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THE INTERNATIONAL LAWYER

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Non-Governmental Organizations: Anticorruption Compliance Challenges and Risks

ELENA HELMER AND STUART H. DEMING*

Abstract

Despite the drastic consequences, corruption and anticorruption compliance risks associated with the activities of international non-governmental organizations (NGOs) have not received adequate attention. NGOs face many of the same risks as traditional business organizations, like violating the Foreign Corrupt Practices Act and other foreign bribery laws, as well as susceptibility to becoming a victim of corruption. An anonymous survey of international NGOs conducted by the authors demonstrates that, for various reasons, NGOs have tended to languish behind business organizations in addressing their corruption-related risks. Unlike a business, the basis for an NGO’s funding often limits what resources can be devoted to compliance. Yet, unlike a business, an NGO’s reputational risk is much greater. For this reason, NGOs must give greater attention to putting in place robust anticorruption compliance programs like those instituted by business organizations.

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Introduction

Over the course of the past decade, enforcement of the anti-bribery provisions of the Foreign Corrupt Practices Act (FCPA), prohibiting the bribery of foreign officials, has experienced tremendous growth. The growth of foreign bribery prosecutions under the FCPA has been exponential in nature when consideration is also given to the use of the FCPA’s accounting and record-keeping provisions as an alternative means of prosecuting behavior prohibited by the anti-bribery provisions.

As Lanny Breuer, the Assistant Attorney General for the Criminal Division of the U.S. Department of Justice (DOJ) has stated, “we are in a new era of FCPA enforcement; and we are here to stay.” This statement accords with the recent record of the DOJ and the Securities and Exchange Commission (SEC), the government agencies charged with enforcement of the FCPA. In 2010 alone, the DOJ and SEC resolved twenty-three FCPA enforcement cases with $1.8 billion in fines and disgorged profits. Over fifty individuals were indicted, tried, or sentenced for FCPA violations during the same period of time—a record number since the FCPA’s adoption in 1977. In 2009-2010, the DOJ alone collected nearly $2 billion from FCPA cases.

Entire industries have become the focal point of FCPA investigations. For example, in November 2009, Mr. Breuer announced that the pharmaceutical industry would be the

2. Id. § 78dd-1,2,3.
4. Id.
5. Often overlooked in the dramatic increase in FCPA enforcement is the critical role of the FCPA’s accounting and record-keeping provisions. See FCPA § 78m. In addition to prohibiting improper inducements to foreign officials, the FCPA placed new and significant obligations on issuers to maintain records that accurately reflect transactions and dispositions of assets and to maintain systems of internal accounting controls. Id. They apply to foreign and domestic issuers of securities as defined by Section 3 of the Securities Exchange Act of 1934 as entities required to register under Section 12 or file reports under Section 15(d). See id. §§ 78a-c, 78o(d), 78l. Issuers can include foreign entities with American Depository Receipts (ADRs). Unlike the FCPA’s anti-bribery provisions, the accounting and record-keeping provisions also apply to majority-owned foreign subsidiaries of an issuer. Id. § 78m(b)(6). The anti-bribery provisions and accounting and record-keeping provisions “were intended to work in ‘tandem’ and thereby complement one another.” Stuart H. Deming, The Potent and Broad-Ranging Implications of the Accounting and Record-Keeping Provisions of the Foreign Corrupt Practices Act, 96 J. CRIM. L. & CRIMINOLOGY 465, 468 (2006) (citing S. REP. NO. 95-114, at 7 (1977)), reprinted in 1977 U.S.C.C.A.N. 4098. “For example, the Senate Report associated with the FCPA’s passage stated that ‘a U.S. company “which looks the other way” in order to be able to raise the defense that they were ignorant of bribes made by a foreign subsidiary, could be in violation of [the accounting and record-keeping provisions] requiring companies to devise and maintain adequate accounting controls.” Id. at 468, n.14 (citing S. REP. NO. 95-114, at 11).
8. Id.
9. See Press Release, Dep’t of Justice, supra note 6.
next focus of the DOJ’s FCPA enforcement efforts. Freight-forwarding, telecommunications, oil and gas, and tobacco industries also drew considerable attention from the DOJ and SEC in 2010 and 2011.

Even though the United States and much of the developed world are home to many nonprofit and non-governmental organizations (NGOs) that operate in countries where corruption is rife, this large sector has yet to be the special focus of enforcement activity. But NGOs and nonprofits suffer many of the same corruption-related risks as traditional business organizations. Are NGOs and nonprofits subject to the FCPA, and can they and their officers, employees, and agents be held liable for FCPA violations? Could the NGO and nonprofit sector be the next frontier in FCPA enforcement?

Related questions include: What are the implications for NGOs and nonprofits as a result of the other anti-bribery legal regimes being implemented and increasingly enforced by other countries? What special provisions are made for NGOs or nonprofits? Are they in any way exempted from the prohibitions on foreign bribery? If not, what are the implications? How else can corruption affect the activities of international NGOs? What proactive steps are they taking? What steps should they be taking? What considerations are unique to NGOs and nonprofits?

Many of these questions cannot be adequately addressed in this article. Rather, the article seeks to draw the attention of NGOs and nonprofits engaged in international endeavors to the growing nature of their compliance risks and the implications of those risks. At the same time, this article seeks to alert policy makers and the legal community to the unique problems that exist in this arena and highlight areas for future research and practice development.

