensation agency primarily reimburses the costs for commercial property damage caused by terrorism, and it also compensates victims of terrorism in Northern Ireland as well. See Hunter, supra note 191.
Criminal Damage (Compensation) Order of 1977. These two acts obligate the British government to compensate property owners in Northern Ireland who are harmed by terrorist acts. The government covers terrorist-caused damage claims from premiums paid to the government through tax revenues. Reimbursement for damages inflicted by terrorist activity requires three steps: (1) regional police must authenticate that terrorists actually caused the property damage; (2) each property owner must obtain a certificate proving the validity of their claim; and (3) owners may then establish their compensation claim against the British government after presenting their certificate.

Many insurance specialists, however, argue that this type of government insurance program encourages false claims. British officials have discovered numerous alleged compensation claims for self-inflicted damages under the rubric of terrorist activity. In fact, the British government is primarily concerned with systematic fraudulent claims where IRA sympathizers purposely allow the IRA to damage their property, in order to split governmental cash settlements with them. In addition, resentment also exists due to the government’s differing insurance approaches on the U.K. mainland and in Northern Ireland. Nevertheless, with practically no insurers covering major terrorist damages, governmental subsidy is the region’s only plausible system for redeveloping terrorist-stricken regions.

196. See Bice, supra note 30, at 463–64.
197. Id.
198. Id. at 449; Gloyn, supra note 183, at 20. Presently, an act of terrorism that would satisfy the compensation certification requirement would be an act as defined by the “Terrorism Act 2000.” Terrorism Act 2000, ch. 11 (Eng.).
199. Insurance specialists refer to the risk of fraudulent claims as ex post moral hazard. Gollier, supra note 14, at 11 (noting that 10% of the insurance industry’s automobile and homeowner insurance premiums stem from fraudulent claims, and that larger penalties could potentially deter policyholders from making fraudulent insurance claims).
201. Id.
203. See Hunter, supra note 191.
During the 1990’s, the British government was able to partially remedy the issue of liability exposure through political and legal means.\textsuperscript{204} The U.K. government took significant steps to decrease the resentment that its controversial measures fostered when combating the IRA.\textsuperscript{205} Due to the IRA’s terrorist efforts, the U.K. had implemented many controversial mechanisms for countering terrorism, such as: exclusion orders, which banned certain people in Northern Ireland from entering the U.K.’s mainland without a trial; and internment powers that allowed police to hold a suspect in detention without trial.\textsuperscript{206} However, in 1997, the U.K. changed its approach in handling the IRA threat, when the British Parliament repealed its previous exclusion orders and internment measures.\textsuperscript{207} In addition, the U.K. also expanded its definition of criminal terrorism in order to include serious instances of terrorism.\textsuperscript{208} The ratification of the Good Friday Peace Agreement\textsuperscript{209} minimized the threat of IRA terrorism due to the prospect of peace between the British government and Northern Ireland activists.\textsuperscript{210} Even though the peace agreement does not guarantee the compliance of other IRA splinter organizations,\textsuperscript{211} so far it has proven beneficial to the British government since claims in Northern Ire-


\textsuperscript{205} Norton-Taylor & Campbell, supra note 204.


\textsuperscript{207} Norton-Taylor & Campbell, supra note 204.

\textsuperscript{208} Id.

\textsuperscript{209} Northern Ireland Act, 1998, ch.47, pts. I–IX. The Good Friday agreement is also known as the Belfast Agreement. For an online version of this statute and more information on the Good Friday agreement, see the Northern Ireland Office’s website at http://www.nics.gov.uk/htbin/betsie/parser.pl/0005/www.hmso.gov.uk/acts/acts1998/19980047.htm#aofs (last visited Feb. 2, 2004).

\textsuperscript{210} See Beatty, supra note 153, at 18.

\textsuperscript{211} For example, “Continuity IRA” and “True IRA” are organizations opposed to the U.K.’s peace offerings. Id.
land have dramatically decreased. Nevertheless, the U.K. now faces a new breed of terrorist threats and has shifted its focus from the issues in Northern Ireland to the multitude of terrorist groups that presently threaten the nation.

B. Israel’s Tax Management and Public/Private Coordination for the Provision of National Terrorism Insurance

Similar to the public terrorism insurance available in Northern Ireland, Israel also insures for terrorism. The Property Tax and Compensation Fund and the Victims of Hostile Action grant the government the authority to assist with terror-

214. U.K. faces terrorism from political activists representing the concerns of Northern Ireland, Middle East, North Africa, Kurdish Separatists, and other domestic groups, such as the Animal Liberation Front. Alan J. Fleming, Terrorism Coverage in the United Kingdom, DJR, at http://www.drh.com/special/wtc/w3_065.html (last visited Jan. 12, 2004).
215. Aside from insuring terrorism, Israeli legislation also clearly protects the interest of the insured in all insurance matters as, for example, the nation’s laws require that insurance changes can be made only if they are favorable or “more beneficial” to the insured party. See David M. Sassoon, Legal Aspects of Insurance, in ISRAELI BUSINESS LAW: AN ESSENTIAL GUIDE 337, 337–39 (Alon Kaplan et al., 1996). Israel’s Insurance Contract law of 1981 establishes these pro-consumer provisions. Insurance Contract Law, 1981, 35 L.S.I. 91, (1980/1981). For an online copy of this law, see the website of Levan, Sharon & Co. at http://www.israelinsurance.com/site/index.php?module=ContentExpress&func=display&btitle=CE&mid=&ceid=61 (last visited Dec. 15, 2004).
ist-caused damages. Through these two pieces of legislation, the Israeli government both funds and administers terrorism insurance for citizens, and in certain instances even for tourists. Each program, however, governs a particular domain: the Property Tax and Compensation Fund covers property and casualty insurance and the Victims of Hostile Action covers life and health insurance.

Under the Property Tax and Compensation Fund, the Israeli government, through the Israeli Income and Property Tax commission, collects a property tax primarily from Israeli businesses. The Property Tax Commission then reimburses claims resulting from terrorism, but up to the property's market value immediately before an attack. The nation's compensation fund also covers the loss of household items at “full replacement value” without accounting for depreciation. However, due to the high number of property damage occurring in a commercial area after an attack, the tax commission takes on the role of fixing the damage through “price adjusters” and con-

218. For the history behind Israel's development of its government compensation programs, see Hillel Sommer, Providing Compensation For Harm Caused By Terrorism: Lessons Learned in The Israeli Experience, 36 Ind. L. Rev. 335, 353–55 (2003) (starting from the nation’s formation to the present).


220. Id.

221. For more information, see Israel's Income and Property Tax Commission's website at http://www.mof.gov.il/itc/eng/mainpage.htm (last visited Jan. 5, 2004).

222. Hillman, supra note 55, at 8.

223. Id. Property owners can receive compensation for all of their “real damages,” which means that the government reimburses the lesser amount of either: (1) the “difference between the value of the asset before the damage occurred and the market value of the asset immediately after the damage occurred;” or “the cost of restoring the asset to its prior condition.” Sommer, supra note 218, at 356.

224. Sommer, supra note 218, at 355. The Commission compensates household items such as “furniture, appliances, electronics, books, and similar items,” but it does not provide coverage for “jewelry, art, antiques, and cash.” Id. at 355, n.124.
tractors. If a property owner wishes to obtain greater coverage, private or additional state coverage is available in order to account for any discrepancies in the State’s replacement price evaluations.

Meanwhile, the Victims of Hostile Action (Pensions) Law provides coverage for the personal costs incurred from terrorist harm through a state program called Law for the Compensation of Victims of Hostile Action, which the National Insurance Institute (“NII”) administers. The situations that can qualify under this statute are quite numerous, as the legislation covers any harm that may occur to an Israeli citizen, resident or visitor that faces harm due to a terrorist attack.

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225. Id. at 356. Thus, the Israeli Tax Commission takes on the role of restoring terrorist stricken property, despite the fact that the Property Tax Compensation Fund law states that individuals are to be financially compensated. Id. However, the nation seems to be benefiting from this administrative system, as it “significantly reduces the amount of time it takes for life to return to normal following a terrorist attack.” Id.

226. See Hillman, supra note 55, at 8.


228. In 1954, the Israeli government established the National Insurance Institute (“NII”) in order to administer Israel’s social security programs. Yehuda Kahane, Insurance In the Israeli Economy, in ISRAELI BUSINESS LAW: AN ESSENTIAL GUIDE 341 (Alon Kaplan et al., 1996). This government agency is responsible for the administration of various social oriented laws. Id. For example, the NII operates the following government programs: victims of hostile activities compensation, military service salaries, unemployment insurance, alimony provisions, coverage for work related injuries, nursing care for the elderly/disabled, child support, maternity leave payments and health insurance. Id. at 341–42. Israeli employers, employees and the self-employed primarily finance the NII’s programs, as the government requires that they pay “contributions” to the national program that can account for a substantial portion of their salary and/or earnings. Id. at 342. As of January 2003, the income ceiling for such contributions is “five times the national average wage for both employers and employees.” NII Home Page, Definitions and Terms Used, at http://www.btl.gov.il/English/btl_index.asp?name=pdf/pamphlets_Eng.htm (last visited Jan. 15, 2004). For more information, see the NII’s website at http://www.btl.gov.il/English/eng_index.asp (last visited Dec. 15, 2003). See also National Insurance Institute, Compensation for Foreign Residents Victims of Hostile Acts, at http://www.btl.gov.il/English/btl_index.asp?name=pdf/pamphlets_Eng.htm (last visited Jan. 20, 2004).

229. The Victims of Hostile Action (Pensions) Law defines an “enemy-inflicted injury” in the following way:
legislation loosely defines terrorist acts in such a manner that it can even include harm caused as a result of self-defense actions against terrorists.\textsuperscript{230} The compensation law’s definition also mirrors to a certain extent the broad definition of terrorism found in the Israeli Prevention of Terrorism Ordinance 5708–1948, which establishes the criminality of such acts. According to the Israeli criminal statute, a terrorist organization is one that resorts “to acts of violence” in a calculated fashion in order “to cause death or injury to a person” or “threats of such acts of violence.”\textsuperscript{231} This definition is very broad,\textsuperscript{232} which means that

\begin{quote}
(1) An injury caused through hostile action by military or semi-military or irregular forces of a state hostile to Israel, through hostile action by an organization hostile to Israel or through hostile action carried out in aid of one of these or upon its instructions, on its behalf or to further its aims.…
\end{quote}

24 L.S.I. 131, § 1. This statute also lists the individuals that can fall under the category of a victim of an “enemy inflicted injury” as either: (1) “an Israel national or resident, whether the injury was sustained in Israel or outside of it,” or “a person who entered Israel under a visa or permit issued under the Entry into Israel Law.….” Id. § 3.

230. Sommer, supra note 218, at 339 (explaining that Israeli legislation covers even “friendly fire,” “as is the accidental explosion of ammunition stocked in anticipation of terrorist attacks”). However, the classification of what actually constitutes a “hostile act” is not clear, as harm can fall into the categories of either criminal or terrorist. Id. at 340.


232. In fact, the statute also makes it illegal for an Israeli citizen to sympathize terrorist groups by publishing, in a written or verbal manner, any words of praise or sympathy for terrorist groups. See Prevention of Terrorism Ordinance, 1948, 1 L.S.I. 76, (1948) at § 4. But cf. U.S. Patriot Act 18 U.S.C.A. § 2339(B) (section entitled “Providing Material Support or Resources to Designated Foreign Terrorist Organizations”) (emphasis added); U.S. CONST. amend. I (In contrast to this particular Israeli law’s approach to speech and association, the U.S. Constitution mandates that “Congress shall make no laws respecting an establishment of religion, or prohibiting the free exercise of speech thereof; or abridging the freedom of speech, or of the press,” which offers a very different national approach to the handling of opinions and expressions contrary to the State). See also John E. Nowak & Ronald D. Rotunda, Constitutional Law 1055–1306 (6th ed. 2000) (providing historical background and analysis for the development of free speech in the U.S.);
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any such act is compensated under the nation’s insurance program. Moreover, victims also have the presumption of an occurrence being a terrorist attack in their favor, as the Victims of Hostile Action Law explains that “[w]here a person has been injured under circumstances affording reasonable grounds for believing that he [or she] has sustained an enemy inflicted injury, the injury shall be regarded as enemy inflicted unless the contrary is proved.” When the National Insurance Institute determines that the applicant has a legitimate claim, it then administers the eligible victim’s compensation in a manner very similar to the U.S. Social Security system in that it provides medical care, lost wages, family assistance, and personal injury settlements, with the only exception being that it also applies to tourists visiting the nation.

Nevertheless, the government limits its overall liability through insurance regulation, as it does not reimburse for damages that insurance companies are forced to insure by law. For example, Israel does not cover certain costs such as business interruption; in such cases, businesses can find such coverage only through private insurance. Therefore, insurance companies wishing to provide their business to Israeli citizens are legally required to pay for their portion of damages caused


233. 24 L.S.I. 132, § 2. See also Sommer, supra note 218, at 340.


235. See Hillman, supra note 55, at 8.

236. See 15 L.S.I. 101–03 (restricting coverage to actual property damage as the statute does not mention business interruption as falling into one of the categories of reimbursable harm). See also Kunreuther, supra note 227, at 14; Sommer, supra note 218, at 357 (noting that this sum also includes all indirect damage such as business interruption and loss of earnings). This limitation has proved restraining as many business owners have faced up to an 80% deduction in reduced business as a result of the high frequency of terrorist activities occurring in the nation’s commercial areas. Id. at 358. However, the Israeli government has decided to potentially cover business interruption damages resulting from terrorism if the government approves such a claim. Id. at 358.
by any given terrorist attack. Through the Israeli government’s strict division of fiscal responsibility between government and insurers, the insurance industry can comfortably issue insurance knowing in advance that they will not be responsible for the entire risk of property damage.

IV. DOMESTIC LEGAL ANALYSIS THROUGH INTERNATIONAL EXAMPLES

“Lay plans for the accomplishment of the difficult before it becomes difficult; make something big by starting with it when small.”

– Lao Tzu, Taoist philosopher

A. U.S. Government Assistance — Prudent Solution, Short Term Scapegoat, or a Little Bit of Both?

A comparative legal analysis of TRIA provides important insights and potential solutions to some of the problems that the U.S. terrorism insurance program now faces. Part IV lays the foundation for this Note’s international analysis, beginning with a critical analysis of TRIA that explains the legislation’s limitations as well as its accomplishments. This analysis is then followed by an international comparison of TRIA with the terrorism insurance programs available in Israel and the U.K. Through international comparison, this Note presents helpful solutions for TRIA’s potential renewal.

1. National Issues That Remain Unresolved

As terrorists coordinate their attacks to inflict maximum damage and devastation, they simultaneously achieve maximum exposure for their own cause. For this reason, the issue

237. See Sommer, supra note 218, at 358.
238. LAO Tzu, TAO TE CHING 70 (D.C. Lao trans., 1963).
239. Lao Tzu, “an older contemporary of Confucius,” is believed to have written several anthologies based on the cultivation of the proper way of life and the true meaning of human virtue. Id. at viii. Tzu’s works, as most ancient Chinese philosophers, not only grapple with the ideals of the personal realm, but his teachings also cover politics and ethics in terms of government and ruling. Id. at xxviii.
240. Terrorist organizations have a “hydra-like feature,” which makes them inherently dangerous and evasive as they can establish network characteris-
of terrorism insurance coverage effects most dramatically the security of properties that either have great symbolic or practical value to the U.S.\textsuperscript{241} As a result, the unavailability of terrorism coverage effects the insurability of properties that fit into what the insurance industry classifies as “Tier 1” or “Tier 2” properties,\textsuperscript{242} which means that they face a higher risk of serving as targets of another terrorist attack.\textsuperscript{243} In addition, since the cost of terrorism insurance remains extremely high, owners of lower potential risk property currently refrain from purchasing terrorism insurance.\textsuperscript{244} Therefore, TRIA does not insure the entire nation against terrorism; instead, it primarily serves as a mechanism for providing government reinsurance coverage for insurers wishing to cover properties that are commercial or


\textsuperscript{242}See Mario Suarez & Steven Abrams, \textit{Outside Counsel: Terrorism Risk Insurance and the Real Estate Industry}, N.Y. L.J., Dec. 10, 2002, at 4. Moody's investor service has established terrorism risk categories in order to classify buildings: Tier 1 properties include genuine ‘trophy’ buildings, regionally well-known properties or assets located near trophy assets; Tier 2 assets consist of large “Class A or B-type central business district buildings and major shopping malls;” and the Tier 3 category includes all others assets. \textit{Id}.

\textsuperscript{243}Id. \textit{But see} Darius Lakdawalla & George Zanjani, \textit{Insurance, Self Protection, and the Economics of Terrorism} 1 (Nat'l Bureau of Econ. Res., Working Paper No. 9215, 2002) (“Potential targets of terrorism have incentives to protect themselves against attack, but rational terrorists will substitute away from fortified targets and [instead shift their attention] toward[s] vulnerable ones.”), \textit{available at} http://www.nber.org/papers/W9215.pdf (last visited Nov. 12, 2002).

\textsuperscript{244}Terrorism insurance coverage in its very essence is primarily commercial insurance concern. \textit{See} Jaffe & Russell, supra note 14, at 20 (comparing terrorism insurance with natural catastrophe insurance, which tends to primarily cover “personal homeowner insurance”).
have a high profile status — either symbolically or economically.245

In fact, insurance analysis companies report that only 25% of owners with properties worth $100 million or more throughout the U.S. have elected to acquire terrorism insurance.246 Property owners currently refrain from purchasing terrorism coverage because insurance companies continue to charge substantial premiums for the additional coverage.247 Therefore, despite TRIA’s mandate that all U.S. insurance carriers must make

245. See Jaffe & Russell, supra note 14, at 20; Woo, supra note 20, at 10 (noting that terrorist can “switch intermittently between political, commercial and economic targets”). See also Goldberg, supra note 38, at 549; U.S. Office of Public Affairs, Treasury Department Announces Proposed Regulation Implementing Claims Procedures Under the Terrorism Risk Insurance Act, (quoting Jeffrey S. Bragg, Executive Director of the U.S. Terrorism Risk Insurance program, in regards to his statement on the program’s role as a reinsurance provider), Nov. 25, 2003, at http://www.treas.gov/press/release/js1022.htm (last visited Jan. 5, 2004) [hereinafter U.S. Office of Public Affairs, TRIA Announcement]. But see LAKDAWALLA & ZANJANI, supra note 243, at 17 (This article clarifies how the effect of terrorism on commercial properties can ultimately concern the nation. It provides the following illustrative example: “A construction project founders in Manhattan due to lack of affordable insurance coverage may be seen as a national public policy issue, while similar foundering associated with windstorm or earthquake insurance coverage is not.”).

246. Christian Murray, City Properties Lack Terror Insurance, NEWSDAY, Mar. 27, 2003, at A46. Interestingly enough, however, smaller and mid-sized companies that possess property have shown a greater tendency to purchase terrorism coverage since terrorism insurance is less costly for properties in their price bracket. Id. See also Barbara Pinckney, Response to Terrorism Insurance is Underwhelming, BUS. REV., April 21, 2003, at http://www.bizjournals.com/albany/stories/2003/04/21/story2.html (last visited Jan. 5, 2004); Jon Chesto, Few Seek Terrorism Insurance, BOSTON HERALD, Feb. 24, 2003, at 23. Due to the limited purchasers of terrorism insurance, insurers complain about the costs TRIA imposes by requiring stringent notification standards. Sam Friedman, Terrorism Rate Hikes To Fall To Single-Digits, NAT. UNDERWRITER — PROP. & CASUALTY, Nov. 10, 2003, available at LEXIS, Nexis News & Bus. Library. The U.S. Treasury Department has also taken notice of the nation’s low rate of terrorism insurance purchases even after TRIA’s enactment. See Ugoletti, Implementing TRIA, supra note 11, at 6.

terrorism insurance “available” to their customers in a manner that offers protection similar to other property insurance plans, prices remain high.248

Premiums remain elevated because insurers find themselves in a situation that insurance specialists refer to as ex ante moral hazard.249 Insurers raise their premiums because terrorist-risk mitigation still remains inefficient.250 Although such price setting may prove reasonable for the insurance industry, a limited amount of consumer force regulates the premiums and deductibles that insurers need to pay while participating in TRIA’s government insurance program.251 TRIA establishes the insurance industry’s deductible for claim payments,252 but it


249. “Ex ante moral hazard” refers to insurers’ anticipation of a low degree of risk prevention and a greater frequency of losses, which ultimately results in higher premiums. Gollier, supra note 14, at 10. In general, however, “moral hazard” describes an insurer’s increased probability of loss due to policyholders’ “carelessness” in mitigating an insured potential harm. Kunreuther, supra note 227, at 9. The issue of moral hazard poses a significant dilemma for the insuring of terrorism under TRIA, as Professor Kunreuther explains that “[i]t is…extremely difficult to control behavior once a person is insured.” Id. at 9. Government assistance, on the one hand, helps influence self-protection by encouraging the purchase of terrorism insurance, but, on the other hand, such policies can also discourage self-protection as insurance can cover most of a policy holder’s potential losses, making it more efficient to refrain from any further protection expenditures. Lakdawalla & Zanjani, supra note 243, at 2.

250. See Kunreuther, supra note 227, at 10.

251. See KENNETH S. ABRAHAM, DISTRIBUTING RISK: INSURANCE, LEGAL THEORY, AND PUBLIC POLICY 39 (Yale University Press, 1986) (noting that local consumer groups are less organized and financed than the U.S. insurance industry to truly influence state insurance legislation). See also FEDERAL-STATE REGULATION OF THE PRICING AND MARKETING OF INSURANCE 8–9 (Paul W. MacAvoy ed., 1977) (discussing the regulation of property-liability insurance companies in the U.S.); Jaffe & Russell, supra note 14, at 20.

does not regulate the insurance industry’s premiums. Most importantly, however, if the insurance industry’s deductibles prove low, the U.S. will assume much of the financial burden of another terrorist attack. In other words, taxpayers will have to pay the cost of an attack despite the insurance mechanisms currently available.

For insurers that have the capacity to provide terrorism insurance at reasonable, albeit still high, rates, TRIA also creates a discrepancy between different states’ coverage. TRIA requires that each insurer’s terrorism insurance cover items that fall within its usual property and casualty coverage plans. However, each state has its own regulations on matters that insurance companies must cover in their plans. As a result,
many property owners may have a “false sense of security” about the terrorism coverage that their insurance provider offers them. In the event of another terrorist attack, insurance companies may have opportunities to make use of such legislative loopholes to their clients’ detriment. In addition, since the legislation is silent on the states’ role in regulating terrorism insurance coverage, tension between federal and state law may also arise.

Thus, the issue remains: what happens to property owners who choose to refrain from obtaining terrorism insurance? In


See Myra E. Lobel, Current Issues in Drafting Reinsurance Contracts, 854 PLI/COMM 7, 39 (2003) (noting that there are currently many variations on “TRIA clauses,” but due to the lack of significant case law on the subject the interpretation and enforceability of such clauses remain unclear). An important issue that remains unresolved is how TRIA’s mandated terrorism coverage integrates with other coverage issues within an insurance policy. Aon Report, supra note 121, at 6. For example, some states require property insurance to include fire-damage in their policies; however, in a state that does not have such a requirement, it remains questionable whether a fire-related damage due to a terrorist attack will qualify. See id.

See, e.g., Department of Treasury, 68 Fed. Reg. No. 40, 9815 (Feb. 28, 2003) (to be codified at 31 C.F.R. pt. 50) (noting that federal law currently provides limited requirements or standards for approving insurers that can fall under TRIA’s mandate).

Insurance professionals call this issue the “Samaritan’s dilemma,” whereby the government finds itself in a difficult position when faced with victims who have not taken precautionary steps and those who prudently protected themselves in advance. BROWN ET AL., supra note 255, at 11. Nevertheless, a national policy or program helps establish a system that offers incentives for “preventative measures” and expedites the compensation process in the event of a terrorist attack. Id. But see Orszag & Pechman, supra note 241 (posing the line-drawing question of: “[w]here does the regulatory process stop?”).
effect, TRIA creates an “adverse selection” issue. In the case of U.S. property terrorism insurance coverage, the adverse selection problem relates to owners who weigh their chances in favor of not insuring their properties against terrorism-related harm. There are three categories of property owners who decide to sidestep terrorism insurance coverage: those who consider their chance of facing a terrorist attack as minimal; those who acknowledge a possibility, but choose to self-insure their property; and/or those who weigh their losses in the hope that the government will ultimately intervene and assist in their recovery from any terrorist act. Accordingly, the U.S. government faces a host of uninsured properties and may encounter a significant financial burden should there be another terrorist attack. As a result, the nation may struggle with the same challenge of providing additional financial relief to victims in the event of another terrorist attack, which is the very

263. See Bragg, supra note 9, at 15. Adverse selection occurs when those with a greater potential for risk disproportionately seek the protection of insurance coverage. Kunreuther, supra note 227, at 8. As a result insurers face yielding a “negative expected return” on their insurance portfolio policies. Id.