In addressing these and related issues, the acronym “NGO” will be used to refer to both non-governmental organizations and nonprofit or not-for-profit organizations. In the United States, and elsewhere, these terms are often used interchangeably to refer to organizations that pursue some wider social aim; that do not distribute surplus funds to owners or shareholders; and that are normally exempt from income and property taxation. Unless the context dictates otherwise, the term “NGO” will be used throughout this article.

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I. NGOs and International Assistance

The most recent edition of the Yearbook of International Organizations lists 64,523 international “civil society organizations” in 300 countries and territories.12 The United States and much of the developed world are home to many NGOs involved in an immense variety of activities domestically and abroad. These activities include education and cultural development, conservation and preservation, fighting poverty and disease, humanitarian assistance, and other forms of foreign aid and disaster relief. Geographically, many of the larger NGOs operate in scores of countries all over the world. For example, among U.S.-based NGOs in 2010 alone, the American Red Cross assisted more than sixty-eight million people in sixty-six countries;13 AmeriCares Foundation was active in ninety-seven countries;14 and CARE USA worked in eighty-seven countries, reaching more than eighty-two million people.15 Faith-based organizations are not far behind, and some even surpass secular NGOs in the reach of their overseas activities. World Vision, a Christian humanitarian relief and development organization, works in nearly 100 countries16 while the Catholic Relief Services’ activities spread to more than 100 countries on five continents.17

The geographic extension of these NGOs is matched by their hefty budgets. According to the Chronicle of Philanthropy, in fiscal year 2009, the latest year for which complete data is available, each of the four largest U.S.-based NGOs focusing on international charitable work, AmeriCares Foundation, Feed The Children, Food For The Poor, and World Vision, had a total revenue of over $1 billion.18 Even during the recent economic downturn when charitable giving was down by eleven percent,19 Food for the Poor and World Vision reported that their net income in 2010 stayed above $1 billion, at $1.047 billion and $1.041 billion respectively.20 The revenue of the American Red Cross for 2010 was almost $3.6 billion, with over $252 million spent on programs outside the United States.21

Significant parts of the budgets of many NGOs are financed by the U.S. government through the U.S. Agency for International Development (USAID), the U.S. State Department, the Millennium Challenge Corporation, and other government entities, as well as by international governmental and other organizations, such as the United Nations and the World Bank.\textsuperscript{22} The traditional U.S. government foreign aid model, as represented by USAID,\textsuperscript{23} relies on private-sector contractors, including NGOs, for the vast majority of program implementation.\textsuperscript{24} In 2008, eighty-five percent of USAID’s budget was committed to contracting organizations through direct grants, cooperative agreements, or contracts.\textsuperscript{25} NGOs routinely compete for USAID grants and contracts along with for-profit entities. NGOs may also sub-contract for other organizations receiving government funding.\textsuperscript{26}

A well-developed network of regular USAID contractors and subcontractors includes both for-profit and not-for-profit organizations. Some of them have been working with USAID for decades, administering projects worth hundreds of millions of dollars and encompassing scores of countries.\textsuperscript{27} A number of large NGOs, such as CARE, Catholic Relief Services, and Save the Children, are major USAID contractors. Among the top twenty “vendors” that USAID lists for 2010 are eight U.S.-based nonprofits, with the amounts of money awarded to them ranging from $165 million to over $432 million.\textsuperscript{28}

The World Bank also recognizes NGOs as “important actors in the development process” and frequently relies on them in the delivery of its programs.\textsuperscript{29} Projects supported by the World Bank often involve national and international NGOs\textsuperscript{30} because of the “skills and resources they bring to emergency relief and development activities and because they

\textsuperscript{22} Though many U.S. government agencies are involved in international development and foreign assistance, in the interest of brevity this article will largely focus on USAID as the primary source of funding.


\textsuperscript{24} Id. at 26; see also Save The Children, Supporting Local Ownership & Building National Capacity: Applying a Flexible and Country-Based Approach to Aid Instruments (May 2010), http://www.savethechildren.org/art/ef/79/de2eb-10ae-432c-9bd0-df91d2eba74a%7D/Save-the-Children-Aid-modalities-for-country-ownership-May-2010.pdf.

\textsuperscript{25} Save The Children, supra note 24, at 1.

\textsuperscript{26} For example, USAID awarded a two-year grant to Catholic Relief Services for the Community Resettlement and Rehabilitation Project in post-civil war Liberia. The latter selected World Vision as a subgrantee to conduct food distribution and food-for-work projects, parts of the USAID grant. See World Vision, World Vision Statement Regarding Alleged Fraud in Liberia, http://www.worldvision.org/content.nsf/about/20090604-liberia (last visited June 5, 2011).

\textsuperscript{27} For example, Chemonics International Inc., a USAID contractor since 1975, worked in almost 140 countries managing more than 900 projects in all key development areas. USAID, About Chemonics Int’, http://ghiqc.usaid.gov/hpi/contractor/chemonics.html (last visited June 5, 2011). “It currently manages more than 105 contracts for USAID in some 70 countries.” Id.


foster participatory development processes.”

The World Bank also uses NGOs as contractors and grantees. Thirty-three large international NGOs are listed on the World Bank’s website as those “with whom the Bank maintains ongoing relations through policy dialogue, training, and/or operational collaboration.” At least a dozen of them are based in the United States or have U.S. branches.

Acknowledging the role played by NGOs and other nonprofits, the World Bank calls civil society organizations—the term that includes such diverse entities as “community groups, non-governmental organizations, . . . labor unions, indigenous groups, charitable organizations, faith-based organizations, professional associations, and foundations,”—“significant players in global development assistance.” The World Bank estimated that, as of 2006, civil society organizations “provided approximately . . . $15 billion in international assistance.”

II. NGOs and Corruption Risks

Many NGOs, especially those providing humanitarian assistance and engaged in development projects, operate in developing countries where they face the same risks as traditional business organizations. One of those risks is corruption. NGOs face two kinds of corruption-related risks. One is the risk of becoming an offender by paying a bribe to a government official, violating the FCPA or other anti-bribery laws. The other risk is becoming a victim of corruption, such as when the funds or assets of an NGO are misappropriated or otherwise misused.

A. The Risk of Violating Foreign Bribery Laws

Under the FCPA, mere status as an NGO does not exempt an entity from being subject to the anti-bribery provisions. NGOs fall into the category of “domestic concerns” subject to the anti-bribery provisions. No legal basis exists for distinguishing between a traditional commercial enterprise and an NGO in determining what qualifies as a "domes-
tic concern.”40 No “carve out,” “safe harbor,” or other express exception exists, nor does an exception exist for an NGO that is strictly charitable in nature.41

The definition of what constitutes a “domestic concern” is broad. In addition to “any individual who is a citizen, national, or resident of the United States,”42 a “domestic concern” includes “any corporation, partnership, association, joint stock company, business trust, unincorporated organization, or sole proprietorship which has its principal place of business in the United States, or which is organized under the laws of State of the United States or a territory, possession, or commonwealth of the United States.”43

Though not binding as precedent, in a recent Opinion Procedure Release the DOJ explicitly found a nonprofit organization to be a “domestic concern” subject to the terms of the FCPA’s anti-bribery provisions.44 It involved “a non-profit, U.S.-based microfinance institution . . . whose mission is to provide loans and other basic financial services to the world’s lowest-income entrepreneurs.”45 To support its mission, the microfinance institution received grants and investments from the “United States government, other governmental . . . aid agencies and development banks, nongovernmental organizations . . . and private investors.”46

Arguably, the only categorical exception may relate to whether the business of the NGO falls within the prohibitions of the FCPA’s anti-bribery provisions. No clarity is provided as to whether the business that is sought to be obtained or retained must be commercial in nature or whether it extends more generally to the business of an individual or entity. What constitutes “business” under the anti-bribery provisions has yet to be clearly defined.47 Neither the language of the statute nor the legislative history provide clear guidance as to whether activities of an NGO constitute “business” as that term is used within the context of the anti-bribery provisions.

While the legislative history of the anti-bribery provisions focuses on business in the classic commercial sense,48 the legislative history also demonstrates that “the business nexus requirement [was] not to be interpreted unduly narrowly.”49 “When the FCPA is
read as a whole, its core of criminality is seen to be bribery of a foreign official to induce him to perform an official duty in a corrupt manner."50 The FCPA was enacted not only because foreign bribery was “morally and economically suspect, but also because it was causing foreign policy problems for the United States.”51

Like the FCPA, none of the international anti-bribery conventions provides an express exception for NGOs. Of the three that the United States has ratified, the Organization for Economic Co-operation and Development Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention),52 the Inter-American Convention Against Corruption (OAS Convention),53 and the United Nations Convention against Corruption (UN Convention),54 all make reference to there being a need for a business or commercial nexus in order for the conduct to be prohibited. The OECD Convention and the UN Convention make specific reference to the prohibition applying to “the conduct of international business.”55 The OAS Convention refers to the prohibition applying “in connection with any economic or commercial transaction.”56

But the business nexus requirements of the most important of the international anti-bribery conventions, the UN and OECD Conventions,57 are not narrow in scope. The UN Convention expands on what may be viewed as a more customary definition of “international business” to include “the provision of international aid” within the meaning of “the conduct of international business.”58 The Interpretative Notes for the Official

50. Id. at 761.
51. Id. at 746.
55. OECD Convention, supra note 52, art. 1; UN Convention, supra note 54, art. 16.
56. OAS Convention, supra note 53, art. VIII.
57. The basis for giving primacy to the OECD and UN Conventions is summarized in the following:

The OECD Convention is narrowly tailored to focus specifically on bribery of foreign officials in the context of obtaining or retaining business. Given its narrow focus and its effective follow-up mechanism for ensuring active and uniform enforcement, the OECD Convention has already had a dramatic impact in a relatively short period on the number of countries actively investigating and prosecuting individuals and entities for improper inducements to foreign officials. As enforcement activity increases and as more countries accede to the OECD Convention, the body of law associated with the OECD Convention will become a principal resource for defining the international norm.

Due to its global nature, and the vast number of ratifications that have already taken place, the UN Convention . . . will play the critical role in the globalization of the international norms. Initially, the UN Convention will serve to expand the scope of cooperation and prompt the adoption of domestic legislation in parts of the world less inclined to participate in the other international and anti-bribery conventions. Over time, with the exception of the OECD Convention, the UN Convention will surpass many of the regional anti-bribery conventions in becoming the focus of [future] developments.


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Records, *Travaux Preparatoires*, of the Negotiations of the UN Convention (Interpretative Notes to the UN Convention), state that the “phrase ‘the conduct of international business’ is intended to include the provision of international aid.”\(^{59}\) By its very nature, the provision of international aid includes the work of NGOs in foreign settings.