264. Terrorism insurance in the U.S. currently displays what insurance experts would refer to as an “extreme case” of adverse selection as agents who face a lower terrorism-related risk consider even the current terrorism insurance premiums too high, and instead choose not to insure the risk at all. See Gollier, supra note 14, at 9.

265. See, e.g., Civia Katz, Penn Discusses Terrorism Insurance, INTELLIGENCER J., July 16, 2003, at B7 (reporting that a Pennsylvania township declined to spend $522 for terrorism insurance coverage, as their other policies increased from 17 to 137%); Kate Alexander, County May Pass on Terror Insurance, AUSTIN AM. STATESMAN, Dec. 23, 2003, at B1 (setting aside reserves to cover any potential terrorist threat). See also Insurance Review, supra note 259, at 16 (indicating that 44% of property owners who are advised to obtain terrorism insurance refrain from making such a purchase); Sarah Veysey, Governments Providing Terror Coverage Backstops: But a Specialist Terrorism Insurer Closes to New Business Due to Lack of Demand, 37 BUS. INS. 23 (2003), available at 2003 WL 9138389 (reporting that although nations such Germany, Austria, France, Spain, and the U.K. — have assisted in the availability of terrorism insurance, many property owners still refrain from purchasing such cover).

266. See Gollier, supra note 14, at 16 (noting that social pressures after a catastrophic event will strongly press for the government indemnification of uninsured victims).
situation that the U.S. government intended TRIA to address and may ultimately prove extremely costly to taxpayers.  

Commentators have also noted that TRIA reduces property owners' incentive to mitigate the risks and damages associated with terrorism. In fact, insurance at high premiums tends to signal the stark reality behind these observations. Many of the properties that are receiving the benefit of terrorism insurance have limited mechanisms to protect their buildings and occupants from another terrorist attack. For example, a commercial building may have financial coverage for terrorism related property and casualty losses, but its property owners at the same time may have taken few steps to mitigate the harm. This discrepancy means that TRIA may protect the insurance industry from facing a fatal blow, but it does not necessarily

268. Lakdawalla & Zanjani, supra note 243, at 1 (arguing that government subsidizing of terrorism coverage can potentially keep agents from protecting themselves, which in turn raises vulnerability). Cf. Geoffrey Heal & Howard Kunreuther, You Can Only Die Once 12–13 (April 12, 2002) (paper prepared for the “Risk Management Strategies in an Uncertain World Conference,” Palisades, N.Y.) (noting that insurance in theory should serve as a mechanism for encouraging airlines to heighten security, but instead can potentially produce the opposite effect of free-loading security by airlines who face less stringent requirements for their own insurance coverage), available at http://www.Ideo.colombia.edu/CHRR/Roundtable/Kunreuther_white.pdf (last visited Oct. 10, 2002). See also Brown et al., supra note 255, at 6 (noting that “the virtues of unfettered markets is the incentives they generally provide for market actors to invest and behave in a socially optimal fashion”).
269. See Kunreuther, supra note 227, at 8–12.
270. See Thomas P. Bloch, Commercial Real Estate Leases: Selected Issues in Drafting and Negotiating in Current Market, SH008 ALI–ABA 277, 280–82 (2003) (suggesting lease provisions for commercial landlords). Landlords have begun to include lease provisions that provide exceptions for service interruption caused by a whole array of potential terrorist-risks and are spreading the costs of additional security measures through lease provisions that allow for rent escalations based on heightened security measures. Id. But see Lakdawalla & Zanjani, supra note 243, at 4 (suggesting that enhanced security measures can also theoretically lead to an increase of terrorist funding as terrorists may take such actions as a sign of insecurity, which marks an accomplishment that they will seek to repeat).
271. “In fact, insurers could find it in their best interest to earn the good will of their clients by treating claimants generously at the expense of the government.” Brown et al., supra note 255, at 7.
indicate that the people occupying these insured spaces are being protected.

Another important characteristic of TRIA is that it also looks at terrorism as being perpetuated by foreign groups.\footnote{The U.S. government considers terrorist groups, such as the one involved in the September 11 attacks, as international.\footnote{TRIA’s definition of terrorism is thus quite specific in contrast to the ISO’s general terrorism exclusion clauses,\footnote{and may leave potential targets of domestic terrorism, such as the small airplane crash in Florida\footnote{or even Timothy McVeigh’s Oklahoma bombing, uncovered altogether, rendering government intervention in effect obsolete. The lending industry also has some serious reservations about TRIA, as the legislation does not provide any specifications that protect lenders.\footnote{TRIA requires that insurers notify their insurance carriers, but nowhere does it state that the lender securing a mortgage for each property also needs notification.\footnote{Accordingly, lenders argue that TRIA does not foster communication between insurers and lenders.\footnote{This lack of information has proven troubling to lenders as the law does not

\footnote{273. See id. \textit{See also} H.R. 3210 § 19(1) (definition of an “act of terrorism”); S. 2600 § 3(1), (definition of an “act of terrorism”).}
\footnote{274. See \textit{supra} Part II (elaborating on the issues regarding the ISO’s definition of terrorism). \textit{See also} Emanuel Gross, \textit{Democracy in the War Against Terrorism — The Israeli Experience}, 35 LOY. L.A. L. Rev. 1161, 1162 (2002) (commenting on the definition of terrorism).}
\footnote{275. See \textit{An Explosive Situation}, INS. DAY, Jan. 8, 2002, \textit{available at} LEXIS, Nexis News & Bus. Library (discussing the light aircraft crash into the Bank of America forty-two story building in Tampa, Florida, which involved an American youth having allegedly sympathized with Osama bin Laden’s cause).}
\footnote{276. See Kenneth M. Block & Jeffrey B. Steiner, \textit{Terror Insurance Uncertainty Still Exists Despite New Federal Law}, N.Y. L.J., July 16, 2003, at 5; Epstein & Keyes, \textit{supra} note 254, at 3. For an overview of lender attorneys’ new insurance considerations as a result of September 11, see Goldberg, \textit{supra} note 38, at 548–51.}
\footnote{278. At this time, lenders must directly contact their borrowers in order to figure out whether their borrowers have obtained terrorism insurance for their mortgaged properties. Block & Steiner, \textit{supra} note 276.}
require notification of their borrowers’ decision to insure or refrain from insuring against terrorism.\footnote{Id. 279. Lenders now complain that TRIA fails to ensure that terrorism insurance be “available” to lenders, as borrowers have the option to decline terrorism coverage if their loan documents do not require it. \textit{Id.} Nonetheless, lenders do have the opportunity to contractually resolve these matters in their loan documents and negotiations.}

\section{TRIA’s Accomplishments}

Although TRIA still has many issues that must be resolved in order to be fully effective, the government program that the legislation established does alleviate some of the major problems that the insurance industry had in underwriting terrorism, especially for trophy buildings and large commercial projects. Since terrorist threats to property primarily stem from the unique political positions of target nations,\footnote{280. For example, U.S. involvement in the Middle East has driven many terrorist groups, such as Al’ Qaeda, to seek vengeance against American culture and economy. \textit{See} Yang Razali Kassim, \textit{Is the Fight Against Terrorism on the Right Track?}, \textit{Bus. Times (Singapore)}, Jan. 18, 2003, \textit{available at} 2003 WL 2349714. \textit{See also} \textit{US Foreign Policy Amounts to International Terrorism – Chomsky}, \textit{TWN}, Feb. 2, 2002, \textit{at} \textit{http://www.twinside.org.sg/title/pa4.htm} (last visited Feb. 12, 2004).} the political component of insuring terrorist risk makes terrorism coverage unfavorable to insurance and reinsurance companies,\footnote{281. For a more detailed discussion of this matter, see \textit{supra} Part II.} because terrorist activity directly correlates to government action and not pure probability,\footnote{282. \textit{See} Orszag & Pechman, \textit{supra} note 241, at 2–3 (arguing for government intervention). The financial exposures that the private industry faces proves troubling as U.S. bankruptcy laws limit corporation and individual’s financial exposure to terrorism caused losses, which serves to limit the private sector’s incentive to take preventative precautions. \textit{Id.} at 3–4.} which insurers rely on and have learned
to calculate. \textsuperscript{283} TRIA has been instrumental in promoting: (1) investment and construction by providing insurers the financial safety net of reinsurance necessary as the problem of insurability still troubles the reinsurance industry; \textsuperscript{284} and (2) seeks to limit the repercussions of prolonged political involvement in the private sector. \textsuperscript{285}

Implementing national terrorism risk-exposure legislation is undoubtedly a costly endeavor given the near impossibility of quantifying the consequences of a major terrorist attack; \textsuperscript{286} furthermore, the financial aspects of the “catastrophic risk”\textsuperscript{287} potential of terrorist attacks urge the need for the government’s intervention. \textsuperscript{288} Large financial reserves, however, prove difficult for insurers to accumulate due to the uncertainty of a potential “early hit” that may require more financial backing than the limited amounts that the insurance industry can raise within a short time. \textsuperscript{289} Infrequency, coupled with high losses,

\textsuperscript{283} See Stempel, \textit{supra} note 43, at 877 (noting that the insurance industry needs to develop analytical mechanisms that will assist underwriters in assessing the risk of terrorism).

\textsuperscript{284} See Kunreuther, \textit{supra} note 227, at 7. See also \textit{BROWN ET AL.}, \textit{supra} note 255, at 5; Suarez & Abrams, \textit{supra} note 242.


\textsuperscript{288} See Gollier, \textit{supra} note 14, at 21.

\textsuperscript{289} \textit{Id.} Insurance companies depend on their ability to transfer wealth through time in order to diversify their potential risks. \textit{Id.} at 23. Furthermore, corporate finance frowns upon firms holding large financial reserves because, in corporate world views, such accumulation of capital is a sign of inefficiency. \textit{Id.} This corporate reality, therefore, makes it difficult for insurance companies to accumulate large monetary reserves. \textit{Id.} Insurance companies can also use capital markets in order to obtain the reinsurance backing necessary to cover terrorism; however, the securitization of terrorist and
necessitates large permanent reserves, but high taxes levied on such monetary reserves also would make it impractical for insurers to assume such responsibility. For this reason, the U.S. and its international counterparts have chosen to intervene in terrorism coverage, especially when the insurance industry finds its reserves already depleted.

Specifically, TRIA now ends the insurance industry’s hunt for reinsurance backing, as the U.S. itself serves as the reinsurer. The government insurance program currently provides the insurance industry with the liquidity it needs in order to insure terrorism. For example, rebuilding costs for a property such as the Empire State Building would require over $2 billion. TRIA now allows for the insurability of such properties and in effect keeps insurers in the picture until they can feel comfortable with underwriting the risk for themselves. In addition, insurers’ terrorism insurance premiums have in fact decreased, which has allowed for the provision of the terrorism catastrophic risks in general are not presently developed enough in order to financially support the insurance coverage of potential U.S. terrorism. BROWN ET AL., supra note 255, at 4. See also Johnson, Gentlemen’s Agreement, supra note 59, at 21 (explaining insurers’ need to reduce their own reserve retention through reinsurance); Pollner, supra note 287, at 9.

290. See Pollner, supra note 287, at 19. However, certain insurance companies insuring terrorism in the U.S. may be utilizing special purpose entities in order to circumvent paying their deductibles, which can potentially limit the amount that TRIA can save in government reserves. See Department of Treasury, 68 Fed. Reg. No. 40, 9815, (Feb. 28, 2003) (to be codified at 31 C.R.F. pt. 50).

291. See Jaffe & Russell, supra note 14, at 12 (noting that the “U.S. tax rules require full taxation of profits that are being retained as reserves against future losses” due to terrorist-inflicted property damage).


295. See Orszag & Pechman, supra note 241, at 8.

296. Terrorism insurance premiums are now 50% lower than before TRIA’s enactment, and various insurance surveys report that premiums for terrorism
insurance coverage required by major construction projects and mortgage lenders of commercial properties.\textsuperscript{297}

Governments that choose — or rather are required — to intervene in terrorism insurance coverage must also prevent temporary assistance from becoming a permanent subsidy,\textsuperscript{298} all the while balancing other national economic needs, especially during times of international insecurity.\textsuperscript{299} The U.S. government designed TRIA in a manner that will hopefully allow the insurance market to gradually take on a larger role in terrorism insurance coverage.\textsuperscript{300} Insurer’s deductibles are set to increase incrementally every year, and the legislation requires that TRIP work closely with NAIC.\textsuperscript{301}

The coalition between the U.S. Treasury Department and the insurance industry creates a means of communication between insurance companies and the U.S. government,\textsuperscript{302} which in turn makes the government insurance program much more efficient.\textsuperscript{303} Several reinsurance companies now provide terrorism

\textsuperscript{297} See Goldberg, supra note 38, at 549.
\textsuperscript{298} See Brown et al., supra note 255, at 8.
\textsuperscript{299} See id. See also Gollier, supra note 14, at 27 (noting that nations intervene in the case of catastrophic risk coverage “[d]ue to [the State’s] natural creditworthiness and its long time horizon, [it] is better shaped than insurance companies to smooth shock over time”).
\textsuperscript{303} Not only does the collaboration between the insurance industry and government make government insurance coverage more efficient, it also enhances the focus on preventing future terrorist attacks. As the insurance underwriting industry is currently generating methods of assessing the terrorist-related risk in insuring property, these underwriting efforts also keep the private sector informed as to national security concerns and measures that the government takes to mitigate such concerns. For example, risk assessment companies, such as AIR Worldwide Corp., have accepted the opportunity to attempt to calculate the risk of terrorism with the help of experts in the FBI, CIA and U.S. Defense department. Schoen, supra note 247. Had such public/private interaction been in place prior September 11, perhaps there would have been a greater public awareness of the terrorist risk that the nation would ultimately face. For example, in 2000, the Pentagon conducted
deductible coverage for insurers who participate in the program, which signals that the reinsurance industry remains in the picture, despite the U.S. government’s intervention. Accordingly, it seems that TRIA does not necessarily serve as a bailout for the insurance industry; rather, U.S. government involvement lays the foundations of the terrorism underwriting process as the insurance industry builds the expertise and capacity to cover such claims for themselves.

B. International Lessons on National Insurance Programs

In order to decrease economic vulnerability to potential terrorist attacks, nations need to provide their own insurance mechanisms. As Part III of this Note illustrated, different nations have their own unique ways of handling the threat of terrorism. National government insurance implementation varies greatly according to each nation’s needs. The U.K. and Israel have already developed their own means of supplying terrorism risk insurance in manners that best support the needs of their nations. In Israel and in Northern Ireland, public insurance assistance affords property compensation for victims who

an undercover study titled “Terror 2000,” which the U.S. government coordinated in order to inform the intelligence sector about potential terrorist threats. Woo, supra note 20, at 16. “One of the prescient conclusions of the study” presented at this meeting forewarned that terrorist groups imminently would attempt to “conduct simultaneous bombings, perhaps in different countries, to maximize the devastation and publicity.” Id. The study’s message fell on deaf ears as such a devastating prospect seemed unrealistic. Id. Post-September 11, both the U.S. government and insurance industry now enjoy the advantages of hind-site, and such reports will probably be taken much more seriously in the future. Furthermore, the private sector’s involvement in terrorism insurance coverage will also demand such government reporting in order to prevent terrorist-related insurance losses.


305. Cf. Barnes, supra note 142 (noting that the similar public/private insurance scheme established in the U.K. does not serve as a mere bailout for the insurance industry).


face the devastation of terrorism on a more frequent basis. Meanwhile, on the British mainland, the U.K. government supplies insurers with the reinsurance backing necessary to keep the nation’s insurance industry involved in terrorism coverage. These international models serve as the ideal typological templates for government intervention as each has dealt with the insurance issues that presently plague the U.S. In order to be economically prepared for a future terrorist attack, the U.S. government should renew the legislation, but only after considering certain alterations that would improve the government program’s effectiveness. The U.K. and Israeli models provide the necessary solutions.

1. The Governmental Power to Tax: An Incentive All in Its Own

In terms of financial risk management, Northern Ireland and Israel’s current insurance programs spread the risk of terrorism nationwide, with multiple taxes supporting such an insurance option. Terrorism insurance in Northern Ireland, for example, seems beneficial since it allows for the entire U.K. to assume the particular region’s risks. However, such an assumption of risk is only viable for limited regional coverage, as evidenced by the U.K.’s limitation to Northern Ireland, because geographic expansion of government responsibility would require an overwhelming tax base, thus raising implementation costs to overwhelming levels. Meanwhile, a national taxation solution such as Israel’s seemingly alleviates the burden on major metropolitan areas, but at a cost to the nation overall. Despite the fact that a purely public national terrorism insurance

308. However, Israel has changed its governmental insurance coverage with respect to foreign trade risks in order to serve as the reinsurer of last resort to insurance companies bearing the initial burden of such claims. See Foreign Risk Up for Privatization and Split Up, ISRAELI BUS. TODAY, Mar. 31, 1998, available at 1998 WL 10113749.
309. See Bice, supra note 30, at 463–64.
310. See id.
311. Id.
312. See HETH, supra note 234, at 172. “A substitute for market insurance is to organize an implicit or explicit system of solidarity for the unlucky citizens through an indemnity financed by the taxpayers.” Gollier, supra note 14, at 16.
system would lighten the burden of insurance costs that states such as New York and California currently face, the U.S. Accounting Office estimates that if the U.S. government solely provided terrorism coverage, the loss to federal tax reserves would be tremendous. TRIA’s private/public dichotomy solves this problem by allowing the private insurance industry to assume responsibility for most claims, as many claims could potentially fall within the Act’s established insurers’ deductible requirements. Despite temporary intervention on the part of the U.S. government in the nation’s recent insurance crisis, concerns remain regarding the permanence the federal insurance subsidies. If the insurance industry’s current government deductible falls too low, another attack may still leave the U.S. vulnerable to the costs of another attack. Furthermore, if the insurance industry finds comfort in the U.S. government’s “reinsurance,” insurers may take a longer time to resume fully insuring terrorism risk through private reinsurers. A future attack, therefore, may still leave the government paying for most of the risk assumed by insurers. However, the U.S. government faces the grimmer prospect of what might happen to properties that decline to participate in TRIA’s program. The political reality is that if another terrorist attack occurs, the situation will require government assistance and compensation. U.S. government assistance in the aftermath of a tragic event, therefore, fails to make use of TRIA and the insurance industry’s expertise and goes against the very purpose of the establishment of the U.S. government’s Terrorist Insurance Program.

313. See CBO STUDY, supra note 88, at 27–35.
314. See BROWN ET AL., supra note 255, at 8 (pointing out that “a continuing government role in the terrorism risk insurance market could hinder the development of private capacity to cover terrorism risk”). Cf. HILLMAN, supra note 55, at 16 (contemplating the benefits of having permanent government involvement in terrorism insurance).
315. See CBO STUDY, supra note 88, at 26–30 (suggesting massive economic problems to U.S. insurance industry even with a government program).
316. See HILLMAN, supra note 55, at 3; Orszag & Pechman, supra note 241, at 4 (noting that if the government does not convince the private sector that it will not provide any bailouts in the case of another attack, the nation may have to intervene).
317. See Gollier, supra note 14, at 16.
The common reason why property owners do not purchase terrorism insurance is due to high premiums. At this time, owners have no incentive aside from the protection of extra coverage to purchase terrorism insurance. TRIA does not provide the purchasers of terrorism insurance any incentives. Meanwhile, insurers have the main incentive of reinsurance backing through the nation’s federal government. Consumers, however, primarily face external incentives from their lenders. For example, many lenders now require terrorism insurance for large commercial buildings and new large-scale construction projects. The problem then remains, for example, in the case of properties that already have mortgages, as it is highly unlikely that lenders will aggressively file loan defaults for the failing owners to purchase terrorism insurance, since many have not done so already.

The Israeli system and the U.K. government’s insurance intervention in Northern Ireland provide some insight as to how the U.S. government can make use of the American tax system.

319. See Orszag & Pechman, supra note 241, at 5 (asserting that the Federal government could make the purchase of terrorism insurance coverage mandatory, which would in turn enhance the insurance industry’s ability to force purchasers into taking greater security measures). See also Gollier, supra note 14, at 10 (noting that the enforcement of a policy in support of risk prevention alleviates the disparities that ex ante moral hazard situations create); Orszag & Pechman, supra note 241, at 2 (explaining the economic theory of “negative externality” in terms of national security relating to terrorism). Terrorist attacks undermine a nation’s sovereignty in the same manner as an invasion and as a result the costs of such an attack “extend well beyond the immediate areas and people affected,” imposing costs on the entire nation. Id. For this reason, private markets and individuals “undertake less investment in security than would be socially desirable” in order to reach satisfactory profit levels. See id. Therefore, government intervention must bridge the security level discrepancy. Id.

320. For example, the question of whether borrowers can impute their purchase of terrorism insurance to their loan principal still remains unclear. See Block & Steiner, supra note 276, at 5. For cases that dealt with this issue before TRIA’s enactment, see Four Times Square Associates, L.L.C. v. Cigna Investments, Inc., No. 107745/02 N.Y. Sup. Ct. 2002, rev’d, 2003 N.Y. App. Div. Lexis 6170 (1st Dep.), and Philadelphia Plaza Phase II v. Bank of America National Trust and Savings Ass’n, 2002 WL 1472337 (Pa. CCP 2002).


322. See Block & Steiner, supra note 276.

323. Id.

324. Id.
in order to encourage terrorism insurance coverage. The U.S. probably would not benefit from a social security type system similar to that available in Israel because Israel’s constant property damage requires more intense government involvement in the protection of property and citizenry. The U.S. can learn a lesson, however, from the Israeli and U.K. government insurance systems in order to implement its own incentives to help induce property owners into purchasing terrorism insurance. In particular, the U.S. can create incentives for consumers of terrorism insurance by incorporating some changes to current U.S. tax laws that would work parallel to TRIA.

Offering tax incentives to property owners for terrorism coverage would help induce property owners to obtain terrorism insurance coverage in addition to property and casualty insurance. U.S. tax law currently allows for the deduction of business and property losses for damaged property.

325. See Sommer, supra note 218, at 359.
326. However, insurance specialists note that even social insurance systems can face the same problems that trouble the private insurance industry, meaning that purely public “solidarity systems” may also face the problems of adverse selection, fraud, and moral hazard. See Gollier, supra note 14, at 16.
327. Terrance Chorvat & Elizabeth Chorvat, Income Tax as Implicit Insurance Against Losses From Terrorism, 36 IND. L. REV. 425, 426 (arguing that by “forcing the government to provide insurance for its failures, the tax system can overcome potential public choice problems...[as] without additional behavioral incentives, individuals will not behave in a socially optimal way with respect to protection from terrorist attacks”); Orszag & Pechman, supra note 241, at 5. See also LAKDAWALLA & ZANJANI, supra note 243, at 13 (explaining how governmental budget considerations can incorporate public protection and government insurance subsidies). Cf. Heal & Kunreuther, supra note 268, at 13 (suggesting the direct taxation of airline companies in order to encourage heightened baggage security); Martin F. Grace et al., The Demand for Homeowners Insurance with Bundled Catastrophe Coverage, (Paper prepared for the Wharton Project on Managing and Financing Extreme Risks, April 4, 2001) (examining the role of government incentives on inducing consumers to purchase insurance coverage for natural perils), available at http://www.aria.org/rts/proceedings/2000/homeowners.pdf (last visited Feb. 12, 2004).
328. IRC § 162 (2000) (enumerating trade and business losses that fall under the category of a legitimate loss for tax deduction purposes); IRC § 165 (2000) (allowing for deduction of losses occurring within the taxable year). An example can help illustrate how U.S. tax laws work with respect to the deductibility of losses:

[A]ssume A has a business and the total assets of the business are worth $100,000 at the beginning of the year, including a $10,000
premiums represent the expected value of loss, the U.S. tax system could provide the public with an incentive to purchase terrorism insurance by allowing for the deduction of such insurance premiums in the same manner that the U.S. Internal Revenue Code would calculate a loss, and such recoveries should be exempt from income.

Incorporating such a tax incentive in support of terrorism insurance will also require the U.S. government to incorporate such tax estimates into the nation’s overall budget, which will encourage decision-makers to incorporate the potential risks of terrorism and evaluate their resources in a manner that best works to prevent future terrorist attacks in the U.S. The Israeli governmental insurance system requires the nation to include its insurance claims in the government budget, and this self-awareness places the issue of national protection at the forefront of their political process. The U.S. can similarly take terrorism insurance into account in a manner that would simultaneously limit its financial exposure of having to pay the cost of another terrorist attack.