The significance of the Interpretative Notes to the UN Convention cannot be overstated. The UN Convention is the only globally negotiated anti-bribery convention that addresses the bribery of foreign officials in the conduct of international business. With 154 parties, the UN Convention has been signed and ratified by most of the world and virtually the entire developed world.\(^{60}\) Notable is the absence of any reservations or declarations with respect to Article 16, the prohibition on the bribery of foreign officials in the conduct of international business.\(^{61}\) This includes the United States.\(^{62}\) The absence of any reservations or declarations is also likely to influence how the implementing legislation of many countries is interpreted and applied.\(^{63}\)

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\(^{59}\) Id.


\(^{61}\) See UN Convention, supra note 54.

\(^{62}\) See id.

\(^{63}\) See, e.g., United States v. Kay (*Kay II*), 359 F.3d 738, 756 (5th Cir. 2004). In determining that U.S. law fulfilled the obligations of the United States under the UN Convention without the need for implementing legislation, the Senate Report stated that “[n]o implementing legislation is required for the [UN] Convention.” S. Exec. Rep. No. 109-18, at 6 (2006), available at [http://ftp.resource.org/gpo.gov/reports/109/er018.109.txt](http://ftp.resource.org/gpo.gov/reports/109/er018.109.txt). “The United States of America declares that, in view of its reservations, current United States law, including the laws of the States of United States, fulfills the obligations of the [UN] Convention for the United States.” Id. at 10. There was no express reservation, declaration, or understanding directly addressing Article 16 of the UN Convention relating to transnational bribery. Id. at 9-10. U.S. ratification may thereby have implicitly broadened the construction to be applied to the business nexus requirement. Or, alternatively, the FCPA was, in effect, deemed to be already sufficiently broad to include such an interpretation. In the prepared remarks of Attorney General John Ashcroft associated with the submission of the UN Convention to the U.S. Senate for ratification, he specifically responded to a question as to the authoritative nature of the Interpretative Notes of the UN Convention. In his answer, he stated:

> The Interpretative Notes for the official records (travaux preparatoires) preserve certain points relating to articles of the instruments that are subsidiary to the text, but nonetheless of potential interpretive importance. In accordance with Article 32 of the Vienna Convention of the Law of Treaties, to which the United States is not a party but that reflects several commonly accepted principles of treaty interpretation, preparatory work such as that memorialized in the Interpretative Notes may serve as a supplementary means of interpretation, if an interpretation of the treaty done in good faith and in accordance with the ordinary meaning given to the terms of the treaty results in ambiguity or is manifestly absurd. Thus, the Interpretive Notes, while not binding as a matter of treaty law, could be important as a guide to the meaning of terms in the Convention and Protocols.

Id. at 60.

Prior to the U.S. ratification of the UN Convention, the settlement reached in United States v. Metcalf & Eddy, Inc., No. 1:99CV12566 (D. Mass., filed Dec. 14, 1999), reprinted in 5 FCPA Rep. 2d 699, 749, suggested that the FCPA’s anti-bribery provisions might extend to the provision of international assistance. In *Metcalf & Eddy, Inc.*, in providing foreign assistance to Egypt, USAID awarded contracts to Metcalf & Eddy, a
In terms of the OECD Convention, the OECD Working Group on Bribery in International Business Transactions (OECD Working Group) has “recommend[ed] that Canada amend its foreign bribery offence so that it is clear that it applies to bribery in the conduct of all international business, not just business ‘for profit.’”64 Under Canada’s Corruption of Foreign Public Officials Act “business” means any business, profession, trade, calling, manufacture or undertaking of any kind carried on in Canada or elsewhere for profit.65 The OECD Working Group emphasized that the OECD Convention “does not distinguish between ‘for profit’ and ‘not for profit’ business transactions.”66 It went on to explain:

Article 1 of the [OECD] Convention applies to bribery of a foreign public official “in order to retain business or other improper advantage” . . . The [OECD] Convention does not limit its scope to transactions that are profitable, and specifically includes benefits to the briber other than pecuniary gain. [T]he Convention applies to bribery by “any person” under Article 1, and “legal persons” under Article 2, without any qualification that the business carried out by the person or [the] nature of the legal person is or is not for profit. [Otherwise] . . . numerous organisations that, while not set up to make a profit for themselves, might still bribe in order to secure business, including state owned and controlled enterprises.67

The Council of Europe Criminal Law Convention (CoE Convention),68 one of the other major international anti-bribery conventions, contains no business nexus requirement. It requires parties to the CoE Convention to adopt “legislation and other measures as may be necessary to establish as criminal offences under its domestic law . . . [the bribery of] a public official of any other State.”69 The Explanatory Report to the CoE Convention emphasizes that there is “no restriction as to the context in which the bribery of the foreign official occurs.”70 Significantly, most Western and Eastern European coun-

U.S. company, for the construction, operation, and maintenance of wastewater treatment facilities for a local unit of government in Egypt. The chairman of the local unit of government did not participate in the evaluation of bidders for further work on the wastewater treatment facilities. But officials of Metcalf & Eddy knew that the chairman could influence his subordinates who were involved in the evaluation process and that the chairman could make his preferences known to USAID officials involved with awarding the contracts. Metcalf & Eddy provided the chairman and his wife and children with two trips in first class to the United States, which included travel to tourist destinations. He was also paid cash per diems despite having already been paid in advance for the trips.

64. OECD WORKING GROUP ON BRIBERY, PHASE 3 REPORT ON CANADA 4 (Mar. 18, 2011), available at http://www.oecd.org/document/46/0,3746,en_2649_37447_44572654_1_1_1_37447,00.html [hereinafter OECD Phase 3 Report on Canada]. The perspective of the OECD Working Group is particularly significant. It is the body that was principally responsible for drafting and negotiating the provisions of the OECD Convention.


66. OECD Phase 3 Report on Canada, supra note 64, at 10, ¶ 17.

67. Id. at 11, ¶ 21 (emphasis in original and footnote omitted).


69. Id. art. 5.

tries, including the United Kingdom, France, Switzerland, and Spain, have ratified the CoE Convention.\footnote{71\textsuperscript{71}}

In general, mere status as an NGO or a nonprofit organization is not likely to insulate an entity from the prohibitions of the FCPA and other foreign bribery laws. Moreover, many NGOs and nonprofit organizations compete directly against traditional for-profit organizations for USAID, World Bank, UNDP, and other entities’ contracts and grants. Indeed, activities of nonprofit organizations are often similar to or interchangeable with those of for-profit organizations.\footnote{72\textsuperscript{72}} As a result, NGOs and nonprofit organizations should be presumed to be fully subject to the anti-bribery provisions of the FCPA and other foreign bribery laws.

The facts and circumstances of a particular situation will ultimately determine whether all of the elements necessary for an FCPA or other foreign bribery law violation are present. Whether corrupt intent can be established is likely to be the critical factor.\footnote{73\textsuperscript{73}} But until a well-founded determination is made that the elements required for a violation cannot be met, an NGO must be presumed to be subject to the terms of the FCPA’s anti-bribery provisions and its foreign counterparts.

1. **Risks Factors**

How often do NGOs face corruption risks associated with violating foreign bribery laws and what factors determine these risks? In a limited survey of international NGOs (the survey),\footnote{74\textsuperscript{74}} the answers to the first question ranged from “never” to “all the time.”\footnote{75\textsuperscript{75}} The

\footnotesize{\textsuperscript{71}} Criminal Law Convention on Corruption, supra note 70 (charting signatures and ratifications). Though the United States has not ratified the CoE Convention, it is a signatory. \textit{Id}. \\
\footnotesize{\textsuperscript{72}} For example, the work of medical organizations, educational institutions, and adoption agencies is performed by both for-profit and nonprofit organizations. Nonprofits and NGOs with high pay scales for senior officials are also less likely to be perceived as being entirely charitable or humanitarian in nature. According to a \textit{USA TODAY} review, “[f]our chief executives whose government-funded non-profit corporations are paid to deliver U.S. foreign assistance earned more than half a million dollars in 2007.” Ken Dilanian, \textit{Review: High Salaries for Aid Group CEOs}, \textsl{USA Today}, Sept. 1, 2009, http://www.usatoday.com/news/world/2009-08-31-us-aid-groups_N.htm; see also Barrett, supra note 19 (listing salaries of the CEOs of the ten largest U.S. charitable organizations). The highest paid CEOs on the list are the President of American Cancer Society, at $1.3 million, and of United Way, at $715,000. In 2010, President of the American Red Cross received $995,718 in pay while the CEO of AED in 2009 was paid over $870,000 in total compensation. See Charity Navigator, American Red Cross Rating, http://www.charitynavigator.org/index.cfm?bay=search.summary&orgid=3277 (last visited June 22, 2011); CEO Update, 2011 Executive Compensation in Associations, http://www.ceoupdate.com/articles/articleDetails.htm?articleid=1720 (last visited June 22, 2011). \\
\footnotesize{\textsuperscript{73}} As the degree to which a nonprofit organization’s work is providing non-commercial humanitarian relief increases, the likelihood that an inducement will not be perceived as having the requisite corrupt intent also increases. A poignant example of the latter is a situation where payments are made to facilitate the movement of medical supplies or food to people in danger. The payment arguably falls within the duress exception that U.S. law and, especially, other common law jurisdictions generally recognize. See, e.g., \textit{Deming, supra note 57}, at 15. Practical realities associated with a jury trial may also bear upon the exercise of prosecutorial discretion in such a situation. \\
\footnotesize{\textsuperscript{74}} Survey of NGOs and Other Nonprofit Organizations on the Issue of Corruption and Anticorruption Compliance (Jan. 2011-Feb. 2011) [hereinafter Survey] (data on file with the authors). The survey was conducted by one of the authors on the condition that the information provided, as well as its source, would remain confidential. For the purpose of anonymity, survey participants will be referenced hereinafter as “Participant 1,” “Participant 2,” etc. when information obtained from a participant is referenced. \\
\footnotesize{\textsuperscript{75}} \textit{Id}.}
factors that were determinative of an NGO’s exposure to bribery risks include the nature of its activities, the countries it operates in, the structure of the organization, the pattern of communication with its field offices, and the level of internal reporting and other internal controls.  

The nature of an NGO’s activities is the most important factor in determining whether it will face significant bribery risks. An NGO that conducts, for example, environmental or conservation programs, provides education and vocational training, or organizes camps for children would be at a lower risk of violating the FCPA and its counterparts than an NGO involved with providing humanitarian aid or relief and development services. It matters little that both NGOs might be operating in the same high-corruption country. In contrast to a situation where an NGO sends experts, volunteers, and others to do the work and provide services, much greater opportunities are afforded to local government officials to demand improper payments when an NGO is distributing or awarding certain assets or funds.

The general level of corruption in a country raises a red flag. In countries where corruption is a way of life, local culture may be highly tolerant of graft, even tacitly approving of it as a means of survival. An NGO’s indigenous staff or its local partners may not see a problem with paying bribes, especially small ones, like facilitating payments, to “keep things moving.” As one survey participant noted, “[b]ribes may be paid on our behalf by local partners but we do not have an ability to monitor them.” Local employees and partners may also be highly susceptible to conflicts of interests. They may be subject to influence by family members, by tribal or ethnic groups, or by other relationships that may not be easy to discern. This may lead to the second type of corruption risks: the misappropriation or misuse of the funds and resources of an NGO.