2. The Public/Private Terrorism Insurance Dichotomy and All It Can Offer

Even though a nation can arguably bear the burden of solely assuming the financial costs of insuring against terrorism, bear-
2004] TERRORISM RISK INSURANCE ACT OF 2002 885

ing the entire risk alone would prove to be highly inefficient.\textsuperscript{333} If the U.S. government took on the role of insurance carriers, the responsibility would also include risk management and documentation, which have proven to be extremely time consuming and expensive in the wake of September 11.\textsuperscript{334} TRIA and Pool Re similarly sidestep this problem by establishing public/private insurance schemes that seem beneficial for a smoother implementation of terrorism coverage, private industry re-development, and national security.\textsuperscript{335} Both insurance programs have many things in common, but they also have important differences that highlight areas where TRIA needs some improvement.\textsuperscript{336}

Both TRIA and Pool Re work to keep the insurance industry involved in the coverage of terrorist attacks. The insurance industry’s assumption of the risks of others requires that the industry also provide incentives for risk management through a lowering of premiums.\textsuperscript{337} Although governments can establish reimbursement incentives, such programs do not prove entirely beneficial, as studies have shown that consumers do not take full advantage of such opportunities.\textsuperscript{338} The insurance industry’s involvement in terrorism coverage, however, serves to force property owners seeking terrorism insurance to assume increased responsibility for ensuring safety and satisfying the

\textsuperscript{333} See Hillman, supra note 55, at 3 (explaining that the federal government’s size and sovereign power provide it with the ability to provide insurance in a way that the private sector could not).

\textsuperscript{334} See Brown et al., supra note 255, at 7. See also Terrorism Risk Insurance Program; Initial Risk Insurance Program; Initial Claims Procedures, 68 Fed. Reg. No. 230, 67101 (Dec. 1, 2003) (to be codified at 31 C.R.F. pt. 50) (explaining how the insurance the insurance industry is currently processing and administering claims).

\textsuperscript{335} See Terrorism Risk Insurance Act of 2002, Pub. L. No. 107–297, § 103; U.K. Treasury Announcement, supra note 165, at 8. See also Lakdawalla & Zanjani, supra note 243, at 13 (arguing that even with mechanisms of public protection in place, government insurance subsidies prove to be the optimal approach in increasing terrorism protection).


\textsuperscript{338} See Woo, supra note 20.
requirements of their lenders. TRIA and Pool Re keep the insurance industry intact, and in this way these programs allow for private intervention in terrorism risk mitigation.

Furthermore, TRIA and Pool Re take advantage of the insurance industry’s capability to process detailed documentation regarding specific properties’ insurance needs and potential requirements. The risk management actions that the private sector offers entail any of the following: building design, structure evaluations, safety equipment, evacuation plans, exit strategies, and heightened security systems for trophy properties — insurers then underscore each action with a reduced principle. By maintaining private sector involvement, both programs allow insurers to keep checks on protection measures. The private sector’s involvement, therefore, helps ensure that adequate measures protect insured properties from terrorist calamity. TRIA and Pool Re’s implementation allow the insurance industry to set higher standards for the mitigation of potential damages caused by terrorism.

339. See Block & Steiner, supra note 276, at 5.
340. The insurance industry provides data on insured losses through reports known as “bordereau” to their reinsurers, and TRIA makes use of this practice by requiring insurance companies to maintain and create such records for the federal program, which in turn keeps this insurance industry practice intact for a later time when the government will cease to regulate terrorism insurance. See Department of Treasury, 68 Fed. Reg. No. 230, 67100, 67102–3 (Feb. 28, 2003) (to be codified at 31 C.R.F. pt. 50).
341. See BROWN ET AL., supra note 255, at 6–7 (explaining that a “profit maximizing firm will invest in risk mitigation up to the point where the marginal costs of additional mitigation is equal to the marginal cost of insuring against that risk”). Two categories of risk mitigation exist: (1) investments that help protect existing buildings from terrorist attack (such as enhanced security, strengthening structural supports, shatter proof windows, and improved air vents, etc.); and (2) influence on new building construction, which includes development considerations such as building size, location, architectural design, etc. Id.
343. However, insurance companies’ incentives to mitigate terrorist risks may also influence developers to avoid constructing high profile buildings or projects. See BROWN ET AL., supra note 255, at 7. See also HILLMAN, supra note 55, at 15 (arguing that the insuring of any risk should also incorporate the private insurance industry).
TRIA undeniably resembles the British Pool Re system, but it differs in many respects as Pool Re has had significant time to mature as a mutual reinsurance program and the U.K. as a nation has thirty years of experience in facing the issue of terrorism.\textsuperscript{344} Pool Re has been covering the U.K.'s terrorism insurance program for eleven years and has gained a substantial amount of monetary leverage and experience.\textsuperscript{345} Similar to the U.S., Pool Re's fate as a government terrorism insurance system was questionable,\textsuperscript{346} but over the years the program has expanded in a manner that allows it to adapt to current terrorism concerns.\textsuperscript{347} Accordingly, the U.S. can learn from Pool Re's experience. The U.S. can specifically take note of the U.K.'s Pool Re approach in expanding coverage, defining terrorism, establishing premium requirements, and allowing for the review of Pool Re's decisions.

Pool Re has proven successful in providing the nation’s terrorism reinsurance needs, and, for this reason, the program has expanded to cover terrorism-related perils that at one time were covered by neither the insurance industry nor the governmental program.\textsuperscript{348} Unlike the U.S., where many states require fire coverage, the U.K. initially did not include this type of damage in the terrorism insurance package offered by Pool Re.\textsuperscript{349} As the U.K. program has gained adequate capital in its reserves, Parliament decided that it would expand its Pool Re program to cover more terrorist-related risks after September 11.\textsuperscript{350} The U.K. now provides coverage for nuclear disaster, flood, etc.\textsuperscript{351} The U.S. Terrorist Insurance Program falls short of such cover-
age, allowing for claims arising from more conventional methods of terrorist attacks.\textsuperscript{352} As many commentators argue that terrorists probably will strike in a manner that has not been accounted for,\textsuperscript{353} traditional forms of terrorism may be changing.\textsuperscript{354} Accordingly, if the U.S. government allows for TRIA’s survival, the legislation will also have to include different varieties of terrorist risk; otherwise its coverage may realistically prove minimal and it may spark litigation in the future.\textsuperscript{355}

The U.K. has also accounted for the changing nature of terrorism as it has broadened the nation’s definition of terrorism overall.\textsuperscript{356} A terrorist attack in the U.K. includes domestic terrorist groups of all types.\textsuperscript{357} The definition of a terrorist occurrence in the U.K. focuses on the effects of such an attack and the intent of such action on the nation.\textsuperscript{358} The U.S., on the other

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\item \textsuperscript{353} See, e.g., PANEL DISCUSSION, COMMERCIAL MORTGAGE-BACKED SECURITIES ROUNDTABLE, IN REAL ESTATE FINANCE AND INVESTMENT JANUARY 13, 2003 (Gale Group, Inc., 2003) (At this roundtable discussion, Joe Franzetti, director of Salomon Smith Barney, emphasized that insurers are currently concerned about bio-terrorism, whereby terrorist could potentially tamper with a building’s HVAC system, which insurers believe could be accomplished more easily than more truck bombings, etc.); Ruth Gastel, Computer Security-Related Insurance Issues, INS. INFO. INST., Sept. 2003, available at LEXIS, Nexis News & Bus. Library (listing “cyber terrorism” as a new issue for first and third party insurance coverage). See generally Thomas, supra note 43, at 413–17 (taking into account the different transaction costs involved in insurance litigation of matters that fall in categories beyond the scope of “traditional terrorism,” i.e., bombings, political hostage-taking and airplane hijacking).
\item \textsuperscript{354} See id. See also Orszag & Pechman, supra note 241, at 11 (explaining that enhanced security is essential for preventing terrorist uses of chemical and biological plants in their plans of mass destruction); U.K. Treasury Announcement, supra note 165, at 2 (noting that terrorist can find ways to go beyond expected or typical scenarios).
\item \textsuperscript{355} See Lobel, supra note 260, at 39 (noting that nuclear, biological and chemical terrorism-caused losses are not presently included in property coverage and that if an attack is labeled as a terrorist act, then it remains unclear whether such exclusionary clauses will remain enforceable if terrorism is found to be the proximate cause of an attack).
\item \textsuperscript{357} Reinsurance (Acts of Terrorism) Act, 1993, ch. 18, § 2(2) (Eng.)
\item \textsuperscript{358} Id. In fact, as a result of the U.K. government’s decision to expand the definition of terrorism, insurers have also made the similar changes in their
\end{itemize}
hand, restricts the definition of terrorism\textsuperscript{359} to attacks by malicious foreign groups.\textsuperscript{360} This important distinction reflects how each nation also views the problem of terrorism. The U.K.'s definition holds a terrorist act to be any act that goes against the Crown and the U.K.;\textsuperscript{361} however, the U.S. approach plainly focuses on terrorist organizations with roots from abroad without realizing that the problem could just as well be a domestic one.\textsuperscript{362} Plainly, terrorist groups do not need to be cultivated abroad; terrorism may also be “homegrown.”\textsuperscript{363} The U.S.' limited legislative definition of terrorism also poses practical problems for the insurance companies that provide terrorism coverage because TRIA's definition limits the scope of coverage\textsuperscript{364} to exclude circumstances where wider coverage is necessary.\textsuperscript{365}

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\textsuperscript{360} TRIA defines terrorism as an act “committed by an individual or individuals acting on behalf of any foreign person or foreign interest, as part of an effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government by coercion.” Id. at 102(1)(A)(iv).

\textsuperscript{361} Reinsurance (Acts of Terrorism) Act, 1993, ch. 18, § 2(2) (Eng.).


\textsuperscript{363} Suarez & Abrams, supra note 242 (reflecting on the Oklahoma City bombing example). TRIA also gives deference to the U.S. Secretary of Treasury to decide whether a U.S. citizen who sympathizes with a foreign interest falls under TRIA's definition of a terrorist. Id. See also Epstein & Keyes, supra note 254, at 3.

\textsuperscript{364} For example, a terrorist act stemming from war could potentially be excluded from TRIA's terrorism definition. Michael Bradford, Terrorism Coverage Poses Challenges, Opportunities; CPU Society 2003 Annual Meeting, BUS. INS., Nov. 17, 2003, at 24H (contemplating the exception that would arise had Congress officially declared a war on Iraq and a terrorist attack took place in support of Iraqi interests). However, the U.S. Secretary of Treasury asserts that the war exclusion only applies to “acts of terrorism committed in connection with a formal, congressionally declared war” and not pursuant to military actions connected to the President's role as the nation's commander-in-chief. Letter from John W. Snow, U.S. Secretary of Treasury, to Michael G. Oxley, Chairman of Department of Treasury's Committee of Financial Ser-
In contrast to the U.K.’s expansive definition of terrorism and coverage exposure, Pool Re initially set specific premiums for all its participating insurance members, and continues to implement a “no adverse selection” principle. Pool Re no longer mandates specific premium prices for the insurance industry’s terrorist insurance packages; however, this change arrived long after Pool Re had established its own substantial financial reserves. The program also clearly demarcates the maximum monetary amount for which the insurance industry would be responsible with regard to terrorist events that occur in one year, which allows insurers to calculate their potential losses in advance. In addition, regardless of the U.K.’s current premium deregulation, Pool Re members and the U.K. Treasury Department are still in the process of negotiating the program’s financial issues, such as premium rates and membership participation thresholds. Pool Re also allows for insurance companies to adjust the premium rates that they charge if their clients take certain “prescribed risk management” steps.

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365. Staring, supra note 306, at para. 5 (noting that the requirement of having two separate policies will especially hold true in the case of marine insurance policies, which tend to require broader international insurance coverage). See also Terrorism Risk Insurance Program, 68 Fed. Reg. No. 133, 41252 (July. 11, 2003) (to be codified at 31 C.R.F. pt. 50).

366. Note that Pool Re no longer regulates the insurance industry’s premiums. See U.K. Treasury Announcement, supra note 165, at 4. However, the U.K. Treasury and Pool Re members will continue to discuss Pool Re’s finance issues, which undoubtedly include the adjustment of premiums. Id. at 7.

367. Atkins, supra note 156; TILLINGHAST UPDATE, supra note 168, at 3. Participating insurers must specifically refer to Pool Re’s rate manual for premium prices. Id. Insurers then must cede this premium amount to Pool Re. Id.


371. TILLINGHAST UPDATE, supra note 168, at 3.
contrast, TRIA allows insurers to charge premiums based on their own ability to cover terrorist harm, and as a result, many insurers use this option as a legal loophole to circumvent providing terrorism insurance. TRIA technically requires all insurers to make terrorism insurance “available” to their clients, but the U.S. Treasury confirmed to many apprehensive insurance companies that this requirement would not also stipulate that rates be reasonable. However, insurers still feel uncomfortable with TRIA’s lack of specificity in that the Act covers amounts that surpass the aggregate threshold amount, but the statute and program have not indicated how the program will approach the number of occurrences issue the nation faced with September 11. For this reason, insurers’ ability to plan their own financial exposure is limited.

372. See Michael Prince, Insurers Frustrate Serio on Terror Law: State Insurance Superintendent Blames Coverage Failure on Industry, CRAIN’S N.Y. Bus., Mar. 24, 2003, at 23 (reporting the details of an interview with Gregory Serio, New York State Department of Insurance’s superintendent, who noted that TRIA requires insurers to provide terrorism insurance coverage, but at the same time insurers have reacted by increasing their terror insurance premiums by 600% or by requesting approval for “broad-based terrorism exclusions”). Insurers, who manage to circumvent potential buyers of their terrorism insurance, can then apply under TRIA for the reinstatement of their terrorism risk exclusions. Terrorism Risk Insurance Act of 2002, Pub. L. No. 107–297, § 105(c).

373. Terrorism Risk Insurance Act of 2002, Pub. L. No. 107–297, § 103; Masters, supra note 117, at 430–31. See also Gollier, supra note 14, at 9, 11 (noting that the prohibition of “discrimination or public information” can artificially increase the premium rate even for low risk agents, which actually serves to enhance the adverse selection problem, but at the same time a policy that allows for pricing discrimination balances policyholders’ incentive to invest in “risk reducing activities”).

Nevertheless, the U.K.’s system can place restrictions on Pool Re insurance members, because it also limits insurers ability to insure with reurers who wish to participate in the government-sponsored program. Pool Re does not require insurers to participate in the program, but its participating insurers cannot seek private or additional reinsurance coverage. The U.K. program mandates that all of its participating members supply their deductibles solely to Pool Re. As a result, over the program’s lifetime, these provisions have allowed for Pool Re to expand its own reserves, decreasing the U.K.’s chances of withdrawing from the nation’s own monetary reserves in the event of another major terrorist attack on the British mainland.

The U.S. could potentially apply such restrictions on participation; however, such restrictive provisions interfere with the government’s intention of keeping the program temporary. TRIA seeks to encourage reinsurers to cover terrorism insurance and for this reason the government insurance program does not limit insurers’ capabilities to work with reinsurance companies. In fact, many insurers of terrorism risk in the

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375. See Cost of Terrorist Attack Insurance Falls by Half, TIMES (LONDON), July 31, 2003, available at 2003 WL 62398122 (reporting that a number of insurers can presently provide customers with competitive rates at lower rates than Pool Re’s participants, making such insurers especially attractive to property owners with covering single “prestige” buildings).

376. Id.; Barnes, supra note 142.

377. See Fleming, supra note 214, at 8. Pool Re’s participation restrictions seem to benefit national insurance companies over international ones. Id. However, private terrorism insurance coverage outside of Pool Re has also developed. See Lloyd’s Terrorism Bulletin No. 4, Oct. 24, 2001, at http://www.millerinsurance.co.uk/Downloads/Terrorism4.doc (last visited Jan. 18, 2004) [hereinafter Lloyd’s Terrorism Bulletin].

378. TILLINGHAST UPDATE, supra note 168, at 3. However, private terrorism insurance coverage outside of Pool Re has also developed. See Lloyd’s Terrorism Bulletin, supra note 377.

379. See TILLINGHAST UPDATE, supra note 168, at 3.

380. See Terrorism Risk Insurance Act of 2002, Pub. L. No. 107–297, § 101. See also BROWN ET AL., supra note 255, at 9 (noting the “persistent concern that long-term government dominance…will mean a loss of the efficiency and innovation fostered by competition within the private sector.”).

U.S. have obtained reinsurance coverage for their government deductible in the likelihood of another terrorist attack.\textsuperscript{382} Reinsurers' reemergence in the realm of U.S. terrorism insurance coverage is two-fold: first, reinsurers are slowly feeling more comfortable with providing insurance companies coverage for the risk of terrorism; second, TRIA provides the insurance industry with a clear cap on its potential losses, which is a sum that insurers can incorporate in their transactions.\textsuperscript{383} It remains unclear, however, whether the reinsurance industry would continue to allow insurers to cede their terrorism risks without TRIA's limitations on potential liability. Nevertheless, Pool Re's example exemplifies the fact that the U.S. can effectively provide support for terrorism insurance coverage without forcing all insurers to participate. The U.K.'s governmental reinsurance model also demonstrates that premium setting plays a huge role in gaining public clientele at least at such a program's initial stages.

Since the formation of TRIA's coverage guidelines and managerial procedures are still in process, it also remains to be seen whether any issues may arise due to the lack of judicial review.\textsuperscript{384} Despite U.K. provisions allowing for judicial review of Pool Re's determinations, the authoritative appeal tribunal originates within the agency itself, potentially undermining the objectivity of the ultimate rulings. However, at least the U.K. allows for some sort of review. Although no crisis has seemingly emerged from the U.K.'s limited review possibility, TRIA's lack of judicial review may prove to be problematic in the U.S. as the legislation forecloses any possibility of judicial review.\textsuperscript{385}

\textsuperscript{382} See Tackling a Burning Issue, supra note 304, at 36.
\textsuperscript{384} Masters, supra note 117, at 431.
Several commentators attempted to thwart TRIA's intolerance for judicial review by arguing that the Administrative Procedure Act ("APA"), 5 U.S.C. § 554, requires the U.S. Treasury Department to allow for claim determination appeals, under Section 102(3) of the APA. Terrorism Risk Insurance Program, 68 Fed. Reg. No. 133, 41250 (July 11, 2003) (to be codified at 31 C.R.F. pt. 50). However, the Treasury Department has countered such legal contentions by asserting that the APA's hearing requirement applies only where a statute requires a hearing on the record, adding that the Supreme Court also supports this interpretation, and since TRIA specifically forbids such hearings, the Treasury Department concludes that the APA does not apply. \textit{Id}.
Such a restriction reduces the transaction costs tied to litigation, but it ultimately may also sacrifice fairness and insurers’ confidence in the government program. Despite TRIA’s rigidity on judicial review, the U.S. Department of Treasury currently works closely with the NAIC in order to establish a program geared to assisting the insurance industry’s needs.

V. CONCLUSION

The question of TRIA’s renewal ultimately lies in who should potentially bear the costs of a terrorist attack — taxpayers, after the fact, or consumers through a previously established insurance system. Undoubtedly, the insurance industry will argue for the program’s continuance, but the real concern should be the U.S. economy and the public’s main interest in the long run. TRIA has assisted in lowering the costs of terrorism insurance coverage, but, in order to give the program its true force, the legislation needs further tailoring to meet the current circumstances that the nation faces.

The U.S. must consider offering property owners incentives to purchase terrorism coverage and fine-tuning TRIA’s regulation of the insurance industry. Through tax incentives, property owners will most likely have a greater compulsion to invest in additional coverage for terrorist-related harm. In addition, the U.S. should make insurance company participation in the government’s terrorism insurance program discretionary, as most inflated premium rates serve as deliberate means of evading terrorism coverage. These high premiums then distort the perspective of consumers, deterring the purchase of such insurance coverage. Incorporating these changes in the government’s ex-


386. See generally Thomas, supra note 43. However, insurers do have the opportunity to request a general interpretation of the statute by written submission to TRIP or through an informal oral hearing. Bragg, supra note 9, at 11.


389. See Gollier, supra note 14, at 17 (explaining that super-terrorism creates an “undiversifiable risk….that must be allocated to…consumers”).
isting program will help ignite the demand for terrorism insurance cover and may also simultaneously accelerate the insurance and reinsurance industries’ capacity and desire to insure terrorism on their own. Stronger market forces will help further decrease terrorism insurance premiums, and the larger consumer base will bring forth larger profits.

As the terrorism insurance market gains its own capacity, the U.S. government should also strongly consider expanding TRIA’s scope and coverage. Since terrorism tactics and techniques evolve with time, insurance coverage should also develop accordingly. TRIA now offers the reinsurance backing necessary for insurers to cover conventional means of terrorism, but it stops at conventional methods taken by foreign groups. Instead, U.S. terrorism insurance coverage should expand in order to be prepared for the worst. Furthermore, TRIA’s foreign based terrorist agendas shifts the focus to problems abroad; however, such problems can develop from within the nation as well. Therefore, TRIA has initiated the process of preparing the insurance industry to insure the risk of terrorism, but the groundwork for complete terrorism coverage is far from being complete.

Although TRIA’s scheduled sunset is approaching, the risk of terrorism remains. This lingering risk continues to chill the nation’s insurance industry from fully embracing terrorism coverage. The protection of a nation’s citizenry requires both national security and financial planning.

391. “Simple calculations suggest that, despite international counter-terrorist action, the risk is currently substantial, as indeed it was before September 11, 2001.” Woo, supra note 20, at 17.
392. But see Brown et al., supra note 255, at 15 (arguing that one of the “key features” of the U.S. terrorism risk insurance program is its “defined exit strategy”).
393. In addition to establishing the right insurance plan for the nation, the U.S. government also must simultaneously focus on the nation’s defensive mechanisms in order to prevent a terrorist attack from occurring again in the U.S. This Note has not emphasized national security mechanisms only because this issue is not within its scope. The issue of U.S. “Homeland Security” legislation and government security programs require their own legal analysis. However, a nation’s security mechanisms are invaluable to the prevention of terrorism. Any mitigation of terrorist risk would also have a positive counter-effect on the nation’s insurance industry’s ability to insure property.
TRIA represents a nation moving forward, overcoming immense suffering and loss. Hopefully, the U.S. will never have to face another terrorist attack, but at least the U.S. has taken one important step, as other nations have done in the past, in preparation.

Irene S. Kaptzis

* J.D. Candidate, 2004, Brooklyn Law School; B.A., 2001, New York University. The author would like to dedicate this Note to her family as their unwavering support and affection ensures, or rather insures, her own well-being and accomplishments.
FROM ITAR-TASS TO FILMS BY JOVE:
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INTRODUCTION

The modern world is characterized by an unprecedented amount of contact among sovereign states. “Growth in international activity and dramatic technological changes have greatly increased the frequency with which national legal systems must interact.” This intensified interaction has, in turn, resulted in a surge in disputes involving various aspects of private international law.

Copyright law is an area of private law which easily assumes this kind of international character because its subject matter effortlessly crosses geographical borders. This trait has been augmented by the development of the Internet and communication technologies. Scholars point out several important factors contributing to the ever-increasing importance of copyright law in the international arena. First, technological development allows a user easy worldwide access to copyrighted works to a degree unthinkable before. Second, the Internet threatens the traditional territorial principle of copyright law. Finally, copyright law has acquired outstanding importance as a result of the “shift of emphasis from manufactured goods to ideas, infor-
mation, and images – the subject matter of intellectual property.

These factors exacerbate old legal problems and may even create new ones in international copyright disputes. One cluster of traditional problems that has gained new importance is that of conflict of laws questions surrounding both initial copyright ownership and transfer of rights.

Problems regarding ownership and transfer of rights have been compounded by the growing transparency of national borders, the shift from industrial to information markets and burgeoning participation of copyrighted works in international commerce.

These changes have, in turn, put unbearable pressure on the traditional interpretation of the principle of national treatment enshrined in the Berne Convention for the Protection of Literary and Artistic Works. According to the conventional understanding of national treatment, the law of a protecting country should determine all the issues of copyright, including ownership. This approach also comports with the related principle of territoriality because it regards copyright as consisting of sepa-

rate sets of rights for each sovereign state. But the disparate copyright regimes envisioned by this conventional understanding hinder the uniform worldwide exploitation of a literary work. It is for this reason that the United States Court of Appeals for the Second Circuit in *Itar-Tass v. Russian Kurier, Inc.* rejected this conventional interpretation of national treatment. The court found that the national treatment principle did not contain a choice of law provision and held that ownership of a copyright should be determined by the law of the country with the most substantial relationship to the work. By rejecting the uniform application of the law of a protecting country, *Itar-Tass* imported the modern conflict of laws analysis into the world of copyright law, which, until that point, had completely ignored conflict of laws issues. Such an approach has the virtue of establishing a single root of title to copyrighted works, thus facilitating their distribution and exploitation. It is also more flexible than the traditional approach.