Whether an NGO operates in a country perceived as being very corrupt is not, by itself, determinative of whether an NGO becomes subject to bribery demands. Though a country’s level of corruption certainly raises concerns as to possible corruption risks involved in operating in that country, it does not necessarily mean that the bribery risks are imminent. Two of the survey participants, an NGO engaged in environmental projects in a number of developing countries and an NGO working with young people and families on educational, recreational, and other similar programs in a multitude of countries, have never encountered demands for corrupt payments. On the other hand, another survey

76. Id.  
77. “[I]n general, a red flag is a set of facts that, in a given context, would prompt a reasonable person to have a basis for concern as to whether prohibited conduct took place or is intended or likely to occur.” DEMING, supra note 57, at 654.  
78. Survey, supra note 74, Participants 1 & 2.  
79. Id. Participant 2.  
80. See infra Part II.2.  
82. Survey, supra note 74, Participants 4 & 5.
participant stated, “every country we work in generates corruption-related concerns.”

Generally, the survey participants most frequently named African countries, Afghanistan, and Pakistan as the most difficult places in which to operate in terms of corruption risks.

The structure of the organization also plays a role in determining the level of risk of violating foreign bribery laws. More centralized NGOs with reasonable oversight by their headquarters appear to have lower risks than NGOs with a highly decentralized structure. This is particularly so where the NGO has a multitude of foreign offices with significant autonomy that are staffed, for the most part, with local employees. Similarly, NGOs relying heavily on indigenous NGOs to carry out their activities face greater chances of violating foreign bribery laws than NGOs that employ expatriates, at least in management positions.

Moreover, organizational structure influences patterns of communication between the headquarters and field offices. To reduce their risk, some NGOs actively pursue collecting compliance-related information and investigate complaints. But in highly decentralized NGOs, local offices have significant autonomy which extends, among other things, to what issues are reported to headquarters. Most problems are supposed to be addressed at the local level. As a result, headquarters may rarely hear compliance-related concerns from the field offices. If they do learn of them, it is several months later and often too late for headquarters to intervene. No common practice appears to exist among NGOs on the related issues of internal reporting and internal controls.

2. Types of Risks

The types of risks of violating foreign bribery laws faced by international NGOs vary according to the country and activities involved. Some organizations have to deal mostly with requests for what are often referred to as facilitating or expediting payments for such things as having documents approved, goods released by customs, or a license for a vehicle issued or renewed. Facilitating payments, typically relatively small in amount, are bribes “the purpose of which is to expedite or to secure the performance of a routine governmental action by a foreign official . . .” Under the FCPA, such payments are not prohib-

83. Id. Participant 1.
84. Id. Participant 2.
85. Id.
86. Id. Participant 3.
87. Id.
88. Id. Participants 1 & 3.
89. Id.
90. Id. Participant 1.

an action which is ordinarily and commonly performed by a foreign official in—
(i) obtaining permits, licenses, or other official documents to qualify a person to do business in a foreign country;
(ii) processing governmental papers, such as visas and work orders;
(iii) providing police protection, mail pick-up and delivery, or scheduling inspections associated with contract performance or inspections related to transit of goods across country;
(iv) providing phone service, power and water supply, loading and unloading cargo, or protecting perishable products or commodities from deterioration; or

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But other foreign bribery laws, such as the Bribery Act 2010 adopted by the United Kingdom (UK Bribery Act), do not contain exceptions for facilitating payments. Thus, authorities in the United Kingdom may prosecute a U.S.-based NGO with a U.K. branch for facilitating payments in a third country.

Other NGOs may see more serious extortionist demands, for example, from police or military at road checkpoints for the right to proceed further into the territory with humanitarian assistance or from local officials or tribal leaders eager to receive “their” share of food or other assistance. While some checkpoint demands may be satisfied with a payment as small as a twenty-dollar bill, other bribery requests may involve significant amounts of goods or money.

Some NGOs encounter even greater bribery demands. Anecdotal information indicates that occasionally, some NGOs get requests from senior government officials to pay significant bribes for the right to operate in their country. Though such demands are usually withdrawn, especially when major donors like USAID or the World Bank get involved, the mere existence of such demands is reflective of the gravity of corruption-related risks for NGOs.

B. The Risk of Becoming a Victim of Corruption

Despite the general unease among international NGOs regarding possible FCPA violations, outright requests for bribes do not appear to be their main corruption-related concern. Most NGOs’ primary compliance concerns are related to corruption in their programs and activities, such as diversion of aid, misuse of funds, fraud in procure-(v) actions of a similar nature.

Id. § 78dd-2(b)(4)(A).
92 Id. § 78dd-1(a), 2(a), 3(a).
95. Survey, supra note 74, Participant 1.
96. Id. Participant 2.
97. Theoretically, even a twenty-dollar payment can get an NGO in trouble. It would be a legal violation in the host country. For many countries, like the United Kingdom, that do not allow facilitating payments, it would also be a violation. The circumstances of the road checkpoint situation may also not fall within the FCPA’s exception for facilitating payments. See FCPA 15 U.S.C. § 78dd-2(b) (1998). The particular facts will dictate whether the circumstances fall within the category of expediting or securing “the performance of a routine governmental action.” Id. § 78dd-2(b), (f)(3).
98. Survey, supra note 74, Participant 1.
99. Id. Participant 3.
100. Id. Participants 2 & 3.
101. Id.
ment, fraud in reporting documents, and accounting irregularities. The consequences of corruption in these areas can be even more daunting for NGOs than the prospect of an enforcement action for an FCPA or other foreign bribery law violation.

Diversion and misuse of aid, when food, medicines, construction materials, and other items are sold for cash or otherwise embezzled or misused, occur frequently in international assistance programs. For example, the Global Fund to Fight AIDS, Tuberculosis and Malaria (Global Fund), financed by the United Nations, many national governments and private organizations, came to the spotlight in January 2011 after the Global Fund Inspector General’s report revealed that “as much as two thirds” of the Global Fund’s grants in Djibouti, Mali, Mauritania, and Zambia had been “eaten up by corruption.” The Associated Press story that broke the news cited forged or non-existing receipts for “training events,” forged signatures on travel and lodging claims, questionable bookkeeping, and outright theft. Subsequent audits uncovered more violations in other Global Fund programs. To date, the total amount of money lost to corruption stands at nearly $53 million.

In a recent case involving World Vision, a large California-based NGO subcontracting for a USAID project in Liberia, two of the organization’s Liberian managers diverted ninety-one percent of USAID-funded humanitarian aid for their personal benefit. As a result, USAID was defrauded of $1.9 million. An anonymous tip prompted an internal audit that uncovered the problem; both managers were later charged and convicted of fraud. World Vision had to reimburse USAID for the misappropriated funds.

According to one survey participant, fraud in reporting and accounting irregularities may range in scope from several hundred dollars to much greater amounts involving well-coordinated and systemic fraud schemes. The same is true about corruption and fraud in procurement, which may include collusion, favoritism, lack of transparency, fictitious bidders, bogus vendors, fake tender processes, overpricing, conflicts of interest, and lack

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102. Id. Participants 3 & 4.
103. Id. Participants 2, 3 & 4.
106. Id.
109. Press Release, Dep’t of Justice, supra note 108.
111. Id.
112. Survey, supra note 74, Participant 2.
of competition. Not infrequently, fraud is committed by the local employees or partners in collusion with local government officials. An example is the Academy for Educational Development (AED) programs in Afghanistan and Pakistan that caused USAID to suspend AED and the Global Fund’s projects in several African countries where local nonprofits fared no better, in terms of corruption and fraud, than government entities.

The consequences of this kind of corruption for NGOs are difficult to overstate. In December 2010, USAID suspended AED after uncovering “serious corporate misconduct, mismanagement, and a lack of internal controls that raise[d] serious concerns of corporate integrity.” USAID undertook a review of every program associated with AED. AED’s suspension prevented it from bidding on or receiving any further awards from the U.S. government. As a result, on March 3, 2011, after nearly fifty years in existence, thousands of development projects, and hundreds of millions of dollars in USAID funds, AED announced that it would sell its assets and dissolve itself. A single program termination was sufficient to bring the organization down.

C. Corruption-Related Risks: Traditional Business Organizations v. NGOs

Do NGOs face the same corruption-related risks as more traditional forms of business organizations? The answer is both yes and no. Obviously, both types of entities are sub-


116. Id.

117. Id.


ject to the FCPA and other foreign bribery laws. But, unlike issuers, which are publicly held companies that are required to register with the SEC, NGOs are not subject to the accounting and record-keeping provisions of the FCPA.

Otherwise, a number of factors are common for businesses and NGOs. Individuals associated with either type of entity, whether officers, directors, employees, or agents, can be prosecuted for violations of the FCPA and its counterparts in other parts of the world. If convicted, a business organization and an NGO can face serious fines, reputational damage, and debarment by governmental agencies, multilateral development banks, and other funding sources.

Yet for NGOs, the consequences of an investigation and conviction of a corruption-related offence, like foreign bribery, can be far more devastating. The biggest threat for most businesses is financial loss, whether stemming from the loss of business opportunities, profits, decline in stock price, or the impact of financial sanctions. Except for those businesses that rely heavily upon procurement opportunities, long-term survival is less likely to be in question.

For NGOs, the loss of reputation, and hence donor money, is most feared. In addition to being barred in many instances from pursuing grants, other charitable funding that is highly dependent upon goodwill can be expected to decrease or simply dry up as the result of a corruption-related investigation. Unlike most businesses, NGOs do not have a prod-

120. See discussion, supra Part II. NGOs are treated the same as more traditional business organizations in being “domestic concerns” under the FCPA. Foreign Corrupt Practices Act (FCPA), 15 U.S.C. § 78-dd (2) (1998).
121. See supra text accompanying note 5.
122. FCPA § 78m, ff; 17 C.F.R. § 240.13b2-1, 2 (2011).
123. E.g., FCPA § 78dd-2(a) provides:

It shall be unlawful for any domestic concern, other than an issuer which is subject to section 78dd-1 of this title, or for any officer, director, employee, or agent of such domestic concern or any stockholder thereof acting on behalf of such domestic concern, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to . . . any foreign official . . . .