However, its application creates a number of serious problems: the fact that a general conflict of laws approach eludes predictability; the difficulties associated with interpreting foreign laws and determining what degree of deference should be given to a foreign judiciary; and obstacles to enforcing decisions. In *Films by Jove v. Berov* ("Films by Jove II"), the United States District Court for the Eastern District of New York, attempting


to apply *Itar-Tass*, was confronted with many of these same problems.  

A universal copyright regime would resolve these problems, but thus far it has remained an unattainable goal.  

In the meantime, scholars have developed two principle methods of ameliorating the difficulties: the Dreyfuss-Ginsburg procedural approach, and the substantive approach suggested by Graeme Dinwoodie.  

This Note’s principal thesis is that, by themselves, these salutary attempts to deal with a pressing problem are inadequate unless supplemented by the establishment of supranational equitable principles. The establishment of a supranational body of equitable principles would be a step towards universal copyright law, and would be easier to achieve because it would not cause interference with sensitive policies underlying national copyright regimes. Once established, the universal law of equity could help to protect third parties and good-faith purchasers in transnational copyright transactions, thus facilitating worldwide exploitation and distribution of copyrighted works.

Part I looks at the traditional approach of copyright law to conflict of laws problems under the Berne principle of national treatment. Part II discusses the parallel universe of the conflict of laws doctrine, which has undergone a revolutionary shift from the territorial approach of the First Restatement to the


27. See generally RESTATEMENT (FIRST) OF CONFLICT OF LAWS (1934).
modern functional analysis. Part III focuses on the rejection of territorial interpretation of the national treatment doctrine and acceptance of the modern conflict of laws doctrine by the United States Court of Appeals for the Second Circuit in *Itar-Tass*. Part IV discusses the problems involved in the application of the modern conflict of laws doctrine to the issue of copyright ownership and transfer of rights. These problems are clearly demonstrated by the decisions of the United States District Court for the Eastern District of New York in *Films by Jove I and II* applying the *Itar-Tass* holding to a more complicated set of facts. Finally, Part V suggests that many of these problems can be solved by the application of supranational equitable principles, in particular the doctrine of apparent authority, aimed at providing certainty and security in commercial transactions.

I. CONFLICT OF LAWS IN THE BERNE CONVENTION PRINCIPLE OF NATIONAL TREATMENT

The Berne Convention for the Protection of Literary and Artistic Works (“Berne Convention”) is one of the most influential copyright treaties in the world. First established in 1886, in Berne, Switzerland, this Convention is now administered by the World Intellectual Property Organization (“WIPO”), an intergovernmental organization created under the auspices of the United Nations. Until March 1, 1989, “the United States was the only major western country not a member” of the Berne Convention.

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Convention that at that time encompassed some 85 nations, including America’s major trading partners. China joined WIPO in 1992 and Russia followed suit in 1995.

A. National Treatment as a Compromise Between Universal Copyright and National Policies

Article I of the Berne Convention unambiguously states that “[t]he countries to which this Convention applies constitute a Union for the protection of the rights of authors in their literary and artistic works.” The leading authority on the Convention, Professor Sam Ricketson, notes that “the expression ‘author’ is left unidentified, although it occurs with great frequency throughout the substantive provisions of the Convention.” This is because the main focus of the Berne Convention was not so much on authorship as on the protection given to authors.

Since the very inception of the Berne Convention, two distinct approaches to the protection of authors’ rights “have vied for primacy.” These principles are “the non discrimination principle of national treatment” which “preserves the integrity of domestic legislation,” and the principle of universal copyright norms, which “guarantees international uniformity and predictability.” At the diplomatic conference of 1884, one of the preparatory stages to the Berne Convention, the German delegation declared itself a “strong supporter of universal codification,” proposing the following question to the Conference:

33. MARSHALL LEAFFER, INTERNATIONAL TREATIES ON INTELLECTUAL PROPERTY 357 (2d ed. 1997).
34. MARSHALL LEAFFER, UNDERSTANDING COPYRIGHT LAW 513 (1999) [hereinafter UNDERSTANDING COPYRIGHT LAW].
36. Id.
37. Berne Convention, supra note 14, art. 1. See also Burger, supra note 31, at 16 (pointing out that this focus on the protection of authors indicated the Continental European influence).
39. Id. at 39.
41. Id. at 267.
42. RICKETSON, supra note 38, at 58.
43. Id. at 59.
Instead of concluding a convention based on the principle of national treatment, would it not be preferable to aim for a codification, in the framework of a convention, regulating in a uniform manner for the whole projected Union, and in the framework of a convention, the totality of dispositions relating to the protection of copyright?  

The French, Swedish and Swiss delegations did not approve of this initiative “in the light of the many differences in national copyright law which still existed.” Instead, the parties accepted a compromise motion of the Swiss Government which stated:

Whereas, desirable as may be a universal codification of the principles which regulate the protection of the rights of authors, in view of the differences in existing laws and conventions, it is to be feared that such a project would postpone for a long time the conclusion of a general understanding.

Although the agreed upon approach “institutes national treatment,” it also tries to avoid local underprotection by creating a floor of minimum substantive standards that member countries must adopt. Both tenets are embodied in Article 5(1) of the Convention which states that:

Authors shall enjoy, in respect of works for which they are protected under this Convention, in countries of the Union other than the country of origin, the rights which their respective laws do now and or may hereafter grant to their nationals, as well as the rights specifically granted by this Convention.

The principle of national treatment requires member states to afford copyright owners from other Berne countries the same protection as that accorded to their own citizens.

44. Ricketson, supra note 38, at 59.
45. Id.
46. Id.
48. Berne Convention, supra note 14, art. 5(1).
49. 2 William Patry, Copyright Law and Practice 1273 (1994).
B. The Traditional Territorial Approach to National Treatment

Traditionally, the principle of national treatment was understood as a territorial approach, dictating that the law of a protecting country applies to all issues in international copyright disputes. A prominent European scholar, Eugen Ulmer, specifically states that “the question of who is the first owner of copyright is also decided in accordance with the law of the country where protection is claimed.”

Although there is some ambiguity as to whether a protecting country should be interpreted as a forum country or a country of infringement, most scholars believe a protecting country to be a forum country. This preference for the forum law is premised upon the greater comfort that courts feel in applying their own law as opposed to foreign law; this comfort is expected, in turn, to improve the quality of judgments and to guarantee more certainty. An additional benefit of this approach is that owners of rights are not affected by confiscation or exploitation measures in the country of the work’s origin whenever these measures are invalid in the protecting countries; for instance, “where a publisher had been expropriated in East Germany, the West German courts held that his reproduction and distribution rights in the Federal Republic are not affected.”

The principle of national treatment was reinforced by the Agreement on Trade Related Aspects of Intellectual Property Rights (“TRIPs”) in 1994. Although TRIPs relies mainly on the

52. Ricketson, supra note 38, at 226 (commenting that “it remains an open question under the Convention” whether a protecting country should be interpreted as a forum country or a country where an infringing act occurred, although in most cases they will be the same).
53. Stewart, supra note 15, at 37 (pointing out that the Berne Convention in its principle of national treatment accepted “broadly speaking lex fori”).
54. Stewart, supra note 15, at 37.
55. Id.
56. Id.
57. Id. at 39.
58. See Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, Legal Instruments-Results of the Uruguay Round
Berne Convention principles, its protection of copyright goes further than Berne. The primary significance of TRIPs is “the extension of the enforcement mechanism of the [World Trade Organization (“WTO”)] to intellectual property obligations.”

An important aspect of the TRIPs Agreement was treating copyright as “a trade issue rather than an information policy issue.” For instance, “[t]he ultimate decision of developing countries to consent to TRIPs was not motivated by a belief that greater protection for [Intellectual Property]” was in their interest; it was prompted, instead, “by a desire to obtain concessions in other areas.”

Scholars agree that dispute resolution based on TRIPs and the WTO framework evidences the beginning of the formation of uniform international copyright law. Nevertheless, although TRIPs strengthens and broadens copyright protection somewhat, it preserves the dichotomy between international and domestic laws by creating a floor — not a ceiling — for the copyright protection member states are obligated to enact into their domestic laws. Consequently, it retains the national treatment principle that “private litigation would be resolved by the application of national law.”

II. THE CONFLICT OF LAWS REVOLUTION IN CONTRACT AND TORT LAW

International copyright law has long escaped the reach of the general conflict of laws analysis because it adhered to the conventional interpretation of the national treatment doctrine, according to which, “the courts in the state where infringement occurs nearly always apply their own national law.” Copyright
law, thus, remained territorial and isolated from the parallel conflict of laws revolution that had taken place in tort and contract cases\textsuperscript{67} where the rigid territorial approach was displaced by various forms of “interest analysis.”\textsuperscript{68}

\textbf{A. Beale’s Territorial Approach of “Vested Rights”}

The traditional territorial approach in the American conflict of laws doctrine had been represented by Joseph Beale,\textsuperscript{69} a reporter for Restatement (First) of Conflict of Laws.\textsuperscript{70} His doctrine of “vested rights” was based “on a view that every state has exclusive jurisdiction over its territory.”\textsuperscript{71} Beale stated that “a right having been created by the appropriate law, the recognition of its existence should follow everywhere.”\textsuperscript{72} However, although Beale’s approach was very influential and enjoyed support among scholars and the courts when pronounced, it came under widespread criticism, in the 1950s and 1960s, for its inflexibility and arbitrariness in the choice of the moment when rights vested and, consequently, the jurisdiction, under which rights have vested. According to Beale’s general principle, “[r]ights were considered to have vested in the jurisdiction where the last act necessary to complete the cause of action occurred.”\textsuperscript{73} For instance, in the case of torts, the rigid rule dictated that the jurisdiction where the rights of the parties vested was the place of the wrong;\textsuperscript{74} in contracts, the place of the contract formation.\textsuperscript{75} Needless to say, such a rule often brought arbitrary and unjust results.\textsuperscript{76}

\begin{itemize}
  \item \textsuperscript{68}See generally Currie, \textit{Selected Essays}, supra note 28; Baxter, supra note 28; Cavers, supra note 28.
  \item \textsuperscript{70}Guzman, \textit{Choice of Law}, supra note 1, at 890.
  \item \textsuperscript{71}Id.
  \item \textsuperscript{72}James A. Martin, \textit{Perspectives on Conflict of Laws: Choice of Law} 5 (1980) (citing Joseph Beale, \textit{The Summary on the Conflict of Laws}).
  \item \textsuperscript{73}Guzman, \textit{Choice of Law}, supra note 1, at 891.
  \item \textsuperscript{74}Restatement (First) of Conflict of Laws § 377 (1934).
  \item \textsuperscript{75}Id. § 332.
  \item \textsuperscript{76}See, e.g., Alabama Great Southern R.R. Co. v. Carroll, 97 Ala. 126 (1892) (where the court of Alabama denied compensation to an injured em-
B. A Revolution in the Conflict of Laws Analysis

1. Currie’s Interest Analysis: True and False Conflicts

The main critic of Beale’s territorial approach in the 1950s and 1960s was Brainerd Currie. Currie developed “an interest analysis” by arguing that: “[w]hen a court is asked to apply the law of a foreign state different from the law of the forum, it should inquire into the policies expressed in the respective laws, and into the circumstances in which it is reasonable for the respective states to assert an interest in the application of those policies.” Curry divided conflicts of laws into two main groups: false conflicts and true conflicts. In a “false conflict” case, the interests of the respective states do not conflict, so “[i]f the court finds that one state has an interest in the application of its policy in the circumstances of the case and the other has none, it should apply the law of the only interested state.” Unfortunately, the situation becomes much more complicated where a “true conflict” between states’ interests exists. In that case, Currie argued that “where several states have different policies, and also legitimate interests in the application of their policies, a court is in no position to ‘weigh’ the competing interests, or evaluate their relative merits, and choose between them accordingly.” Therefore, in true conflicts, he recommends the use of the law of the forum: “[i]f...the court finds that a conflict
between the legitimate interests of the two states is unavoidable, it should apply the law of the forum.\textsuperscript{83}

Although Currie’s approach to false conflicts is accepted by the majority of courts and commentators today,\textsuperscript{84} his treatment of true conflicts has often been considered too parochial. It has been rejected by many scholars\textsuperscript{85} who criticize it for discriminating unfairly against nonresidents,\textsuperscript{86} encouraging forum shopping,\textsuperscript{87} and making it impossible to know in advance what law will be applied.\textsuperscript{88} Additionally, critics argue that a preference for the forum law does not give proper consideration to “a whole range of policies and values…relating to effective and harmonious intercourse and relations between and among communities….”\textsuperscript{89}

2. Alternative Solutions to “True Conflicts”

In response to the above critique, alternative solutions for the “true conflicts” approach were suggested. Professor William Baxter, for instance, developed a comparative impairment doctrine which stated that: “normative resolution of real conflicts cases is possible where one of the assertedly applicable rules is more pertinent to the case than the competing rule.”\textsuperscript{90} In contracts, another approach emerged advocating the validity of the contract.\textsuperscript{91} According to this principle, in a dispute between parties with equal bargaining power, a contract should be upheld as valid if it is valid under any law which the parties could have reasonably taken into account.\textsuperscript{92}

\begin{itemize}
\item[83.] Currie, Comments, supra note 78, at 1242–43.
\item[84.] MARTIN, supra note 72, at 85.
\item[87.] Baxter, supra note 28, at 9–10.
\item[88.] Cavers, supra note 28, at 22–23.
\item[89.] Mehren, supra note 28, at 938. See also RESTATEMENT (SECOND) OF CONFLICT OF LAWS (1971).
\item[90.] Baxter, supra note 28, at 9–10.
\item[91.] See generally ALBERT A. EHRENZWEIG, A TREATISE ON CONFLICT OF LAWS (1962). See also ALBERT A. EHRENZWEIG, PRIVATE INTERNATIONAL LAW (1967).
\item[92.] Id.
\end{itemize}
3. The Restatement (Second) of the Conflict of Laws

Widespread dissatisfaction with the territorial approach of the First Restatement continued and eventually prompted the American Law Institute’s Restatement (Second) of the Law of Conflict of Laws.\textsuperscript{93} Professor Willis Reese, a reporter for the Second Restatement, signaled that “conflict of laws is in a state of flux,”\textsuperscript{94} and pointed out that “wide differences presently exist with respect to underlying objectives and values.”\textsuperscript{95} He then suggested that the Second Restatement “reflects contemporary trends and cross currents respecting choice of law.”\textsuperscript{96}

The Second Restatement is built around the “the concept of locating the state with the ‘the most significant relationship’ to the parties and the occurrence or transaction giving rise to a lawsuit, and then applying that state’s law.”\textsuperscript{97} This principle is behind all black-letter rules of the Second Restatement, cast in the form of presumptions, which are rebuttable by the general principles stated at the beginning of both chapters on torts and contracts.\textsuperscript{98} In turn, these general principles have to be “read in the light of the choice-influencing principles of section 6,”\textsuperscript{99} which is open-ended and policy-oriented,\textsuperscript{100} and reads as follows:

1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.

2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include
   a) the needs of the interstate and international systems,
   b) the relevant policies of the forum,
   c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,

\textsuperscript{93} Martin, supra note 72, at 38.
\textsuperscript{95} Id.
\textsuperscript{96} Mehren, supra note 28, at 964.
\textsuperscript{97} Harold P. Sotherland, A Plea for the Proper Use of the Second Restatement of Conflict of Laws, 27 VT. L. REV. 1, 8 (2002).
\textsuperscript{98} Id. at 8.
\textsuperscript{99} Id. at 9.
\textsuperscript{100} Id. at 8.
d) the protection of justified expectations,

e) the basic policies underlying the particular field of law,

f) certainty, predictability and uniformity of result, and

g) ease in the determination and application of the law to be applied. 101

Although the Second Restatement has been favorably received by judges, most academics have sharply criticized it,102 pointing out that its “unprincipled eclecticism has done little to strengthen the intellectual underpinnings of our discipline.”103

In sum, the Second Restatement is a true reflection of the continued flux in conflict of laws analysis. Discussing the idea of creating the Third Restatement, a prominent scholar has summarized the current situation in conflict of laws by stating: “We simply cannot agree.”104 This state of flux is deepened by a noticeable shift from a state perspective to an individual perspective105 and from a domestic perspective to international one.106

III. THE CONFLICT OF LAWS REVOLUTION IN INTERNATIONAL COPYRIGHT

A. Conflict of Laws Issues Under the Traditional Interpretation of the National Treatment Doctrine

Having rejected the territorial interpretation of national treatment, copyright law has inherited all the flexibility, but also the confusion, of the modern “interest analysis.” Until recently, run of the mill international copyright controversies have not contained any difficult choice of law issues, and the principal copyright treatises hardly needed to give more than a passing discussion of conflict of laws issues.107 The same is true

101. Restatement (Second) of Conflict of Laws § 6 (1971).
105. See generally Guzman, Choice of Law, supra note 1.
106. See Reimann, supra note 2, at 576; Juenger, supra note 103, at 414.
of the major conflict of laws treatises, which have reciprocally tended to give intellectual property short shrift.\textsuperscript{108} This lack of interest from the perspective of U.S. conflicts scholars is explained by the fact that “the domestic multistate dispute has prevailed as the model for primary judicial and scholarly attention to conflicts issues in the United States.”\textsuperscript{109} Copyright controversies did not present any serious issues in multistate domestic disputes because of preemptive federal legislation.\textsuperscript{110} On the other hand, in international copyright cases, it was assumed that the Berne Convention principle of national treatment, interpreted as a territorial approach, led to the proposition that the law of the forum was the applicable law.\textsuperscript{111}

B. Rejection of the Traditional Interpretation

1. Need for Uniform Marketability of Title

Globalization has dramatically changed all that. “Increased global exploitation of copyrighted works and trademarked products has...forced courts and scholars to reconsider the apparent simplicity of choice of law questions in intellectual property cases.”\textsuperscript{112} This change of attitude was specifically influenced by two main factors: the difficulty in locating the exact territory where a copyrighted work originated or was disseminated;\textsuperscript{113} and the importance, for the sake of efficient world-wide exploitation of copyrighted works, of having a single copyright that can be enforced throughout the world.\textsuperscript{114}

Efficient worldwide dissemination of copyright is closely tied up with the question of predictability and certainty. In his work on copyright, Paul Goldstein states that “[o]f all the criteria against which a choice of law rule is to be measured, none is more salient that the predictability that promotes certainty in copyright transactions.”\textsuperscript{115} In the issue of ownership, “transna-
tional certainty...may best be served by a rule that establishes a single root of title for copyright in a work, possibly in the work’s country of origin.”\textsuperscript{116}  This point of view is supported by other scholars advocating the work’s source country (country of first publication, or domicile, or nationality of the author) as determining “who is the initial title holder”\textsuperscript{117} because “that choice of law rule ensures that the work will not change owners by operation of law each time the work crosses an international boundary.”\textsuperscript{118}

2. A New Era for the Conflict of Laws in International Copyright Disputes: \textit{Itar-Tass v. Kurier}

The United States Court of Appeals for the Second Circuit in \textit{Itar-Tass} accepted the source country approach by holding that, in international copyright disputes, the issue of ownership should be governed by the law of the work’s country of origin.\textsuperscript{119}

The case involved a copyright infringement suit by several Russian newspapers and the Itar-Tass news agency against a Russian-language newspaper published in New York. The plaintiffs complained that the defendant had copied materials from their newspapers. Since the copying was obvious and undisguised, the only issue of note in the case was the plaintiffs’ standing to bring the action which, in turn, depended on ownership of the copyright. It was a momentous issue, which required the Second Circuit, for the very first time, to deal with copyright ownership in the context of conflict of laws.\textsuperscript{120} Judge Newman concluded that the Berne Convention principle of national treatment does not contain choice of law rules.\textsuperscript{121} Then the court proceeded to “fill in the interstices...by developing federal common law on the conflicts issue.”\textsuperscript{122} Judge Newman reasoned that “copyright is a form of property” and in relation

\begin{itemize}
  \item \textsuperscript{116} \textit{Id.} at 102.
  \item \textsuperscript{117} Ginsburg, \textit{Ownership, supra} note 10, at 169.
  \item \textsuperscript{118} \textit{Id.}
  \item \textsuperscript{119} \textit{Itar-Tass Russian News Agency v. Russian Kurier}, 153 F.3d 82, 91 (2d Cir. 1998).
  \item \textsuperscript{120} \textit{Id.} at 88. It is also interesting to note that the District Court applied Russian law to the issue of ownership without considering the conflict of laws issue therein. \textit{Id.}
  \item \textsuperscript{121} \textit{Id.} at 89.
  \item \textsuperscript{122} \textit{Id.} at 90.
\end{itemize}
to property, under the Second Restatement’s approach, the governing law is “determined by the law of the state with ‘the most significant relationship’ to the property and to the parties.” 123

Relying on the Second Restatement the court concluded that Russian law should govern the issue of ownership. 124 Under that law, newspaper articles are exempted from the general work-for-hire doctrine, so the newspaper plaintiffs did not own copyright in the separate articles written by their employees. Consequently, they lacked standing to bring the action. 125

Although the principle announced in Itar-Tass — that initial ownership is determined by the law of the country of a work’s origin, and that infringement is determined by the law of the country of infringement — was initially disapproved by some commentators, 126 it is now generally accepted by most academics. 127 While the Itar-Tass court explicitly stated that it did not make any ruling regarding transfer or assignment of copyrights, 128 the facts of Itar-Tass presented an opportune pattern for easy transition from the traditional territorial interpretation of the national treatment principle to a more flexible approach, because those facts unambiguously pointed to Russia as the country of origin, and the difference between Russian and American law was outcome-determinative. 129

Unfortunately, this bright-line rule loses its simplicity in a slightly different set of facts. This is because, as the leading

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123. Itar-Tass, 153 F.3d at 90.
124. Id.
125. Id. at 92–93 (holding, however, that the news agency plaintiff owned the copyright in the work of its employees because it was not excluded from the work-for-hire doctrine, under the Russian law).
128. Itar-Tass, 153 F.3d at 84.
129. Id. at 88. The District Court in Itar-Tass applied Russian Law without even considering the choice of law issues in this case and their relation to the Berne principle of national treatment. Id.
treatise on copyright law points out, “[b]y looking to U.S. law as the *lex loci delicti* to determine infringement and remedies, but looking to the law of the “home country” to determine threshold issues, *Itar-Tass* raises a host of issues.”

These fall into three broad categories: (1) those relating to initial copyright ownership; (2) those concerned with transfer of the copyright interest; and (3) those arising from the copyright-contract dichotomy.

The first cluster, that concerning copyright ownership, encompasses possible difficulties in separating the issues of ownership and infringement; application of the U.S. work-for-hire doctrine to the different settings of other countries’ laws; and, of course, the difficulties associated with determining foreign laws. Additional complications can arise in conflict of laws analysis from the possibility of more than one country being designated a country of origin “when nationality, domicile, place of creation, or first publication are not united in the same country.” Thus, the *Itar-Tass* approach solves the territoriality problem of national treatment, but also opens up for copyright disputes the Pandora’s box of conflict of laws problems that have long dogged other spheres of law, such as torts and contracts.

*Itar-Tass* also expressly left open the question of which law governs the transfer of initial copyright ownership. According to Nimmer on Copyright (“Nimmer”), it would be illogical to look to the law of the state with the most significant relationship to the property and parties in determining copyright ownership, but not to do the same thing in the “realm of assignments”

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130. 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 17.05(3) (2000) [hereinafter NIMMER ON COPYRIGHT].
131. *Id*.
132. Professor Ginsburg points out that relevant factors in determination of the law governing initial ownership of a work for hire can be: (1) country of a nationality of an employee; (2) country of a nationality of an employer; (3) country where the contract was localized or country determined by the choice of law clause in the contract; (4) country of the first publication; or (5) country of forum. Ginsburg, *Ownership*, supra note 10, at 168.
135. *Itar-Tass*, 153 F.3d at 91 n.11.
136. NIMMER ON COPYRIGHT, supra note 130, § 17.05(2).
Nevertheless, the unwillingness of the Itar-Tass court to tackle the conflict of laws in copyright assignments is understandable because this problem is even more complicated than that of initial ownership. One aspect of it is the fundamental question of whether copyright is transferable at all, since “some legal systems allow for transfer of the copyright itself, while others do not.” In general, civil law countries tend to be very protective of individual authors at the expense of the policy of free alienability favored by common law countries. Where an author from a civil law country makes the kind of transfer of his or her rights to a U.S. party that that author’s country prohibits, but U.S. law allows, a true conflict problem can arise.

Additionally, different outcomes can result from restrictions on alienation being characterized — as they often are — as belonging to the sphere of contracts, not copyright law. As Professor Ginsburg points out, “[c]oncerning transfers of copyright ownership, potentially applicable choice of law rules include: (1) the law chosen by the parties to the contract; (2) the law of the country in which the contract can be localized; (3) the law of the forum.” Thus, the logical extension of the interest-analysis in Itar-Tass to the assignments of copyrights can complicate the potential conflict of laws issues.

IV. APPLICATION OF THE ITAR-TASS APPROACH IN FILMS BY JOVE V. BEROV

A. Facts of Films by Jove v. Berov

The decision of the United States District Court for the Eastern District of New York in Films by Jove clearly illustrates both the merits of the Itar-Tass approach and the significant
difficulties discussed above. *Nimmer* refers to *Films by Jove* as a complex example of choice of law issues in international copyright.\(^{142}\) *Films by Jove* had a pattern of facts uniquely suited to test the *Itar-Tass* approach. This case involved the issue of ownership of copyright in approximately 1,500 animated films produced by the film studio Soyuzmultfilm in Russia between 1936 and 1991. But, while the issue of ownership in this case seems, at first blush, to be similar to that in *Itar-Tass*, it can be distinguished by some important legal and social factors. The legal factors include the fact that the animated films in *Films by Jove* were restored works;\(^{143}\) that they were covered by the Berne Convention § 14bis regarding cinematographic works;\(^{144}\) and that there was a transfer of copyrights from the initial rightholder.\(^{145}\) The social factors involved are the significant public importance of the copyrighted subject-matter in this case\(^{146}\) as well as the somewhat unusual position taken by the Russian government in displaying a very strong interest in this subject-matter.\(^{147}\)

Because the subject-matter of a controversy often determines the outcome of a legal analysis, it seems logical to begin the discussion of this case with the description of the animated films involved in this controversy, their social importance, and the complicated transactions in which they were involved before proceeding to the legal analysis of the issue.

1. The Subject Matter of the Case: Cheburashka

The 1500 animated films at issue in *Films by Jove* were children’s classics in Russia. Each of them would reward separate discussion, but four films dedicated to a personage called Che-

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143. 17 U.S.C. § 104A(b) (1995) (“a restored work vests initially in the author or initial rightholder of the work as determined by the law of the source country.”).
burashka stand apart. Cheburashka is an exotic small brown animal with big ears and big eyes whose adventures are described in books of the Soviet writer Uspenskiy. These books served as the foundation for a popular series of animated films. The prominent role of these films is underscored by the Russian press’ reference to Cheburashka movies as being at the heart of this controversy in Films by Jove. Several generations of people in the Soviet Union were brought up with a firm belief that Cheburashka films were a national property, an attitude that persists even after the dissolution of the Soviet Union, and turns the issue of copyright ownership in this case into a locally sensitive matter.

In 1992, the plaintiff, an American enterprise named Films by Jove, Inc., entered into a licensing agreement with the lease enterprise Soyuzmultfilm Studios (“SMS”), allegedly a legal successor of a state enterprise of the same name, Soyuzmultfilm Studios (“Soyuzmultfilm”). Under this agreement, Films by Jove, Inc. acquired the right of exclusive international distribution for the animated films produced by Soyuzmultfilm. Subsequently, Films by Jove, Inc. invested about three million dollars in the restoration of the films and granted to the defendant, Berov, a right to distribute them through his retail stores in Brooklyn. When Berov violated the terms of the agreement, Films by Jove, Inc. sued him for copyright infringement.

Berov conceded the issue of infringement, but the case was dramatically complicated by the intervention of a third party plaintiff.

The third party, Federal State Unitarian Enterprise Soyuzmultfilm Studios (“FSUESMS”), is owned and controlled by the

150. Films by Jove I, 154 F. Supp. 2d at 446.
151. Id.
152. Id.
153. Id.
154. Id. at 434.
Russian state. FSUESMS alleged that it was the true owner of the copyrighted material because it was the only lawful successor to Soyuzmultfilm. According to FSUESMS, SMS was not the owner of the copyrights and, therefore, could not grant an exclusive distribution license to Films by Jove, Inc. The question of ownership, thus, became the controlling issue in the case.

2. District Court’s Analysis

Relying on the *Itar-Tass* ruling, Judge Trager held that initial ownership in copyright disputes should be governed by the law of the country with the most significant relation to the matter in question. The country with the most significant relation to the films here was clearly Russia, since the animated films were produced there by the Soviet enterprise Soyuzmultfilm Studios. During perestroika, this state enterprise was transformed into a lease enterprise also called Soyuzmultfilm Studios, which entered into the agreement with Films by Jove in 1992. Thus, the issue of ownership was to be decided in accordance with Soviet-Russian law. Additionally, the court noted that the animated films were “restored works.”\(^{155}\) The Uruguay Rounds Agreements Act of 1995 17 U.S.C. 104A(b), which provides for restoration of copyright in certain foreign works that had fallen into the public domain for non-compliance with formalities, states that ownership of a restored work belongs to “the author or initial rightholder of the work as determined by the law of the source country of the work.”\(^{156}\) This provision, too, seems to support the *Itar-Tass* rule dictating the choice of Russian law. Therefore, Judge Trager applied Russian law to the facts of the case.\(^{157}\)

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155. *Id.* at 448.
157. It is interesting that the court did not mention the provision of the Berne Convention expressly providing for the issues of ownership to cinematographic work in either of its two decisions. *See generally Films by Jove I, 154 F. Supp. 2d 432; Films by Jove II, 250 F. Supp. 2d 156.* The *Itar-Tass* court mentioned this provision in passing, remarking that “[t]he Convention does not purport to settle issues of ownership, with one exception not relevant to this case.” *Itar-Tass,* 153 F.3d at 91. This exception provides that “ownership of copyright in a cinematographic work shall be a matter for legislation in the country where protection is claimed.” *Id.* at 91 n.12 (citing Berne Conven-
Judge Trager saw the central issue as whether the lease enterprise, Soyuzmultfilm Studios, was the rightful owner of the copyrights to the films – for, if it was, then it had the power to grant Films by Jove, Inc. the exclusive right to distribute them abroad. Matters, however, were hardly that simple. The court faced the difficult problem of trudging through the legal jungle of the privatization process in post-Soviet Russia and of wading through the complex legal metamorphosis of the Soviet state enterprise Soyuzmultfilm, which first turned into a lease enterprise in 1989, and then became a joint stock company in 1999. Additionally, the court had to sort out the formation, in 1999, of the FSUESMS, which also claimed to be a successor to Soyuzmultfilm.

After a detailed and thoughtful discussion of the relevant Soviet-Russian law, the court concluded that the Soviet state enterprise Soyuzmultfilm was the initial owner of the copyrights, which were thereafter transferred to the lease enterprise by operation of law when the state enterprise was transformed into the lease enterprise. Consequently, these rights
were not limited by the lease, and its expiration did not cause them to expire.\textsuperscript{163}

In its analysis, the court considered numerous inconsistent decisions from Russian commercial courts (Arbitrazh courts) of different levels,\textsuperscript{164} where the adversaries (SMS and the FSUESMS) disputed the validity of each other’s corporate registration.\textsuperscript{165} The most relevant opinion, however, was that of a lower level court (Moscow Region Arbitrazh Court) on December 26, 2000, stating that “...copyrights to animated films created by the state enterprise ‘Film Studios Soyuzmultfilm’ were transferred by operation of law to its successor – lease enterprise ‘Film Studios Soyuzmultfilm.’”\textsuperscript{166} They could, therefore, not be transferred by the lease agreement nor limited by another agreement.\textsuperscript{167} Although this decision was later vacated by the intermediate court (the Federal Arbitrazh Court for the District of Moscow), the \textit{Films by Jove} court found the vacating decision to be “incoherent and, more important, irrelevant to the issue of copyright transfer.”\textsuperscript{168} The court concluded that the reasoning of the December 26th opinion “remained unscathed.”\textsuperscript{169} Judge Trager also relied on the implication in the case record that the court of the highest level in Russia (the Higher Arbitrazh Court of the Russian Federation) might have a different view of the case.\textsuperscript{170} The District Court, therefore, granted summary judgment to the plaintiffs on August 27, 2001.\textsuperscript{171}

Contrary to the District Court’s expectations, however, the Higher Arbitrazh Court of the Russian Federation issued an opinion three months later in favor of FSUESMS — overruling the lower courts’ decisions.\textsuperscript{172} The Higher Court stated that “the

\begin{footnotes}
\item[163] \textit{Id.}
\item[164] Russian commercial courts consist of “a lower court level, an appeals court level, a second appellate court level in the Federal Arbitrazh Court for the District of Moscow and a final appellate level in the Higher Arbitrazh Court of the Russian Federal.” \textit{Id.} at 439 n.17. \textit{See also} HIROSHI ODA, \textit{RUSSIAN COMMERCIAL LAW} 24–28 (2002).
\item[165] \textit{Films by Jove I}, 154 F. Supp. 2d at 439–46.
\item[166] \textit{Id.} at 441 (quoting the decision of Moscow Region Arbitrazh Court).
\item[167] \textit{Id.}
\item[168] \textit{Id.} at 474.
\item[169] \textit{Id.} at 475.
\item[170] \textit{Films by Jove I}, 154 F. Supp. 2d at 474.
\item[171] \textit{Id.} at 480.
\item[172] \textit{Films by Jove II}, 250 F. Supp. 2d at 158.
\end{footnotes}
relevant provisions of the leasing statute did not provide for the conversion of a state enterprise into a lease entity, and furthermore that any succession of rights from a state enterprise to the lease entity would not survive the expiration of the lease term.\textsuperscript{173} 

In response to the defendants’ motion for reconsideration,\textsuperscript{174} Judge Trager confessed that the Higher Court’s decision had undermined “certain operative premises” which supported his previous decision,\textsuperscript{175} but he refused to reconsider it, because the Higher Arbitrazh Court’s decision proved to be “clearly erroneous.”\textsuperscript{176} Additionally, Judge Trager found evidence on the record that the Higher Arbitrazh Court’s decision was “strongly influenced, if not coerced, by the efforts of various Russian government officials seeking to promote ‘state interests.’”\textsuperscript{177} In these circumstances, he questioned the independence of the Russian judiciary and affirmed his earlier ruling.

B. Problems of Copyright Law Revealed in Films by Jove

Films by Jove demonstrates four problems inherent in the Itar-Tass approach: (1) the conflict of laws problems; (2) difficulties in interpretation of foreign laws; (3) the required degree of deference to parallel decisions of foreign courts; (4) and the international impact of the decision, in particular its effect on international transactions.

1. Conflict of Laws Problems

As with Itar-Tass, the facts of Films by Jove unambiguously pointed to Russia as the country of origin for the films.\textsuperscript{178} The
issue of initial ownership was, therefore, to be determined by Russian law because all the participants were Russian nationals and the place of origin was clearly Russia. On the other hand, in contrast to Itar-Tass, Films by Jove involved transfers of the copyright, but the court concluded that there was no reason to consider transfer of rights because the dispositive issue was that of ownership.\textsuperscript{179} Sometimes, it is difficult to draw a bright line between ownership and transfer of rights, but in a purely domestic transfer of rights it does not seem proper to go only halfway and not to use the law of the source country.\textsuperscript{180} The transfer of copyright from Soyuzmultfilm to SMS, being a purely domestic transaction, cannot be meaningfully distinguished from the issue of initial ownership.

2. Difficulties in Interpretation of Foreign Laws

In contrast to the comparatively simple task of interpreting foreign copyright law in Itar-Tass, the foreign law issues in Films by Jove are significantly more challenging. The Films by Jove court had not only to interpret the Soviet-Russian copyright law, but also to grapple with the messy and inconsistent process of privatization in Russia.\textsuperscript{181} The court successfully coped with its immediate task, but the increase in international copyright disputes will undoubtedly compel significant expendi-

ownership has to be controlled by the law of the source country, i.e. Russia. Then, the relevant question is which of these two provisions has supremacy. The Berne Implementation Act of 1988 amends the Copyright Act to provide that “[t]he provisions of the Berne Convention...shall not be enforceable in any action brought pursuant to the provisions of the Berne Convention itself.” 17 U.S.C. § 104(c). Therefore, it is reasonable to conclude that the provision of the Copyright Act shall have a priority. Evidently, the district court came to the same conclusion by applying the Russian law to the issue of ownership.

\textsuperscript{179} Films by Jove I, 154 F. Supp.2d at 477 n.42.
\textsuperscript{180} Nimmer on Copyright, supra note 130, § 17.05(2).
\textsuperscript{181} Paul B. Stephan, A Becoming Modesty — U.S. Litigation in the Mirror of International Law, 52 DePaul L. Rev. 627, 636–37 (2002) [hereinafter Stephan, A Becoming Modesty] (commenting that “until the introduction of elements of a market economy, that nation had the most of formal engagements with intellectual property law generally and copyright law in particular. Even now, more than a decade after the end of the Soviet Union, most copyright rules remain precatory and aspirational. Precise questions of ownership turn on the legitimacy of convoluted enterprise reorganizations and privatization transactions that took place during a period of radical legal instability.”).
ture of judicial time on understanding and interpreting foreign copyright laws.

3. Degree of Deference to Parallel Decisions of Foreign Courts

Another problem is the potential conflict between the United States courts’ interpretation of a foreign law and that of the source country’s court. Discussing the Itar-Tass decision, Nimmer pointed out that the U.S. courts would have to decide whether the decisions of a foreign court of the highest level deserved deference or, possibly, refuse to follow that court’s pronouncements because they come from a civil law system, which lacks a system of stare decisis.\footnote{Nimmer on Copyright, supra note 130, § 17.05(3).} Nimmer concluded that these matters remained “unaddressed in the ruling, and hence unanswered at present.”\footnote{Regarding the Itar-Tass ruling, Nimmer enumerated some of the questions concerning the issue of deference to foreign courts decisions. For example, “[i]s it only a decision of the highest court that deserves deference? Or should even that court’s pronouncements not be followed, to the extent that they come from a civil law system, which lacks a system of stare decisis?” Id.} In Films by Jove, the court’s answer to the latter question was a refusal to follow the decisions of the highest court in Russia, in part because Russia does not have the doctrine of stare decisis, and in part because the decision of the court was unduly influenced by the government.\footnote{Films by Jove II, 250 F. Supp. 2d at 205, 216.} The court’s rejection of the Russian judiciary’s opinion in this case is justified. As Professor Stephan, who was a plaintiffs’ expert in Films by Jove, wrote, “it appeared that the Russian government had taken actions it did largely to influence the outcome of the U.S. case.”\footnote{Id.} It is also obvious that the Higher Arbitrazh Court’s decision, subsequent to Professor Stephan’s paper, was instigated by the desire to influence the U.S. litigation.\footnote{Id.} This evidence of undue influence on the Russian judiciary placed the court in a strange dilemma: it could not ignore Russian law, but neither could it give effect to the Russian judiciary’s tainted interpretation of the law. Such disparity of interpretation of foreign laws is particularly troublesome because it undermines the policy of comity.

\footnote{Films by Jove II, 250 F. Supp. 2d at 208–12.}
4. The International Impact of the Decision

Perhaps the most important issue in international legal disputes, however, remains the international impact of the decision. In Films by Jove, the immediate impact was the plaintiff's successful assertion of its distribution rights in the animated films against Berov's infringement. But this may be a limited victory, for it is not at all clear that the defendant FSUESMS can be prevented from distributing the films in other parts of the world.187

Yet, paradoxically, despite these difficulties of worldwide enforceability, Films by Jove has broad political ramifications because it is a serious obstacle in the way of the Russian government's attempt to repossess the assets it lost during the period of privatization in Russia. Indeed, the decision prompted a plethora of publications in Russia and in Russian-speaking communities all over the world. Many supported the decision,188 but some complained that an American court had robbed the Russian people of their cultural legacy.189 Most agreed that Russia's international image had been tarnished.190 This broad political impact is both beneficial and detrimental. It is detrimental because it could exacerbate a conflict between nations. But it is beneficial because it reminds governments of the importance of the Rule of Law. If a country's own judiciary is not up to the task or shirks its responsibility, courts of other countries may need to step into the breach. The U.S. judiciary need not sacrifice justice for the sake of comity.

187. See Zakin, Komu prinadlezhit Cheburashka?, supra note 149 (the head of FSUESMS publicly stating his intention to enter the international agreements concerning the distribution of the animated films in disregard of the above decision).
189. See Kononov, Teper' Ya Cheburashka, supra note 149.
190. See Sulkin, Nekotoriye Osobennosti Natsional'nogo Piratstva, supra note 188; Sulkin, Mozhno li Krast' v Gostiakh Serebrianiye Lozhi?, supra note 179; Zakin, Komu prinadlezhit Cheburashka?, supra note 188.
A. The Need for Uniformity in International Copyright Disputes

The shift from the territoriality of national treatment to the functional approach of Itar-Tass goes a long way towards satisfying the need for copyright's worldwide marketability. The importance of the international marketability of copyrights, as previously noted, stems from the transition from an industrial to an information economy, a tendency attested to by TRIPs' linkage between intellectual property and trade. Apart from TRIPs, scholars also increasingly relate copyright to property in general, as in the Restatement (Second) of Conflict of Law's principle for immovable property, on which the Itar-Tass court relied. Although this tendency is criticized for not taking into consideration the special character of intellectual property, it satisfies an important need in the modern development of copyright law. Until there is a universal copyright law protecting the rights of authors and guaranteeing marketability of copyrights worldwide, academics and judges must go on elaborating alternative ways of attaining these goals. But, the obstacles already noted — a lack of consensus in the general choice of law doctrine, problems with characterization of the issues as ownership or transfer of copyrights, characterization of transfers under contracts or copyright law, difficulties in interpretation of foreign laws, the uncertainty regarding the required deference to foreign judgments, and effectiveness of foreign judgment enforcement — remain. Most of these are amply illustrated in Films by Jove. Although a universal copyright law is the ultimate

192. See Guzman, International Antitrust, supra note 63, at 950.
194. See Brennan, supra note 12, at 316 (“Trying to force fit intellectual property into the confines of industrial goods law is reminiscent of the ugly sisters of Cinderella butchering their feet to fit slippers never meant for them.”).
mate solution, that would require a consensus that is, as of yet, unattainable. In the meantime, scholars have proposed various stop-gap ameliorations briefly noted below. They are the middle ground between the universal and the particular.

B. The Compromise Between National Copyright Laws and the Need for Uniformity

1. The Dreyfuss-Ginsburg Approach

The Draft Convention on Jurisdiction and Recognition of Judgments in Intellectual Property Matters by Professors Rochelle Dreyfuss and Jane Ginsburg addresses the enforceability of judgments and the need for an effective resolution of international copyright disputes. It envisions the adoption of a convention under the auspices of the current international organizations, such as the WIPO or WTO. Such a convention would be open to countries that are members of TRIPs and would cover approximately the same scope of rights. It would also contain the elaboration of the rules of cooperation among courts in the cases of parallel litigation, solidification of claims, and choice of law rules. Although this approach solves many problems of international copyright litigation, its success depends on its formal adoption or accession by states, which is anathema to the jealously cherished freedom of sovereign states to determine their own copyright policy. In this respect, TRIPs may be the high water mark for years to come.

195. See generally Dreyfuss & Ginsburg, supra note 25.
196. Id. at 1065.
197. Id.
198. Id. at 1068.
199. Id. at 1069–71.
200. Id. at 1071.
201. Id.
202. Many scholars point out the internal conflict between developing and developed countries embodied in TRIPs and its threat to enforceability. See J.H. Reichman & Pamela Sanderson, Intellectual Property Rights in Data?, 50 VAND. L. REV. 51, 97 (1997) (commenting that “universal intellectual property standards embodied in the TRIPs Agreement became enforceable within the framework of a World Trade Organization, largely as the result of sustained pressures by a coalition of powerful manufacturing associations in Europe, the United States, and Japan.”); Peter K. Yu, Toward a Nonzero-sum Approach to Resolving Global Intellectual Property Disputes: What We Can
In the case of parallel litigation, the success of the proposal will depend on unprecedented cooperation among various national courts. As amply shown in Films by Jove, it is not realistic to expect U.S. courts to defer to the decisions of Russian courts in a case where the strong interests of an American plaintiff are involved and the defendant is also an American company. It is equally unrealistic to expect a Russian court to defer to a U.S. court’s interpretation of Russian law. Consequently, although the Dreyfuss-Ginsburg model boldly tackles many of the difficulties encountered in international copyright disputes, its realization is by no means certain.

2. The Graeme Dinwoodie Approach

In contrast to the Dreyfuss-Ginsburg model’s concentration on jurisdiction and enforcement of judgments, Professor Graeme Dinwoodie’s approach is directed at substantive issues. Instead of applying the variegated copyright law of different countries, “the substantive method suggests that the court develop a solution that accommodates more than one interest.” Dinwoodie noted that “[w]hen compared with the traditional negotiation of treaties, national court’s development of ‘international law’ is more responsive to social conditions and hence more dynamic.” He does acknowledge that his approach can be criticized for lack of certainty. His response is that “in the long term some ex ante uncertainty might be worth the gains in terms of aptness and legal rules.” Nevertheless, it seems inevitable that a court’s process of weighing the interests and trying to accommodate more than one would lead to an intolerable amount of uncertainty, confusion and inconsistency. Indeed, it is not clear how the substantive approach of Professor

Learn From Mediators, Business Strategists, and International Relations Theorists, 70 U. Cin. L. Rev. 569, 581 (2002) (noting that although TRIPs succeeds in providing higher standards for the protection of intellectual property, “it masks the significant cultural and ideological differences between developed and less developed countries...”).


204. Dinwoodie, A New Copyright Order, supra note 26, at 564.


206. Dinwoodie, A New Copyright Order, supra note 26, at 572.
Dinwoodie could ever resolve the dispute in a case like *Films by Jove*.

3. A Supranational Body of Principles of Equity

a. Foundation

As mentioned at the outset, this Note suggests that the most promising approach is the supplementation of the above ameliorative proposals by a supranational body of equitable principles. This body of principles does not amount to universal copyright law; rather, it is a measured safeguard against some of the dangers associated with the process of balancing conflicting interests and policies. One commentator suggests the idea of a “global justice-constituency” which will need, first, to “articulate what the public purpose [of copyright] is at the global level, instead of simply transporting ready-made purposes and rules from national jurisdictions” and, second, to “formulate rules, norms, and concepts that are carefully calibrated to achieve that public purpose.” Such a body of laws can serve as a solid foundation for the development of universal copyright law and also help solve some difficult situations when policies of several foreign states are deadlocked in a particular copyright dispute.

In a somewhat similar vein, this Note suggests the elaboration of a supranational body of equitable norms, which will help to ensure justice in international disputes when the conflict of law doctrine does not give a clear indication as to what interest should prevail, or when that indication egregiously contradicts the general principles of fairness and justice. This approach is supported by Andrew Guzman’s idea that the purpose of choice of law rules is to increase global welfare — as opposed to the traditional approach of simply protecting “governmental interest.” Equitable principles such as those of promissory estoppel, protection of a good faith purchaser, and apparent agency should be included in this supranational body of law. Some of them are, indeed, present in the national laws of many foreign

208. Id.
c. The goal of solidifying them into a robust supranational body of equitable norms is not unattainable. It can be done through both international regulation as well as private adjudication. Some hail formal regulation, such as that signaled by the spectacular success of Berne and TRIPs. Others, however, may see private adjudication as more promising on the view that courts are more dynamic than public international law-making. Through adjudication norms can be elaborated in the course of judicial dialogue, during which courts “will be hammering out both doctrinal solutions and direct relationships to manage the increasingly complex job of multi-jurisdictional dispute resolution.” This Note argues that regulation and private adjudication complement each other, just like their product, supranational equitable norms, complements the ameliorative Dreyfuss-Ginsburg and Dinwoodie models.

b. Application of Equitable Principles to Films by Jove

i. Theory of Apparent Authority

The common law doctrine of apparent authority is a well-settled principle of the law of agency which “exists to protect third parties who are misled by appearances.” According to the Restatement (Second) of Agency (1958), “apparent authority to do an act is created as to a third person by written or spoken word or any other conduct of the principal which, reasonably interpreted, causes the third person to believe that the principal consents to have the act done on his behalf by the person pur-
porting to act for him.”\textsuperscript{214} It is important to note that apparent authority to bind the principal can exist even when there is no actual agency.\textsuperscript{215} Apparent authority is a synthesis of two separate policies underlying the doctrine: the first holds that, between two innocent parties, the loss should be placed on the party who could have more easily avoided the confusion; and the second is the protection of the normal commercial operations.\textsuperscript{216} Because of these important policies, the doctrine of apparent authority is widely applied in various spheres of U.S. law.\textsuperscript{217}

The versatility of the doctrine of apparent authority can be illustrated by its application to the facts of Films by Jove. As their alternative theory, the Plaintiffs in that case advanced the argument that the Russian government either “induced [Films by Jove, Inc.’s] reasonable reliance by cloaking the lease enterprise with apparent authority to license the Soyuzmultfilm Studio copyrights; or had the effect of ratifying…the licensing agreement after it was executed.”\textsuperscript{218} The facts of the case leave no doubt that the plaintiff Films by Jove, Inc., had every reason to believe that SMS was the true owner of copyrights given to it

\begin{flushleft}
\textsuperscript{214} Re\textsuperscript{em}atement (Second) of Agency § 27 (1958).
\textsuperscript{215} Kleinberger, supra note 213, at 27.
\textsuperscript{216} Id. at 36.
\textsuperscript{218} Films by Jove II, 250 F. Supp. 2d at 214.
\end{flushleft}
by the Russian state. The plaintiff's reliance was both reason-
able in the circumstances, and it was caused by numerous acts
and omissions of the Russian government, such as the letter of
September 16, 1992, sent to SMS by a state official confirming
SMS's worldwide distribution rights in the films;\textsuperscript{219} the January
22, 1997 document from the Russian State Taxation Auditors,
which “specifically references the lease enterprise’s 1992
agreement with [Films by Jove, Inc.], indicating that the lease
enterprise paid taxes on the proceeds received from [Films by
Jove, Inc.],\textsuperscript{220} and the two licensing agreements between SMS
and state-owned Russian television studios.”\textsuperscript{221} Although the
state was fully aware of the licensing agreement between SMS
and Films by Jove, Inc., it did not claim copyrights or challenge
the agreement. On the contrary, by its letter of September 16,
1992 the government actually represented to Films by Jove, Inc.
that the license agreement was valid. Elementary notions of
justice and fairness do not leave any doubt that the plaintiff
who relied, in good faith, on the state’s acts and omissions
should prevail. Under the law of agency in the United States,
therefore, the plaintiffs should, and would be likely to, win their
case.

ii. Conflict of Laws Issues

However, there remains the issue of determining which coun-
try’s substantive law should be applied to the problem of agency
and the equities of the case. It is reasonable to conclude that
Russian law should apply because both the agent and the prin-
ciple were in Russia. Unfortunately, the principle of equity in
Russian law is even less developed than Russian copyright
law.\textsuperscript{222} Consequently, the very same problems we encountered
earlier — interpreting foreign law, the degree of deference to
the foreign court judgments, and the threat of pervasive incen-
tive to a court of a foreign country to distort its interpretation of

\textsuperscript{219} Films by Jove II, 250 F. Supp. 2d at 214.
\textsuperscript{220} Id.
\textsuperscript{221} Id. at 215.
\textsuperscript{222} See generally ANDREYEV, PREDSTAVITEL’STVO V GRAZHDANSOM PRAVE
[Representation in Civil Code] (1978); Kuz’mishin A., Klassifikatsiya Predsta-
vitel’stva i Polnomochiya v Grazhdanskom Pраве [Classification of Represen-
tation and Mandate in Civil Code], 8 KHOZIAYSTVO I ПРАВО 27–36 (2000).
the law in order to influence the outcome of the international dispute — are still with us.

On the other hand, it seems improper in these circumstances for an American court to apply the American law of equity to the assignment of rights in Films by Jove. Although there is no clear answer to this question in the international choice of law doctrine, most of the existing approaches seem to disapprove it.

The approach most widely adhered to is *lex loci actus*. According to this approach, the law of the place where the agent acts determines the issues of agency. It is argued that the purpose of this approach is to protect commercial intercourse, in particular a third party’s position, because it requires the third party to consult only the law of the country where the agent acts. However, *lex loci actus* is variously interpreted to mean the law of the country where the agent really commits his acts, the law of the country where the agent has to act according to his agreement with the principal, the law of the country where the agent has his place of business, or the law of the country that governs the contract between the agent and the third party. When applied to Films by Jove, all these interpretations, except the last one, point to the use of Russian law. Indeed, even the last one does not unequivocally point to American law: although it is true that the contract between SMS and Films by Jove, Inc. contained a choice of law clause stipulating that the law of California apply to issues arising under the contract, it is doubtful that, under the apparent authority argu-

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223. In a recently decided case, the New York Court of Appeals found American Law, rather than Russian law, controlling the issue of the contract validity and apparent authority because of the choice of law clause in the contract and New York’s significant ties. Indosuez Int’l Fin. B.V. v. Nat’l Reserve Bank, 98 N.Y.2d 238 (2002).
224. VERHAGEN, supra note 210, at 73.
225. Id. at 74.
226. VERHAGEN, supra note 210, at 75.
227. Section 292(2) of the Restatement (Second) of Conflict of Laws also clearly points to Russian law stating that the principle will be bound “under the local law of the state where the agent dealt with the third person, provided at least that the principle had authorized the agent to act on his behalf in that state or had led the third person reasonably to believe that the agent has such authority.” RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 292(2).
moment, Russia as the principal should be bound by California law by dint of this choice of law clause.

Moreover, the choice of law rules in the law of equity do not always protect the third party to the transaction, nor do they have the virtues of certainty and predictability. This is because of different local laws and the difficulties embedded in the modern choice of law doctrine already noted herein. So, the combination of local equitable protection with conflict of laws rules does not really resolve the problem. The suggested solution lies in a particular construction of the equitable principles which sidesteps many of the difficulties just mentioned.

c. Supranational Norms of Equity as the Safe-Guards in International Copyright

This Note proposes the idea of a supranational body of equitable principles as the solution to obvious distortions encountered in the processes of resolving disputes by a straight balancing of conflicting interests in the interest of justice. Many countries already have the principles of equity mentioned in their laws, though the level of protection can vary and some states may not have every principle found in others. Nevertheless, it seems that uniform norms of equity protecting commerce are much easier for nations to accept than drastic changes in national copyright laws. Supranational equitable principles are, therefore, a more viable avenue for correcting the grossly unjust outcomes that conflicts in international copyright laws would countenance.

In a case like *Films by Jove*, a supranational body of equitable principles could be relied on to protect the plaintiff from the skewed decisions of Russian Arbitrazh courts of different levels. Supranational equitable principles would help to balance the interests of the parties and avoid direct conflicts with other countries’ laws. Under this approach, U.S. courts would not have to argue with the Russian judiciary over whether, under Russian law, the ownership of the copyrights belonged, or not, to SMS at the moment of its licensing agreement with Films by

Jove. It would be sufficient to say that, under international principles of equity, acts and omissions of the Russian government clothed SMS with apparent authority to give worldwide distribution rights to Films by Jove, and directed the latter’s reasonable reliance. The Russian government would be precluded from interfering with Films by Jove, Inc.’s exercise of its rights.

CONCLUSION

The body of supranational equitable principles, including apparent authority, should be developed to serve as safeguards for the serious problems inherent in the straight functional approach to conflict of laws adopted in Itar-Tass. Though supranational equitable principles are uniform (as their name implies), these equitable principles are more palatable because they do not rise to the level of universal copyright law, and because they already exist in the major legal systems of the world. They are not the lightning rod that a fully-fledged copyright law might be; yet they provide more or less the same benefits: smoother international copyright commerce. Their reach is not greater than their grasp, nor is it less than what is realistically attainable. They are the ideal interim measure while consensus builds for a universal copyright law, and may, indeed, contribute to the attainment of that happy but still elusive end.

Anna Tydniouk∗

∗ J.D., Brooklyn Law School (expected 2005). The author dedicates this Note to her husband, Igor Tydniouk, and her son, Andrey, for their support and patience during these long school years. The author also dedicates this Note to her parents, Lev Sakhnovich and Yelena Melnichenko, for their inexhaustible love and care. The author would also like to thank Brooklyn Law School Professor Samuel Murumba for his invaluable advice and encouragement throughout the writing process.
DOMESTIC VIOLENCE IN PAKISTAN:
THE TENSION BETWEEN
INTERVENTION & SOVEREIGN
AUTONOMY IN HUMAN RIGHTS LAW

I. INTRODUCTION

In international human rights jurisprudence, the tension between intervention and autonomous statehood is both endemic and intractable. One defining attribute of human rights is that they are the rights of all, without regard to such particularities as nationality, culture, or religious affiliation. At a minimum, this universality claim holds that the manner in which a state treats its own people is no longer its internal business since all states owe an obligation to the entire interna-

1. The U.N. Charter itself embodies this tension by recognizing the universality of human rights and the notion of sovereign autonomy. Regarding the universality of human rights, the Charter promotes “universal respect for, and observance of, human rights and fundamental freedoms for all without distinction as to race, sex, language or religion” and indicates that “[a]ll members pledge themselves to take joint and separate action in co-operation with the organization for the achievement” of that goal. U.N. CHARTER, arts. 55, 56. However, these clauses directly conflict with Article 2(7) of the U.N. Charter, which states:

Nothing contained in the present Charter shall authorize the United Nations to intervene in matters which are essentially within the domestic jurisdiction of any state or shall require the Members to submit such matters to settlement under the present Charter; but this principle shall not prejudice the application of enforcement measures under Chapter VII.

U.N. CHARTER, art. 2(7).

tional community to respect human rights. Yet, the reality is that the world is still divided into sovereign states, representing diverse cultures and religions, which not only claim autonomy and deference, but often do so in the name of one or another human right. This tension between intervention and autonomy has often been cast in terms of universalism and cultural relativism, but that characterization is flawed in that it is both unhelpfully simplistic and unable to settle ideological battles. This Note focuses, instead, on an emerging curiosity regarding the tension between intervention and autonomy as played out in women’s human rights jurisprudence.

This conflict between intervention and autonomy is brought to a pitch by the intrusive nature of the conception and implementation of human rights, which seems to be widely (though sometimes grudgingly) tolerated with regard to genocide, war crimes, imprisonment, and torture. Why, then, is the same intrusion adamantly resisted with regard to women’s rights violations, such as domestic violence, rape, denial of sexual auton-


DOMESTIC VIOLENCE IN PAKISTAN

omy, reproductive rights, and a myriad of other “cultural practices” that are anathema to women’s fundamental dignity? Contemporary feminist legal scholars view this discrepancy in terms of gender bias, as a reflection of the “gendered” nature of international human rights law. Through insights such as the public-private distinction forged in domestic battles for women’s liberation, these scholars explain the silences of international human rights law in terms of patriarchy. Challenges to the public-private dichotomy can be further enhanced by globalization, expanding awareness and invoking change from the international community. Like that between society and the home, the public-private barrier of the international community and the states must also be broken; the veil of state sovereignty must be pierced.

With a specific focus on Pakistan as a prototypical case, this Note argues that while liberation from within one’s culture, religion, history, and state may be ultimately essential for the full realization of human rights in general, this method is insufficient for women’s human rights because women’s rights are different. Unlike imprisonment, torture, or even execution, women’s rights speak to a whole normative ecology of abuse that is systemic, endemic, pervasive, and deeply embedded in every nerve and sinew of the state, culture, or religion that circumscribes their lives. Endemic system-wide violations cannot be repaired internally by recourse to other aspects of the value system. Repairing women’s rights from the inside is like trying to lift oneself up by the bootstraps. Change “from within” for the human rights movement in Pakistan and around the globe would entail so radical an overhaul of internal particularities

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8. See generally Charlesworth, supra note 7, at 613–14. See also HENKIN, supra note 7, at 45.


10. See HENKIN, supra note 7, at 45 (discussing the public and private dichotomy regarding the international “public” and the state “private”).
that it would render them unrecognizable. Leaders of state
governments, cultural traditions, and religions do not have the
will or capacity to bring about so unpopular a change anymore
than their counterparts in the states of America’s “Deep South”
did to end racism. For this reason, women’s human rights re-
quire that the international community “pierce the veil” of the
sovereign, cultural or religious autonomy, the way the U.S. fed-
eral government intervened in southern states to end racial
segregation.

In arguing that women’s rights uniquely require interna-
tional intervention around the globe, this Note will discuss the
persistent patterns of women’s rights violations in Pakistan. Part II will explore the severity of the beatings, mutilations,
and honor killings that these women survivors in Pakistan ex-
perience. Part III will discuss the relation of these violations to
international human rights obligations through sources of in-
ternational law which make Pakistan responsible for protecting
human rights violations within its borders. Part IV will reveal
the scourge of impunity — endemic violations without remedy
—in Pakistan’s creation of protective measures which, in fact,
do not protect women. Law enforcement officials impede
women from asserting their rights by discouraging complaints,11
failing to file complaints,12 and frequently sexually assaulting
individuals who come in to make these complaints.13 Women
whose cases survive the apathy, and indeed antipathy, of police
agents are represented by attorneys who endure intimidation
and violence and confront judicial bias and misinformation con-
cerning the role of wives and the discretion of husbands to
abuse their wives in Islam.14 Part V will present the case for
intervention, making suggestions for reform and emphasizing
the need for both state and international accountability. Fi-
nally, Part VI will conclude that Pakistan’s inadequate protec-
tion of fundamental human rights makes a mockery of women’s

11. HUMAN RIGHTS WATCH, CRIME OR CUSTOM? VIOLENCE AGAINST WOMEN IN PAKISTAN 45 (1999) [hereinafter CRIME OR CUSTOM].
12. Id. at 51–52.
13. HINA JILANI, HUMAN RIGHTS & DEMOCRATIC DEVELOPMENTS IN PAKISTAN 142 (Human Rights Commission of Pakistan 1998) [hereinafter JILANI, HUMAN RIGHTS].
14. See infra Parts IV.C & D.
rights and is a prototypical case where intervention is appropriate.

II. PAKISTAN: A MICRO COSM OF WOMEN’S RIGHTS VIOLATIONS

Fakhra Yunas was one Pakistani woman who endured severe domestic violence over an extended period of time. One day in particular was worse than all the rest. As Fakhra Yunas awoke from her nap, she noticed that her husband was running from the room. Fakhra then stood to see that her clothes were slowly dissolving and her body was beginning to burn. Suddenly, she was unclothed and in immense amounts of pain. She was the survivor of yet another form of abuse by her husband: an acid attack. This attack “burned the hair off Fakhra’s head, fused her lips, blinded one eye, obliterated her left ear, and melted her breasts.” Even after this torture, Fakhra had inconceivable difficulty escaping her abuser. No arrest was made even after her family filed a complaint for this acid attack. Her husband continuously threatened her and attempted to force her to return to him. Leaving the country to receive treatment for her wounds also proved difficult because Pakistan’s Interior Minister, retired Lieutenant General Moinuddin Haider, was afraid of the effect such negative publicity might have on the country’s international relations. Thus, no arrest was made and Fakhra’s husband continued to stalk and threaten both her and her family. Pakistan effectively deprived Fakhra of any means of recourse and the international community did nothing to assist her.

Unfortunately, Fakhra is only one of the many women in the Islamic Republic of Pakistan who experience such forms of

16. Id.
19. Id.
20. Id.
21. Id.; AGENCE FRANCE-PRESSE, supra note 17.
22. See Bloch, supra note 15 (discussing the delay of Fakhra’s visa to undergo reconstructive surgery in Italy based on the fear that media attention would “sully” Pakistan’s reputation).
abuse at the hands of both their husbands and the state. Forms of domestic violence vary across societies, cultures, and religions.\(^{23}\) Abuse is a social problem which is “sanctioned and controlled through culture, religious beliefs, law, and the norms of friendship, kinship, and neighborhood groups.”\(^{24}\) To the majority of Muslims, Islam is both a religion and a culture; it is a way of life and an everyday practice, one that does not permit violence toward one’s spouse.\(^{25}\) Pakistan claims to be an Islamic nation, invoking Islamic laws, and adhering to international custom and treaties. Yet, in Pakistan, the perpetrators of domestic violence go virtually unpunished.\(^{26}\)

According to the Pakistan Institute of Medical Sciences, over 90% of married women report being physically or sexually abused by their spouses.\(^{27}\) In addition, women who attempt to file complaints or leave their husbands are subject to further abuse.\(^{28}\) These women are trapped by the laws of the Islamic Republic of Pakistan and the state agents who enforce them.\(^{29}\) The failure of state institutions leaves these survivors without any source of domestic recourse. Pakistan’s inadequate response, and often complete inaction, is a blatant human rights violation in international law. In order to restore rights and protect women, the international community must take action and pierce the sovereign veil.

**A. Stove Burnings, Acid Attacks, & Mutilation**

Despite international human rights law, substantial amounts of violence against women continue to occur with virtually no

\(^{23}\) See Mary Joe Frug, Women and the Law 151 (Foundation Press 1992).

\(^{24}\) Id.


\(^{26}\) Nuzhat Ara, Pakistan: Has the Suffering of Pakistani Women Touched the General’s Heart, Lotus Social Welfare Trust Int’l, at http://www.lswti.itgo.com/women%20rights.htm; Crime or Custom, supra note 11, at 52.


\(^{29}\) Jilani, Human Rights, supra note 13, at 140–41.
action or reaction by the state of Pakistan.\textsuperscript{30} In addition to being beaten, slapped, kicked, or sexually abused,\textsuperscript{31} many Pakistani women are also burned, doused with acid, or physically mutilated in other ways.\textsuperscript{32} According to the Progressive Women’s Association, in just five years, approximately 3560 women reported being attacked with gas, fire, or acid.\textsuperscript{33}

One common form of domestic violence in Pakistan is the crime of stove-burning. In these situations, survivors and abusers generally claim that a woman’s garments caught fire while cooking or that an explosion on the gas stove burned her.\textsuperscript{34} In reality, batterers use these so-called accidents (which occur for any number of reasons, ranging from adultery to dinner being late) as a means to power and control.\textsuperscript{35} The abuser usually douses the victim in kerosene oil and then sets her on fire from the gas stove.\textsuperscript{36} In one case, a pregnant sixteen year old was set aflame by her husband and mother-in-law as a punishment for disobeying her husband.\textsuperscript{37} Another girl, only one year older, was tied to a post and set on fire by her brothers.\textsuperscript{38} One husband, a religious figure at a local mosque no less, even went so far as to tie his wife to the bed and thrust a “red-hot iron bar inside her vagina.”\textsuperscript{39} These situations and acid attacks, like that of Fakhra,\textsuperscript{40} are all too common and, in the state of Pakistan, the perpetrators frequently go unpunished.\textsuperscript{41} International media at-

\begin{itemize}
\item\textsuperscript{30} Douglas, supra note 27.
\item\textsuperscript{31} Id.
\item\textsuperscript{32} Carol Deckert, ‘Honour killings’ are plain murder; Widespread acceptance saw 1780 women die in Pakistan in 5 years, HAMILTON SPECULATOR A11, Mar. 8, 2002, at 2002 WL 21422242.
\item\textsuperscript{33} Id.
\item\textsuperscript{34} Anita Pratap, Ghastly Domestic Abuse: Burning Women, at http://ww w.cnn.com/WORLD/9702/10/pakistan.women (Feb. 10, 1997).
\item\textsuperscript{35} See Schneider, Battered Women and Feminist Lawmaking, supra note 9, at 21–22 (noting the use of domestic violence as a means to power and control).
\item\textsuperscript{36} Pratap, supra note 34.
\item\textsuperscript{37} Deckert, supra note 32.
\item\textsuperscript{38} Id.
\item\textsuperscript{39} AMNESTY INT’L, WOMEN IN PAKISTAN: DISADVANTAGED AND DENIED THEIR RIGHTS, HUMAN RIGHTS ARE WOMEN’S RIGHT 3 (1995) [hereinafter AMNESTY INT’L, DISADVANTAGED AND DENIED THEIR RIGHTS].
\item\textsuperscript{40} See generally Bloch, supra note 15.
\item\textsuperscript{41} Ara, supra note 26; CRIME OR CUSTOM, supra note 11, at 52; Douglas, supra note 27.
\end{itemize}
tention may be the only means of effectively pushing the state into action,\textsuperscript{42} though Pakistan takes every necessary step to prevent such attention.\textsuperscript{43} Since the Pakistani government is incapable of protecting women against such atrocities, the international community has an obligation to ensure these fundamental rights.

\textit{B. Honor Killings}

An even more severe form of domestic violence is that of honor killings. Honor killings are just as horrific as they sound — women are murdered in the name of honor, as a way of restoring honor to her family.\textsuperscript{44} In Pakistan, hundreds of women are killed every year under the pretext of honor.\textsuperscript{45} Moreover, these numbers only reflect the reported incidents of this crime.\textsuperscript{46} The state of Pakistan is unwilling and incapable of protecting these women against such violence or holding the perpetrators of these crimes accountable. Nevertheless, the international community condemns this violence but does nothing to restore women’s fundamental rights.

The most infamous honor killing case in Pakistan is that of Samia Sarwar. After her arranged marriage at the age of 17, Samia was subjected to constant physical abuse by her husband.\textsuperscript{47} Despite this abuse, she remained with her husband for nearly ten years.\textsuperscript{48} The breaking point occurred when Samia became pregnant and her husband threw her down a flight of

\textsuperscript{42}See, \textit{e.g.}, AMNESTY INT’L, DISADVANTAGED AND DENIED THEIR RIGHTS, supra note 72, at 8 (“media coverage has forced police to register a complaint brought by a woman”). See also Bloch, supra note 15 (where General Lieutenant General Moinuddin Haider denied Fakhra Yunas a visa to the U.S. out of fear of international media attention).

\textsuperscript{43}For example, Pakistan’s Interior Minister prevented Fakhra Yunis from leaving the state based on fears of negative, international publicity. Bloch, supra note 15 (discussing the delay of Fakhra’s visa for reconstructive surgery); AGENCE FRANCE-PRESSE, supra note 17.

\textsuperscript{44}Patel, supra note 28.


\textsuperscript{46}Id.


\textsuperscript{48}Id.
stairs. Unfortunately, what Samia believed was the beginning of her life was actually the end. When Samia told her parents that she was getting a divorce, her parents were distraught with shame and threatened to murder her if she left her husband. Still, Samia stood firm as her entire family turned against her. She refused to endure anymore abuse and instead, she fled to a shelter and contacted a well-known women’s rights activist and lawyer. Even when her mother requested to see her, Samia was so terrified of being harmed that she only agreed to meet her mother because it was the sole way for her to attain divorce papers. At their meeting, Samia’s mother was accompanied by her uncle and a chauffeur, whom she claimed was required to help her walk. However, this chauffeur was not there to help her walk at all — at his first chance, the “chauffeur,” a hired gunman in disguise, shot and killed Samia and tried to kill her lawyer as well.

Samia was one of many women killed in order to avoid shame or embarrassment to her family. But, divorce is not the only reason for these murders. Honor killings also occur “when a wife does not serve a meal quickly enough or when a man dreams that his wife betrays him.” Realistically, domestic violence is not the product of any specific act or series of acts; women are not to blame for this violence. Violence is a batterer’s means of power and control, furthering male privilege and domination. In addition to these norms, Pakistani society uses the excuse of culture and tradition to vindicate these

49. Id.
50. Id.
52. Id; Ruane, supra note 47, at 1523–24.
53. Patel, supra note 28; Ruane, supra note 47, at 1524.
54. Patel, supra note 28; Ruane, supra note 47, at 1524.
55. AMNESTY INT’L, PAKISTAN: VIOLENCE AGAINST WOMEN IN THE NAME OF HONOR, supra note 45.
56. See Susan Schechter, Women and Male Violence: The Visions and Struggles of the Battered Women’s Movement in BATTERED WOMEN AND THE LAW 23–24 (2001) (denying victim provocation theories as a justification for domestic violence); Linda Gordian, Heroes of Their Own Lives: The Politics and History of Domestic Violence, in BATTERED WOMEN AND THE LAW 20–21 (2001) (noting that historically women were blamed for such acts and batterers were made the “aggrieved parties”).
57. SCHNEIDER, BATTERED WOMEN AND FEMINIST LAWMAKING, supra note 9, at 21–22.
crimes in terms of respect and honor. According to women’s rights activist and lawyer, Hina Jilani, “the right of women in Pakistan is conditional on her obeying social norms and traditions.” If the woman does not follow social norms, such disobedience is sufficient reason to kill her.

Furthermore, the dominant group (in this case, men) interpret religion and culture in the ways most beneficial to themselves and offer these views as the only legitimate interpretation. Due to the resulting male-biased culture and religious interpretation in Pakistan, women are treated as commodities, symbols of male ownership. Therefore, any disobedience or even rumor of disobedience is enough to dishonor a man and killing that symbol of disobedience will restore a man’s honor. While officially condemned by Pakistan and the international community, neither do anything to ensure that women are not further subjected to honor killings or that perpetrators are punished for these acts.

III. PROMISES UNFULFILLED: STATE RESPONSIBILITY FOR VIOLATIONS OF WOMEN’S HUMAN RIGHTS

A. U.N. Convention on the Elimination of All Forms of Discrimination Against Women

Traditionally, states were only responsible for those actions performed by state agents, and not the actions of private individuals. However, international human rights law must protect individuals from abuses instituted by their own govern-

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61. Id.
ments by holding such states accountable. 64 Pakistan deprives women survivors of violence of their “rights to life, liberty, and security of person,” 65 and claims to do so for the benefit of these women. 66 However, discrimination or selective enforcement of human rights laws (in this case, by not enforcing women’s rights specifically as human rights) is a state act in violation of international human rights law. 67 Based on the general acknowledgement of these human rights violations through treaties and custom, the international community is also responsible for ensuring that Pakistan fulfills this obligation.

Under the United Nations’ Convention for the Elimination of All Forms of Discrimination Against Women [hereinafter CEDAW], gender-based violence is a violation of women’s fundamental human rights. 68 As a party to that Convention, Pakistan is bound to “pursue all appropriate means and without delay [implement] a policy of eliminating discrimination against women,” including those forms of discrimination which impair the “enjoyment or exercise by women…of human rights and fundamental freedoms.” 69 Additionally, the Committee of this Convention defines domestic violence as inhibiting “women’s ability to enjoy rights and freedoms on a basis of equality with men.” 70 CEDAW also declares that under widespread international law and human rights declarations, states are liable for failing to protect human rights by investigating or punishing perpetrators, and for these failures, states must provide just

64. Id. at 38; An-Na‘im, Toward a Cross-Cultural Approach, supra note 60, at 20.
65. JILANI, HUMAN RIGHTS, supra note 13, at 140.
66. The benefits referred to are those “in the name of modesty, protection, and prevention of immoral activity.” Id. at 143.
compensation.\textsuperscript{71} States must not only ensure that their agents do not commit violations, but must also “affirmatively protect” all individuals.\textsuperscript{72} Having ratified this convention, Pakistan is thus required to protect women from domestic violence, even though such violence may be perpetrated by private individuals.\textsuperscript{73} Finally, the widespread ratification of this Convention creates obligations on the part of the international community to ensure that women’s rights are protected.

Despite the fact that CEDAW is binding as an international agreement,\textsuperscript{74} the Pakistani government has only made superficial attempts to comply with its obligations under CEDAW.\textsuperscript{75} CEDAW specifies that Pakistan must “modify the social and cultural patterns of conduct of men and women,”\textsuperscript{76} and yet, the state has only made verbal claims that domestic violence crimes must end\textsuperscript{77} and has not implemented any of the suggestions made by the Pakistani Commission of Inquiry for Women.\textsuperscript{78} Additionally, Pakistan has not submitted any national reports documenting its progress in this area,\textsuperscript{79} as is required under the agreement.\textsuperscript{80} Thus, Pakistan continues to violate CEDAW and the international community, aware of these violations, stands idly by, unwilling to take action to protect women.

\begin{itemize}
\item \textsuperscript{71} Culliton, Finding a Mechanism to Enforce Women’s Right to State Protection, supra note 68, at 514.
\item \textsuperscript{72} Id. at 513.
\item \textsuperscript{73} Id. at 510–13.
\item \textsuperscript{74} See Restatement (Third) of Foreign Relations Law of the United States, § 102, cmt. f.
\item \textsuperscript{75} Patel, supra note 28. See also Crime or Custom, supra note 11, at 26–28 (discussing Pakistan’s obligations under international law); U.N. Convention on the Elimination of All Forms of Discrimination, Country Reports, at http://www.un.org/womenwatch/daw/cedaw/reports.htm (noting Pakistan’s failure to submit reports regarding progress in modifying social and cultural acceptance of violence against women).
\item \textsuperscript{76} CEDAW, supra note 69, at art. 5.
\item \textsuperscript{77} General Musharraf Pervez, President of Pakistan, asked that law enforcement and judges take action against perpetrators of honor killings. However, this statement has not invoked any change and no further action was taken. Patel, supra note 28.
\item \textsuperscript{80} CEDAW, supra note 69, at art. 18.
\end{itemize}
B. Evidence of Customary International Law

Although Pakistan is not bound by international treaties and declarations to which they are not a party, if the standards expressed therein are widespread, these documents may constitute evidence of customary international law.\(^{81}\) Once defined as custom, such standards are binding on all states, including Pakistan.\(^{82}\) There are a number of international treaties and declarations asserting a state's responsibility to effectively protect the fundamental human rights of those individuals under its jurisdiction. Additionally, where the international community recognizes a state's failure to protect and ensure women's rights, the international community is obligated to act.

One example of customary law developed when the United Nations strengthened and affirmed the notion that states have obligations towards human rights violations against women in the Declaration on the Elimination of Violence Against Women.\(^{83}\) This document defines violence against women\(^{84}\) and establishes fundamental human rights for women.\(^{85}\) Additionally, the declaration creates a set of standards by which states should abide in order to affirmatively prevent these violations and protect women's fundamental rights.\(^{86}\) While not binding, the purpose of the declaration was to establish an international

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\(^{81}\) See Restatement (Third) of Foreign Relations Law of the United States, § 103, cmt. c.

\(^{82}\) See Restatement (Third) of Foreign Relations Law of the United States, § 102(1)(a).


\(^{84}\) This declaration recognizes violence against women as a “manifestation of historically unequal power relations between men and women, which have led to domination over and discrimination against women.” \textit{Id.} at pmbl. This definition defines violence as “physical, sexual or psychological harm or suffering to women, including threats of such acts, coercion or arbitrary deprivation of liberty,” occurring in both public and private life as a “violation of the rights and fundamental freedoms of women.” \textit{Id.} at pmbl., art. 1.

\(^{85}\) Article 3 details the rights afforded women regarding the “equal enjoyment and protection of all human rights and other fundamental freedoms in the political, economic, social, cultural, civil or any other field.” \textit{Id.} at art. 3.

\(^{86}\) \textit{Id.} at art. 4 (declaring steps which should be taken by states in their condemnation of violence against religion without consideration for “custom, tradition or religio[n]”).
standard, a form of customary international law. Additionally, the International Covenant on Civil and Political Rights, the Universal Declaration of Human Rights, the Convention Against Torture and Other Cruel, Inhumane, or Degrading Treatment, and the American Convention on Human Rights, all declare the affirmative duty of states to protect individuals against human rights violations. Therefore, even though Pakistan may not be a party to these declarations and treaties, these documents still constitute evidence of customary international law, binding on Pakistan, and acknowledging the international community’s desire to enforce and protect these rights.

Similarly, in the Velasquez-Rodriguez Case, the Inter-American Court of Human Rights held the state of Honduras responsible for failing to adequately investigate and prevent unexplained disappearances of particular residents. The state’s tolerance of these forced disappearances was classified as a “grave violation of the victim’s fundamental human rights.” Even though these disappearances could not definitively be attributed to state or private actors, Honduras was liable for failing to insure the protection of human rights. According to this decision, states are required to sufficiently respond to conduct violating human rights and must “organize the governmental apparatus and, in general, all the structures through which public power is exercised, so that they are capa-

87. See Crime or Custom, supra note 11, at 29 n.32.
94. Culliton, Finding a Mechanism to Enforce Women’s Right to State Protection, supra note 68, at 549 (citing the Inter-American Court of Human Rights in the Velasquez-Rodriguez Case).
95. See American Convention, supra note 92, at 9 I.L.M. 673 (1970).
Thus, states are required to respect and protect the fundamental rights of all individuals under its jurisdiction. These international standards are founded on the notion that all human beings deserve equal protection of their rights and freedoms. Under these standards, states are responsible for the failures of police officers and judges, as well as other state agents, which deny sufficient recourse for individual human rights violations. Furthermore, based on the prevalent acceptance of these human rights standards, the international community is obligated to ensure the protection of women's rights.

IV. THE FACE OF IMPUNITY: PROTECTIVE MEASURES THAT DO NOT PROTECT

A. Police Intervention or Lack Thereof

Despite all of the abuse that they have experienced, domestic violence survivors are only subjected to more abuse throughout the Pakistani criminal justice system. In the preliminary account of Fakhra Yunas, the survivor was so brutally abused by an acid attack that she had to undergo over 30 surgeries in order to restore her face and body to that resembling an average human being. Yet, her husband, a prominent politician, was not prosecuted for his crime and instead continued to harass and threaten her. Even after a police report was filed, no arrest was ever made. Given the status of Pakistani law enforcement agencies, women survivors have no method of re-

100. See CRIME OR CUSTOM, supra note 11, at 45–63 (detailing the gender bias of law enforcement, attorneys, judges, and medico-legal doctors).
102. Id.
103. Id.
course and police officials lack the training to competently handle such gender-specific violence. Rather than asserting women’s fundamental human rights, the police generally look to traditional and social mores, and therefore, treat domestic violence as a private, familial issue.

Under the Pakistani Criminal Procedure Code, when women come to the police station to file complaints against their batterers, police enforcement agencies have the responsibility of detailing the nature of the crime, requesting a medico-legal exam, escorting the survivor to that exam, and delivering all results and evidence to the prosecutor. However, cases are rarely handled in this manner. Instead, police officers usually advise survivors to reconcile with their batterers. Survivors are informed that filing a complaint would bring dishonor to their family and such familial issues should be settled in the privacy of one’s home, without intervention by the state. By encouraging reconciliation or mediation, law enforcement agencies are reinforcing the batterer’s power and control over the survivor. Additionally, police officers frequently belittle and disregard survivors of domestic violence. Even claims regarding honor killings are usually not investigated, but are instead justified based on culture and tradition. Many police officers refuse to investigate incidents of domestic violence, deeming them private. One police employee conducting a medico-legal exam even went so far as to opine to the lawyer of two minor rape survivors, one of which was ten years old, that the girls

104. JILANI, HUMAN RIGHTS, supra note 13, at 141.
106. PAK. CRIM. P. CODE, §§ 154, 155 (1898); POLICE RULES, ch. XXIV–XXV (1934).
107. CRIME OR CUSTOM, supra note 11, at 52 (noting that in Lahore and Karachi, none of the survivors interviewed had their cases handled according to the Pakistani Criminal Procedure Code).
108. JILANI, HUMAN RIGHTS, supra note 13, at 143.
109. Id. at 142.
110. See Karla Fischer et al., The Culture of Battering and the Role of Mediation in Domestic Violence Cases, 46 S.M.U. L. REV. 2117, 2159 (1993).
111. CRIME OR CUSTOM, supra note 11, at 53.
112. Patel, supra note 28; JILANI, HUMAN RIGHTS, supra note 13, at 140.
113. Ruane, supra note 47, at 1539–41.
were “willing participants” in the act. On the rare occasion that the officer actually files a report, the perpetrator often bribes a member of the law enforcement to alter or lose the report.

Pakistan has taken no active measures with law enforcement officials to better protect women against human rights violations. The state has not provided any training for police officers on domestic violence nor has the state taken any steps to help officers become more sensitive to the needs of domestic violence survivors. The police response or lack thereof is effectively a refusal to acknowledge domestic violence as a criminal issue. Instead, the outcome is the acceptance of domestic violence behind the closed doors of the family unit, as an accepted part of society. As a result of this police apathy towards domestic violence and reluctance to investigate, many women are deterred from contacting the police at all. Thus, the Pakistani government allows its law enforcement to stand in the way of women survivors, while the international community does nothing to assist these women.

B. Sexual Assaults by State Agents

While most law enforcement agencies do not enforce women survivors’ fundamental rights, police apathy is only the beginning of the problem. Survivors of domestic violence endure multiple violations of fundamental human rights at the hands of the authorities. Many women who go to police stations to file complaints regarding domestic violence are “beaten, kicked,

114. CRIME OR CUSTOM, supra note 11, at 48; JILANI, HUMAN RIGHTS, supra note 13, at 143.
115. See Ruane, supra note 47, at 1543 (discussing police ability to demand bribes from either party due to the difficulties of filing reports).
116. Id.
117. AMNESTY INT’L, PAKISTAN: VIOLENCE AGAINST WOMEN IN THE NAME OF HONOR, supra note 45.
118. See Jilani, HUMAN RIGHTS, supra note 13, at 140–44.
119. Id. at 143.
120. Id.
121. CRIME OR CUSTOM, supra note 11, at 53.
122. See AMNESTY INT’L, DISADVANTAGED AND DENIED THEIR RIGHTS, supra note 72, at 7–18; CRIME OR CUSTOM, supra note 11, at 45–63.
and raped in the police stations to humiliate them, to intimidate them or to extract money.”

When asked why she does not file a complaint of domestic violence, one survivor of stove-burning stated, “What is the use? I belong to a respectable family; we don’t go to the police....If a woman goes to a police station she cannot protect her honor.” This survivor’s comment refers to the police authority’s widespread abuse of power, entrapping and sexually assaulting women, thus leaving women defenseless and humiliated. Incidents of sexual assault by police officers are particularly appalling since rape claims are difficult enough to prove when the perpetrators are not state agents. Furthermore, while rape is technically a crime under Pakistani law, this offense is so difficult to prove that the perpetrator is rarely punished.

Due to the correlation created by placing rape and adultery under the same provision, the Pakistani rape statute encourages the use of an unsuccessful rape claim as an automatic conviction for adultery. Under this statute, making a claim for rape may be seen as an admission to the act of sexual intercourse, in effect, a confession. These convictions are based on

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123. AMNESTY INT’L, DISADVANTAGED AND DENIED THEIR RIGHTS, supra note 72, at 7. See also Berta Esperanza Hernandez-Truyol, Out of the Shadows: Traversing the Imaginary of Sameness, Difference, and Relationism A Human Rights Proposal, 17 WIS. WOMEN’S L.J. 111, 142 n.185.

124. AMNESTY INT’L, DISADVANTAGED AND DENIED THEIR RIGHTS, supra note 72, at 7–8.


126. Seth Mydans, In Pakistan, Rape Victims are the ‘Criminals’, N.Y. TIMES, May 17, 2002, available at http://www.nytimes.com/2002/05/17/international/asia/17RAPE.html. Rape laws require four witnesses to the act or a confession. Zina Ordinance § 8; see also Quraishi, supra note 125, at 294. Additionally, not only are women on the whole not allowed to testify, but the rape victim herself is not permitted to testify to the act. Anika Rahman, A View Towards Women’s Reproductive Rights Perspective on Selected Laws and Policies in Pakistan, 15 WHITTIER L. REV. 981, 999–1000 (1994).

127. Quraishi, supra note 125, at 303–04.

128. Id. at 291.
the premise that if a woman cannot prove rape, she must have been a willing participant in the sexual act and, therefore, she is a promiscuous woman and is liable for adultery. 129 In terms of evidentiary standards, a woman must prove rape beyond a reasonable doubt, but her alleged rapist is given the benefit of the doubt. 130 If she is unable to meet this burden, her insufficient rape claim constitutes prima facie evidence of adultery. 131 According to women’s rights advocate Asma Jahangir, this standard implies that male perpetrators are presumed “innocent until proven guilty,” while women are subjected to a presumption of guilt. 132 Therefore, unsuccessful rape claims are frequently used as evidence of adultery. 133 As a result, approximately, 90% of rape claimants end up imprisoned for adultery. 134 Thus, when a woman cannot prove rape, which is particularly likely when the perpetrator is a police officer, she may subsequently be charged with adultery, causing additional disgrace to her family, and often leaving her in jail for a substantial period of time.

Additionally, women assaulted by police officers do not come forward for fear of being attacked again. 135 In one case, a woman filing a rape claim was instead charged with adultery and held in custody, during which she was repeatedly raped by police officers. 136 Custodial violence and sexual assault in police custody are so widespread that the penal law was amended to

129. Id. at 304.
131. Id.
132. Mydans, supra note 126.
135. Amnesty Int’l, Disadvantaged and Denied Their Rights, supra note 72, at 7–9 (detailing the violence and threats of violence endured by domestic violence survivors in police custody).
bar the remand of women to police custody.\textsuperscript{137} Still, despite the numerous reports of sexual assault by police officials, virtually no action is taken against the perpetrators.\textsuperscript{138} Furthermore, women who file rape complaints against officers are frequently threatened with adultery claims.\textsuperscript{139} Thus, when the perpetrator is an individual in the authority position of a police officer, the crime goes unpunished even more frequently than in other cases of rape.\textsuperscript{140}

According to Human Rights Watch, 70\% of women in police custody are sexually or physically assaulted by officers and almost all of these officers go unpunished.\textsuperscript{141} Police officers are agents of the states who beat and rape many women survivors of domestic violence. They are also state agents who go unpunished for their crimes because many police officers refuse to file complaints against each other. Amnesty International’s 2002 Report verified that women who file domestic violence claims against their husbands are usually disregarded and sent home to their husbands after suffering additional abuse at the hands of police officers.\textsuperscript{142} These forms of state-sanctioned violence are failures by the state of Pakistan to protect women survivors and insure fundamental human rights.\textsuperscript{143} The failure of the state to exert its authority over state agents further emphasizes the need for the international community to take action.

C. Intimidation & Violence Towards Representing Attorneys

On the rare occasion that a domestic violence claim makes it into the legal system, the survivor is subjected to yet more abuse. Survivors who are driven enough to pursue their claims beyond the police barrier will soon discover that their allies are

\textsuperscript{137} Pakistan Penal Code, § 167 (1995).
\textsuperscript{138} Jilani, Human Rights, supra note 13, at 142.
\textsuperscript{139} Quraishi, supra note 125, at 291.
\textsuperscript{140} Jilani, Human Rights, supra note 13, at 142.
\textsuperscript{143} Human Rights Watch, Police Abuse of Women In Pakistan, supra note 141.
few and far between. Having already alienated their families, as did Samia Sanwar,,¹⁴⁴ these women find that they are faced with many obstacles in legal representation. For claims involving criminal prosecution by the state, survivors encounter insurmountable gender bias, and when hiring counsel, they are represented by attorneys who are faced with death threats as a result of accepting their cases.¹⁴⁵ While the state is required to assist survivors in their claims, the survivor and her heirs have primary control over whether to prosecute the perpetrator.¹⁴⁶ This control is frequently used to evade the criminal justice system where the family asks the abuser or hires someone to kill the survivor who is dishonoring them.¹⁴⁷ Additionally, the women’s rights organizations for which domestic violence attorneys often work are frequently denounced by government officials.¹⁴⁸ Essentially, women survivors are never afforded sufficient representation based on the circumstances.

Throughout Pakistan, prosecutors openly disclose gender bias and skepticism regarding domestic violence claims. A few prosecutors from the Lahore District Attorney’s office even commented that rape claims must be entirely fabricated because a woman could simply slap a man to defend herself; thus, she must have consented.¹⁴⁹ Some prosecutors and advocates go so far as to state that rape does not occur in Pakistan, but is instead an illness invented by western culture.¹⁵⁰ These comments come from the attorneys representing the state in criminal prosecutions against domestic violence perpetrators; in theory, these individuals are on the survivor’s side. However, these survivor attorneys do not believe in the existence of rape

¹⁴⁴. Ruane, supra note 47, 1523–24 (describing Samia Sanwar’s parents who threatened her life and eventually killed her because she wanted to divorce her abusive husband).
¹⁴⁶. Ruane, supra note 47, at 1539.
¹⁴⁷. See infra Part III.D.1.
¹⁴⁹. CRIME OR CUSTOM, supra note 11, at 49–50.
¹⁵⁰. See, e.g., id. (stating that “rape in the west is a sickness” and “[Pakistan] is not a sick society”).
and do not view rape or domestic violence in general as criminal issues at all. Rather, they find these issues to be private, familial matters, essentially placing them outside the domain of the state. These prosecutors are agents of the state who have decided rape claims are generally fictitious or inadequate before they even hear an individual's story. Such comments further emphasize the lack of understanding and competence amongst attorneys in Pakistan. With these attorneys representing the survivors, how could any claim succeed? The failure of the state to prosecute domestic violence based on systematic, discriminatory acts constitutes a violation of international human rights law, worthy of international reform.

Unfortunately, attorneys representing survivors are faced with intimidation and threats, including death threats. After killing Samia, her murderer shot at her attorney, attempting to kill the lawyer who aided Samia in divorcing her abusive husband. Samia's lawyers are the two most prominent Pakistani women's rights lawyers, Asma Jahangir and Hina Jilani. These founders of the first human rights organization and first women's law firm in Pakistan constantly face death threats triggered by social contempt for their work. Following the murder of Samia, members of the Peshawar Chamber of Commerce, of which Samia's father was the chairman, and Islamic scholars declared Jahangir and Jilani to be non-believers of Islam, accused them of "misguiding women," and issued a religious edict on Muslims to kill them. Furthermore, despite the fact that the accused shooter was identified by an eyewitness, the shooter was never arrested, nor was any action taken

151. Id.
152. Thomas & Beasley, supra note 63, at 1124–25.
153. Ruane, supra note 47, at 1539.
155. Id. Asma Jahangir and Hina Jilani are also representatives for the Human Rights Commission and Amnesty International. Id.
156. See Kerry Kennedy Cuomo, Speak Truth to Power, 73 Pa. B.A. Q. 169, 171 (2002). See also, Amnesty Int'l, Murdered In the Name of Honor, supra note 145.
against these death threats.\textsuperscript{158} Even after Samia’s murder, the Senate of Pakistan refused to consider legally condemning honor killings.\textsuperscript{159} Instead, the Government of Pakistan assured the UN Commission on Human Rights that it would take all necessary measures to ensure the safety of Jahangir, but did not publicly condemn the threats.\textsuperscript{160} Jahangir made a public statement on the issue saying,

> Threats to kill me are being made publicly and people are being exhorted to commit violence against me. Are we living in a lawless society, where there is no respect for human life or dignity of the person? An incident in which a client is killed in the office of her lawyer shows that sanctity of law and \textit{Constitution} have been completely eroded...The government has shown complete insensitivity towards this naked violation of the rule of law. Why has the government failed to take action against persons publicly announcing their intent to kill me and are blatantly publicizing this threat with their names through the press? I want to warn the government that they will be fully responsible for any harm that comes to me because of their failure to perform their legal and constitutional duty.\textsuperscript{161}

Under the formidable barriers of law enforcement and attorney representation, survivors find it nearly impossible to succeed in pursuing a domestic violence claim. Having survived the gender bias and assault of the law enforcement officials, survivors are then represented less than adequately, to say the least. When state agents take on the case, the perpetrators are prosecuted by attorneys who do not believe the allegations to be true. If survivors pursue their complaints with their own private, legal representation, their attorneys are threatened by large portions of the community and so-called religious death orders are issued, which have yet to be condemned by the government. If any harm does come to Asma Jahangir, how will

\textsuperscript{158} Am\textsc{nesty Int’l}, \textsc{violence against women in the name of honor}, \textit{supra} note 45; Ruane, \textit{supra} note 47, at 1523–24.

\textsuperscript{159} Human Rights Watch, \textsc{world report 2000: events of 1999}, \textit{supra} note 148, at 208.

\textsuperscript{160} Am\textsc{nesty Int’l}, \textsc{murdered in the name of honor}, \textit{supra} note 145.

\textsuperscript{161} Am\textsc{nesty Int’l}, \textsc{pakistan: violence against women in the name of honor, the failure of the government of pakistan to act on honor killings} (1999), \textit{at} http://www.amnestyusa.org/countries/pakistan/reports/honour/honour-11.html.
the government be held accountable? Without the international community obligation to take action, the Pakistani government will continue to deny both survivors and their attorneys the protection of the law. In essence, women survivors are not only left to fight for their basic human rights without the aid of the state, but are in fact impeded by the state as well as social institutions.

D. Judicial Bias & Disregard

1. Judicial Discretion

Unfortunately, the bias of the legal system does not end with the obstacles of obtaining adequate representation. Like law enforcement agencies and state prosecutors, judges are also biased against women's claims of domestic violence. Judges review these claims in the context of tradition and culture, rather than according to the penal laws of the country or international law. In addition to these traditions and customs, judicial decisions are also based on Islamic law, which is left at the discretion of the trial judge. Despite the high percentages of domestic violence rates, judges continue to reject the notion of domestic violence as a significant, criminal issue and instead claim that these acts of violence against women are superseded by social and religious norms.

Since domestic violence is not acknowledged as a distinct crime in Pakistan, physical abuse falls under the category of person-to-person violence. In 1997, Pakistan invoked the Qisas and Diyat Ordinances, creating penal laws for crimes of violence. Qisas crimes are those of murder, attempted murder,
or any crime causing bodily hurt. According to the Pakistani Penal Code, hurt occurs when one causes “pain, harm, disease, infirmity or injury to any person or impairs, disables or dismembers any organ of the body or part thereof [of] any person without causing his death.”

In burning someone with kerosene oil, throwing acid on them, or thrusting a red hot iron bar in someone’s vagina, egregious “harm” occurs, pain certainly ensues, and injury is done. It would be preposterous to claim that no pain was felt by these women or no damage was done, especially in the face of the 30 surgeries that Fakhra Yunas will need to even resemble a human being again, not to mention the mental anguish.

Qisas and Diyat refer to forms of punishment for the perpetrator for committing these crimes of violence, namely physical retribution and compensation, respectively. The survivor or her heirs can either pardon the offender or request Qisas or Diyat. Unfortunately, not only are many women persuaded by the police and the judges to drop their charges, but many of their family members also force them to return to their husbands in order to avoid any family dishonor.

Thus, the legal system is essential to protecting women’s fundamental rights because these rights are often disregarded by their families. However, survivors are further oppressed when judges disregard instances of violence as private, domestic disputes. In some cases, the state may invoke taz’ir punishment, also known as imprisonment, even after a settlement has already been reached. However, this punishment is purely at the discretion of the judge. Thus, again, these cases are frequently dis-


167. CRIME OR CUSTOM, supra note 11, at 40.
168. PAK, PENAL CODE § 332. See also CRIME OR CUSTOM, supra note 11, at 40 n.93.
170. CRIME OR CUSTOM, supra note 11, at 40–41. The Ordinance also sets monetary limits for crimes of murder. Id. at 42.
171. Id. at 41.
172. Id. at 41–45.
173. Ruane, supra note 47, at 1541–42.
174. CRIME OR CUSTOM, supra note 11, at 42.
175. Gottesman, supra note 125, at 442.
176. Id.
missed since the male-biased judicial system does not recognize domestic violence as a crime and the international community fails to take any action.

When a complaint finally comes before a judge, judicial discretion is all-determining in Pakistani law. Under Pakistani Penal Code Section 302(c), punishments occur in cases where “according to the Injunction of Islam the punishment of qisas is not applicable.” This law gives judges, who are not necessarily religious scholars, the immense task of determining the “Injunction of Islam” and wide discretion to enforce their individual interpretation of the relevant issue as they relate it to Islam. As in many cultures, the dominant groups interpret religion and culture in the ways most beneficial to themselves and offer these views as the only legitimate interpretation. Thus, the dominant interpretation of Islam is inherently male-biased and therefore the fate of women survivors is left to the discretion of biased judges. Furthermore, as a result of the inconsistencies of judicial discretion and the largely male-operated court system, the majority of perpetrators are not convicted and those who are often receive reduced sentences.

This judicial discretion is best exemplified by a case in point. After a hearing regarding one man’s violence towards his wife, the perpetrator severely beat his wife in the courthouse, while still in police custody. Zia Anwar, advocate for the survivor, remarked, “I approached the judge and complained against the husband...[the judge] told me that as long as she was [the perpetrator’s] wife, he could treat her in whatever way he chose, and added that even the Quran gives the man this right.”

177. CRIME OR CUSTOM, supra note 11, at 42.
178. Id.
179. PAKISTAN PENAL CODE § 302(c). See also CRIME OR CUSTOM, supra note 11, at 42.
180. Id.
181. See An-Na’im, Toward a Cross-Cultural Approach, supra note 60, at 20.
185. Id.
pus regarding a survivor subjected to cruel treatment and illegal confinement by her husband, indicating that in some cases a man may legitimately abuse his wife based on her “disobedience.”

Additionally, in Younis v. State, the Appeals Court reduced the sentence of a man charged with murdering his wife with multiple stab wounds throughout the body based on the theory that she must have provoked such anger. The court stated that the survivor must have done something to “enrage him to that extent,” further symbolizing the judiciary’s insensitivity and lack of understanding regarding domestic violence. In Pakistan, women’s rights are based on social norms and thus the failure or potential failure to meet social “standards of morality” prevents women from receiving equity in the legal system. Furthermore, the excuse of culture or religion as a means to allowing discrimination is flawed, as human rights are fundamentally recognized by the international community through declarations and treaties. Pakistan’s acknowledgment of these rights through various treaties, such as CEDAW or the Declaration on the Elimination of Violence Against Women, makes any claims to culture and religion invalid. Thus, Pakistan’s judicial disregard for women’s human rights under the false pretense of religion or social norms constitutes blatant human rights violations, worthy of international action.

Even in cases of honor killings, families who pursue claims are often dissuaded or ignored by the judicial system.

189. JILANI, HUMAN RIGHTS, supra note 13, at 143–44.
191. See supra Part II.
192. See supra Part II.B.
Pakistani court system allows the victim or his heirs to absolve the perpetrator of any prosecution, so that any crime against a victim can be completely pardoned by the family members of the victim. A family member can forgive the perpetrator for murder at any stage in the process, thus, the perpetrator may never be arrested or prosecuted. Thus, a man can kill his wife and then go free after being pardoned by the victim’s family.

In situations of public slander, regardless of its truthfulness, the woman’s family is often so consumed with restoring honor to the family name that they ask the husband to kill their daughter under an agreement to pardon him. While this scenario seems extreme, a woman’s honor is said to symbolize the honor of her family, supposedly justifying such retribution. Still, the Pakistani government makes no efforts to educate the judges and the international community currently claims that it is under no obligation to take action.

2. Judicial Misinterpretation of Islam

Due to the wide-ranged discretion of judges, judicial opinions often reflect socially cultivated gender discrimination under the guise of Islam. To the contrary, under no condition is violence against women permitted in Islam. Yet, judges and religious scholars naturally interpret religion and cultures in ways most beneficial to themselves. Thus, as men are interpreting the religion, the dominant interpretation of Islam is inherently male-biased. This internal struggle between the dominant group and the subordinate group is sometimes called a struggle for control over the “symbols of power” in that society.

194. AMNESTY INT’L, PAKISTAN: VIOLENCE AGAINST WOMEN IN THE NAME OF HONOR, supra note 45; CRIME OR CUSTOM, supra note 11, at 41.
196. Id.
197. See Ruane, supra note 47, at 1531.
198. Id.
199. CRIME OR CUSTOM, supra note 11, at 50–51.
200. See generally SISTERS IN ISLAM, supra note 25.
201. See An-Na‘im, Toward a Cross-Cultural Approach, supra note 60, at 20 (explaining that dominant groups interpret religion and culture to their advantage and frequently offer these views as the only legitimate interpretation).
202. Id.
judges are imposing Islamic viewpoints and interpretations, which are inconsistent and arguably inaccurate. Their interpretations of Islam are based on interpretations by male Islamic scholars, including Quranic verses often taken out of context and used to impose a male-dominated familial situation. As Pakistani women have no means to participate in the interpretation of Islam and, therefore, the creation of the laws, they are left to struggle against a discriminatory legal system.

The most often cited Quranic verse interpreted to permit violence towards women is that of Sura Nuza which provides guidance during times of marital conflict. Taken out of context, this verse can be interpreted as allowing men to beat their wives in times of disobedience. However, in interpreting the religion of Islam, one must take into account three sources of the religion: the Quran, hadith, and sunnah. Furthermore,

203. See, e.g., Quraishi, supra note 125, at 287 (detailing an alternate interpretation of rape in Islam).

204. An-Na'im, Toward a Cross-Cultural Approach, supra note 60, at 34.

205. See, e.g., ZINA ORDINANCE § 8 (requiring that victims bring four male eye-witnesses to the crime or that rapists confess in order to substantiate rape claims); Anika Rahman, A View Towards Women's Reproductive Rights Perspective on Selected Laws and Policies in Pakistan, 15 WHITTIER L. REV. 981, 999-1000 (1994) (discussing the impermissibility of female testimony in court proceedings even regarding acts committed against her, such as rape). Additionally, unsuccessful rape claims are frequently used as evidence of adultery, and the victim’s claim may be converted into an adultery charge against her. See CRIME OR CUSTOM, supra note 11, at 26–27; Jo Lynn Southard, Protection of Women’s Human Rights under the Convention on the Elimination of All Forms of Discrimination Against Women, 8 PACE INT’L L. REV. 1, 76 (1996); Quraishi, supra note 125, at 303–04; Shahla Haeri, The Politics of Dishonor: Rape & Power in Pakistan, in FAITH AND FREEDOM: WOMEN’S HUMAN RIGHTS IN THE MUSLIM WORLD 169–70 (1995).

206. Quran 4:34 states,

Men are the protectors and maintainers of women because Allah (SWA) has given one more than the other, and because they support them from their means. Therefore the righteous women are devoutly obedient, and guard in [the husband’s] absence what Allah (SWA) would have them guard. As to those women on whose part you fear disloyalty or ill conduct, admonish them, do not share their beds, and beat them; but if they return to obedience, seek not against them means: Allah (SWA) is most High, Great [above you all].

Id.

207. The Quran is the holy book, the word of God, as revealed to Prophet Muhammad; hadith includes the sayings and teachings of Prophet Muhammad; and, sunnah refers to the practices and actions of Prophet Muhammad.
Quranic verses must be interpreted based on the motive, intent, and the purpose behind the passages. At the time this particular verse was revealed, physical and emotional violence against women was rampant and practices such as female infanticide and the inheritance of widows by other family members were prevalent, signifying the role of women as property. Sura Nuza was written to provide a restriction on the abuse of women, not the permission to assault one’s wife. Additionally, this “beating” was determined to be the symbolic gesture of a very light tap which leaves no mark, not as a punitive measure. The Quran also states of men in relation to their wives, “nor should you treat them with harshness...on the contrary, like with them on a footing of kindness and equity.” The Quran thus admonishes any sort of brutality, whether physical or verbal and in fact, invokes the very equity denied by the state of Pakistan.

Second, with reference to hadith, Prophet Muhammad (PBUH) viewed the institution of marriage as a determinative part of religion. In fact, he often referred to marriage as half of the perfection of religion. By these terms, marriage in itself accomplishes half of the requirements of Islam, representing half of one’s faith. In continuing with this perfection of marriage, each individual is to follow the Islamic terms of marriage, each expecting certain requirements of the other and fulfilling obligations to them as well. Specifically, the Prophet (PBUH) strongly opposed any violence towards women. Regarding domestic violence, he asked some of his followers, “how can one of you hit his wife like an animal, [and] then...embrace her?” and “how can one of you whip his wife like a slave...[when] he is...
likely to sleep with her at the end of the day?"

He also attempted to end these forms of cruelty towards women by instructing Muslims to “[f]ear Allah in respect of women...[because] the best of you are they who behave best towards their wives.” Finally, with reference to the Quranic verse restricting physical acts to those that are purely symbolic, the Prophet (PBUH) stated that it is “not permissible to strike anyone’s face, cause any bodily harm or even be harsh.” In these hadith, the Prophet (PBUH) stressed the importance of kindness and respect towards women and condemned any form of marital abuse or violence.

In fact, Prophet Muhammad (PBUH) never abused his wives in any way, physical or emotional. Instead, the Prophet (PBUH) was known to be very kind and helpful to his wives and even when unhappy with them, he was never known to lose his temper with them. Thus, in following the practices of the Prophet, as Muslims are required to do, no abuse is allowed or should be permitted against women based on his disapproval of violence. By allowing this violence, the Pakistani government is allowing judicial bodies to discriminatorily enforce laws based on inaccurate interpretations of Islam and in violation of international law.

Unfortunately, culture and custom often cloud the judicial interpretations of religion. While many Islamic scholars have promoted the adoption of custom into their legal system in an attempt to maintain cultural identity, cultural customs must be disregarded when in conflict with the basic doctrine of Islam. However, Muslims are often unable to distinguish laws based on religion from those rooted in historical custom. Instead, the Pakistani community is forced to rely on judicial application

218. SISTERS IN ISLAM, supra note 25, at 8.
219. Id.
220. Al-Hibri, supra note 215, at 40–43. See also Declaration on the Elimination of Violence Against Women, supra note 83, at art. 4.
221. Id.
of the religion to each set of facts. The problem is that these judges are not necessarily trained or well-educated on the religion of Islam. Judges are essentially imposing their interpretation of Islam on women survivors, violating the theories of the religion and the fundamental human rights of these women. Judges insist on reinforcing these discriminatory customs in order to maintain Pakistan’s traditional patriarchal society.\(^{222}\) Additionally, these decisions violate the Constitution of Pakistan’s guarantee for gender equality.\(^{223}\)

Yet, judges continue to make discriminatory statements in their decisions, invoking gender inequality in the home and in society. As state agents, judges must enforce the law of the state and protect women’s rights; any failure on their part is a failure by the state. The combination of Pakistan’s verbal acknowledgment that violence against women must end\(^{224}\) and judicial justification of that violence\(^{225}\) exemplifies the Pakistani government’s refusal to ensure the fundamental rights of women on a substantive level and the necessity of the international community’s action in order to enforce these rights.

3. International Media Attention as a Means to Enforcement

Despite the societal acceptance of domestic violence, all judicial decisions regarding domestic violence do not result in total victory for the perpetrator. While most judges treat women as their husbands’ property, in the last couple of years, a few judges have also convicted male perpetrators of violence.\(^{226}\) These convictions are usually the result of intense international media attention.\(^{227}\) One prevalent example of such a case is that

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223. PAK. CONSTT. art. 25(2).
225. CRIME OR CUSTOM, supra note 11, at 45.
227. See, e.g., AMNESTY INT’L, DISADVANTAGED AND DENIED THEIR RIGHTS, supra note 72, at 8 (where a woman’s complaint was finally registered after sufficient media attention). See also Bloch, supra note 15 (where General Lieutenant General Moinuddin Haider denied Fakra Yunas a visa to Italy out of fear of international media attention).
of Zahida Perveen.\textsuperscript{228} When Zahida’s husband suspected her of adultery, he tied up his pregnant wife’s hands and feet, blinded her in one eye by shoving it in with a rod, and then cut off her nose and her ears.\textsuperscript{229} In an attempt to restore her sight and escape her abuser, Zahida came to the United States, but only after the brutality of her husband’s crime received U.S. media attention was her husband prosecuted for this torture and abuse.\textsuperscript{230} Unfortunately, with the exception of those situations receiving international media attention, virtually all perpetrators of domestic violence in Pakistan go unpunished.\textsuperscript{231} The impact of international media attention further emphasizes the significance of action by the international community on every level.

V. THE CASE FOR INTERVENTION

A. Legal Reformation

Historically, culture and tradition in Pakistan permit male violence against women.\textsuperscript{232} Based on this so-called culture and tradition, police, lawyers, and judges discriminate against women. Pakistan’s failure to adequately protect abused women and punish batterers only perpetuates this cycle of violence.\textsuperscript{233} Whether based in custom, tradition, or religion, survivors of

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\bibitem{228} Amir Zia, \textit{Abused Pakistani Women Seek Treatment in the U.S.}, \textsc{Columbian} A6, Jan. 9, 2001, \textit{at} 2001 WL 6276791.
\bibitem{229} \textit{Id.}
\bibitem{230} Her husband was convicted and sentenced to 14 years in jail. \textit{Id.}
\bibitem{231} Ara, \textit{supra} note 26; Douglas, \textit{supra} note 27. Additionally, recall the Pakistani government’s initial denial of a visa to Fakhra Yunas to receive medical treatment overseas in an attempt to avoid negative international media attention. \textit{See} Bloch, \textit{supra} note 15; \textsc{Agence France-Presse}, \textit{supra} note 17.
\bibitem{232} \textit{See generally} \textsc{Crime or Custom}, \textit{supra} note 11; \textsc{Amnesty Int’l, Disadvantaged and Denied Their Rights, supra} note 72; \textsc{Amnesty Int’l, Pakistan: Violence Against Women in the Name of Honor, supra} note 45; \textsc{Amnesty Int’l, Pakistan: Violence on the Increase and Still No Protection, supra} note 142; \textsc{Amnesty Int’l, Murdered in the Name of Honor, supra} note 145.
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domestic violence are denied their fundamental human rights by the state of Pakistan and change must occur immediately.

As a state subject to international treaties and customary law, Pakistan is required to take affirmative action to protect the fundamental rights of individuals, including women. At a minimum, this protection and enforcement of women’s rights is achieved by effective investigation and protection by police officers, adequate prosecution by attorneys, and punitive measures in the legal system. Scholars have recommended restructuring the legal system in other countries by (1) identifying domestic violence as a crime, (2) creating a punishment which deters perpetrators from committing crime, and (3) providing survivors with immediate protection from the perpetrators.

Despite the international recognition of violence against women as a customary human rights violation and the condemnation of such acts by the Pakistani government, domestic violence is still dominantly perceived in the Pakistani legal system as a private, familial issue. By identifying domestic violence as a crime in itself, Pakistan would be acknowledging to state agents and the public that domestic violence is not simply a private matter and women’s rights must be enforced by state agents. Punitive action against the perpetrator would also deter further crimes. As long as domestic violence is condoned by state officials, and perpetrators of assault, mutilation, and murder are validated by judicial decisions as being within a husband’s Islamic rights, domestic violence will continue and worsen as a legitimized action. Finally, no action taken by a survivor can succeed if they are not provided with social and legal protections. Women attempting to file a complaint against or divorce their batterers are subjected to threats of violence as well as physical and sexual violence. Additionally, attorneys

234. See generally Culliton, Legal Remedies, supra note 233, at 258.
235. Katherine M. Culliton recommends these changes to the legal systems in Chile and the United States to protect the rights of women survivors. Id. Additionally, the Inter-American Human Rights Commission recommends similar measures regarding domestic violence. See Culliton, Finding a Mechanism to Enforce Women’s Right to State Protection, supra note 68, at 547–48.
236. See supra Part II.B.
238. Honor killings often take place as the result of the dishonor the victim brings upon the husband and his family by leaving her husband. See
attempting to aid these survivors are subjected to similar threats, edicts, and violence.\textsuperscript{239} Without the state’s condemnation of such threats and the provision of safe havens and legal protection for survivors, no action can be taken to adequately protect women’s human rights.

However, the official acknowledgment of these changes will not be effective so long as gender discrimination exists in the law enforcement and judicial arena. Legislation should be created requiring police officers, attorneys, and judges to be educated on issues of domestic violence. Police officers and attorneys must be trained on matters of domestic violence so as to be more sensitive and take more seriously the crimes, rather than ignoring them as familial matters. Additionally, law enforcement officers must be held liable for the harm they commit in failing to protect survivors who request help as well as their additional crimes of violence against these women. Perhaps, such liability can be enforced through the employment of more female police officers and education regarding violence in Islam. Finally, judges must be educated on domestic violence, the law surrounding it, and the religion they claim to invoke. Based on their large discretionary power, judges must be educated on the religious, national and international legal condemnation of domestic violence. Since General Musharraf Pervez’s request that judges take action against perpetrators of violence did not result in any changes,\textsuperscript{240} perhaps judges need also to be evaluated and held accountable for their denial of women’s human rights.

As symbolized by Pakistan’s historical verbal acceptance of women’s rights as equal and protected human rights and the government’s consistent inability to invoke change,\textsuperscript{241} these internal legal changes will be difficult. Another way must be found to enforce women’s fundamental rights. Domestic violence is a form of female oppression so atrocious and systemic that governmental inadequacies cannot be lightly brushed aside. Having acknowledged and declared violence against women as a fundamental human rights violation in treaties and

\textsuperscript{239} AMNESTY INT’L, MURDERED IN THE NAME OF HONOR, supra note 145.
\textsuperscript{240} Patel, supra note 28.
\textsuperscript{241} See supra Part II.A.
declarations, the international community must take action to enforce these rights. Human rights must be redefined to consist of normative obligations on the international community with respect to women's rights.

B. Grass Roots

As legal reform will not create immediate modifications, in the meantime social and cultural reform must commence. This change must come from those oppressed and subordinated by the system, the women. Over the years, women have become increasingly more aware of the injustice that the Pakistani legal system affords them. However, women must be educated on a larger scale to include all classes.

Female education is essential across all lines regarding the denial of women's fundamental human rights. Many women may not embrace this so-called “feminist” movement for women’s rights because they have been taught that feminism essentially conflicts with Islam. The education and enforcement of women’s rights must embrace and invoke Islam in order to be effective, especially when submersed in the Islamic nation and culture of Pakistan. Since many women in Pakistan are not aware of their Islamic rights and are ensconced in the custom and tradition in which they have been raised, education is essential regarding women’s rights and protections under Islam. Women must be aware that domestic violence is not permitted in Islam in order to actively pursue their rights.

Additionally, since perpetrators of violence are usually punished under the pressure and shame of international media attention, a media campaign should also be launched. This campaign should draw attention to the lack of legal action

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242. See supra Part II.
245. See id. See also An-Na’im, Toward a Cross-Cultural Approach, supra note 60, at 25.
246. AMNESTY INT’L, DISADVANTAGED AND DENIED THEIR RIGHTS, supra note 72, at 8 (“media coverage has forced police to register a complaint brought by a woman”). See also Bloch, supra note 15 (where General Lieutenant General Moinuddin Haider denied Fakhra Yunas a visa to the U.S. out of fear of international media attention).
against domestic violence perpetrators. Beginning with the inadequate documentation of domestic violence incidents, through the law enforcement’s dismissals and abuses, and finally through the judicial system’s legitimization, these cases should be brought to the general public’s attention as well as that of the international community. With the benefit of the Internet, information can be spread across the world within a matter of seconds. These incidents of violence must be documented, acknowledged, and condemned by the international community. In the face of the international community’s condemnation of Pakistan’s violations of fundamental human rights, some action or enforcement will be taken by the Pakistani government, even if initially only on a case-by-case basis. Furthermore, the international community must take action against the blatant violations of women’s rights where the government of Pakistan fails; they are obligated to protect women from these endemic, egregious harms. Enforcement by means of moral and political pressure can often bring about substantial long term changes.247

VI. CONCLUSION: PAKISTAN AS A PROTOTYPE CASE

Pakistan’s consistent failure to take action against domestic violence constitutes a gross violation of women’s human rights. Women in Pakistan are subjected to disturbing acts of violence and are offered no redress by the state. From the law enforcement agencies to the court system, women are invariably discriminated against and ignored, as domestic violence is consistently concealed as a private, familial issue. Additionally, the authorization of violence against women under the guise of Islam is a gross manipulation of the religion. Police officers, attorneys, and judges deny women their fundamental human rights as protected under customary international law. As these individuals are agents of the state, Pakistan is responsible for violating international law by preventing women from enjoying their fundamental human rights. The state of Pakistan is obligated to reform its legal and social system to allow women the rights afforded to them under international law.

If Pakistan fails to protect these women’s rights, as has been the historical case, the issue then becomes one for the interna-

tional community. Much discourse occurs in international law regarding the question of normative obligations. These obligations are based in ethical responsibilities and in creating treaties and declarations which condemn domestic violence and ensure the protection of women against discrimination, the international community is essentially recognizing an ethical obligation towards women rights.

Historically, men defined international human rights, and therefore women’s rights, protections, or perspectives were not considered in this definition. Thus, the current definition of human rights revolves around the needs of the male elite. International human rights law must be redefined to make the international community responsible for the enforcement and protection of women’s rights. Just as the U.S. government prohibited racial discrimination and began to enforce racial equity amongst its states, so too must the international community prohibit violence against women and enforce gender equity around the globe. Hate crimes against minorities rightfully invoked large scale intervention, and likewise, violence against women is worthy of such intervention and protection. Similarly, the death of 3030 people on September 11, 2001 warranted international action in order to enhance safety around the world. In Pakistan, approximately 3560 women reported being attacked with gas, fire, or acid in the short time span of five years. If this statistic was to include women around the world abused, raped, and murdered, the numbers would be overwhelming, and would still not include those who do not report such acts. Should these hate crimes also not warrant some international concern and action? If the international community chooses to invade Afghanistan and Iraq for various safety reasons, isn’t the safety of women just as important where in-

249. Id. at 275.
251. HENKIN, supra note 7, at 43.
253. Deckert, supra note 32.
ternal governments fail year after year? When women continue to die and governments are incapable of protecting them, who will help them?

The international community can condemn Pakistan through economic action,\textsuperscript{254} attempt to take action in the International Criminal Court of Justice,\textsuperscript{255} or allow for women survivors of Pakistan to bring their international human rights claims in a domestic arena. Regardless of the means, the time has come for the international community to take responsibility for basic, fundamental human rights violations. The systemic and pervasive abuse of women is inherently different from human rights violations that can be repaired from within culture and religion. As demonstrated through this case study of Pakistan, violence against women represents endemic, system-wide violations of human rights which governments, cultures, and religions do not have the will or capacity to change. The international community must pierce the veil of sovereignty in order to protect women from the violence justified and tolerated by their governments. Without the redefinition of human rights to impose obligations on the international community, violence against women will continue to occur around the world, denying women their fundamental human rights and empowering perpetrators to continue violating these rights.

\textit{Manar Waheed}\textsuperscript{*}

\textsuperscript{254} \textit{See, e.g.}, U.N. Charter, art. 41 (authorizing Members of the United Nations to withdraw “economic relations and of rail, sea, air, postal telegraphic, radio, and other means of communication, and the severance of diplomatic relations). While this article refers to measures taken with respect to international peace and security, similar measures could be applied to force the protection of women’s human rights.


\textsuperscript{*} B.A. Wellesley College (1999); J.D. Brooklyn Law School (expected 2004). I would like to thank to my parents, Tabassam and Abdul Waheed, and my brother, Numan, for their constant love, support, and tolerance throughout my academic career. I would also like to thank Brooklyn Law School Professor Samuel Murumba for his invaluable advice and patience in the final stages of this writing process.