Id. § 78dd-2(a) (emphasis added).
124. A host of statutes and regulatory regimes exist that provide for the debarment from government contracts of individuals and entities found to have engaged in fraud and other forms of corrupt conduct. See, e.g., 48 C.F.R. 9.406-2 (2011); see also Council Directive 2004/18, 30.4.2004 O.J. (L 134) 114-240 (EC) (on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts). The World Bank and many of the other multilateral lending institutions have instituted a series of procedures providing for debarment and cross-debarment of individuals and entities found to have engaged in fraudulent or corrupt activities. See, e.g., Stuart H. Dening, Anti-Corruption Policies: Eligibility and Debarment Practices at the World Bank and Regional Development Banks, 44 INT’L L. & POL’Y 871, 871 (2010).
uct to sell.\textsuperscript{127} In most situations, funding sources can look elsewhere for a vehicle to meet their needs or address issues of concern to them:

Aid agencies exist in a relationship with their public and funders where they are seen as holding funds in trust. They are the vital link between those with compassion and those with need. Those with compassion want their dollar to go to the needy and are perceived as only giving if they are sure their wishes are being met. Aid agencies feel they are caught in a bind. They seek to ensure that their reporting emphasizes how little they spend on overheads (to suggest that “every cent” goes to the needy), yet without systems of financial tracking, checks on authority, internal audits properly funded, and training and monitoring, aid may go astray.\textsuperscript{128} If an aid agency admits either internal corruption or being the victim of corruption, it risks losing the confidence of its aid provider public and thus its funding life-blood.\textsuperscript{129}

III. NGO Anticorruption Compliance Programs

Since NGOs face many of the same corruption risks as traditional business organizations, the remedy is also similar: putting in place a robust compliance program. A number of large, well-established NGOs now have, or are in the process of establishing, anticorruption compliance measures as part of their broader compliance programs. But unlike compliance programs at many large publicly held companies, anticorruption compliance programs at NGOs are generally a relatively new development.\textsuperscript{129}

Most of the major NGOs have policies that govern all their operations, including fundraising, delivering programs, meeting donor requirements, employment, finance, legal, and other issues. In addition, many of them have adopted codes of ethics or codes of conduct that govern conflicts of interest, whistleblower policies, and other corruption-related concerns.\textsuperscript{130} Global hotlines, both telephone and internet, are becoming more routine.\textsuperscript{131} Due diligence practices, however, seem to be at an early stage of development, with some NGOs only recently turning their attention to this aspect of compliance.\textsuperscript{132} Putting in place policies and procedures and other components of a compliance program are less challenging than conducting due diligence and actively monitoring and enforcing

\begin{itemize}
\item \textsuperscript{127} Due to the risk to their business, defense contractors have historically been at the forefront in addressing compliance issues relating to foreign bribery. Like many NGOs, they are highly dependent upon governmental sources of revenue. But, in many instances, the nature of their product, such as a sole-source contract, makes it less likely that the long-term survival of the business will ultimately be put in serious jeopardy.
\item \textsuperscript{129} Survey, supra note 74, Participants 1, 3, & 4.
\item \textsuperscript{130} Charity Navigator specifically includes this information in the “Accountability” section for each NGO it rates. See, e.g., Charity Navigator, Compassion International, http://www.charitynavigator.org/index.cfm?bay-search.accountability&orgid=3555 (last visited June 27, 2011).
\item \textsuperscript{132} Survey, supra note 74, Participant 3.
\end{itemize}
a compliance program. For some NGOs, the move towards instituting more formal compliance programs was driven by public revelations of questionable practices, pressure from major donors, or the prospect of losing USAID funding. “Compliance was a condition for improvement, for resolving critical issues,” said one survey participant referring to the problems his organization has encountered with one of the U.S. government agencies. Losing government funds can be deadly, as demonstrated by the recent demise of AED, one of the largest and oldest NGO contractors for USAID. Another major NGO, Oklahoma-based Feed The Children, was recently engulfed in a scandal that drew media attention due to its $1 billion budget and the global scope of its activities. Feed The Children’s board of directors, after ousting its charismatic president and facing a significant decline in donor support, put in place elements of a compliance program, including a new ethics policy, a nepotism policy, and a fraternization policy.

A. Anticorruption Compliance Programs for NGOs: General Considerations

The same general principles that apply to compliance programs of issuers and other companies that are subject to the FCPA and to the UK Bribery Act should apply to NGOs. Consideration also needs to be given to harmonizing compliance policies governed by the FCPA and the UK Bribery Act. The basic contours of an effective internal compliance program should resemble those set forth in the U.S. Federal Sentencing Guidelines for organizations and the U.K.’s Ministry of Justice’s Guidance issued in conjunction with the UK Bribery Act.

133. See discussion infra pp. 138-39.
134. Survey, supra note 74, Participant 2.
137. See, for example, the UK Bribery Act provides no exception, facilitating payments will need to be prohibited throughout an organization. Similarly, the UK Bribery Act’s prohibitions on improper inducements to private individuals or entities, often described as “private bribery,” will also need to be implemented throughout an NGO. Bribery Act, 2010, § 1 (U.K.), available at http://www.legislation.gov.uk/ukpga/2010/23/contents. On the other hand, since the definition of a foreign official is broader under the FCPA, prohibitions on the payment of improper inducements to foreign officials will need to include candidates as well as political parties and party officials. See Foreign Corrupt Practices Act (FCPA), 15 U.S.C. § 78dd-2(a)(2) (1998).
1. **Critical Components of an Effective Compliance Program**

In implementing a compliance program, the DOJ’s policy guidance must always be kept in mind. “[T]he critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether . . . management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives.”\(^\text{140}\)

It must determine whether a “compliance program is merely a ‘paper program’ or whether it was designed, implemented, reviewed, and revised, as appropriate, in an effective manner.”\(^\text{141}\)

The considerations for an anticorruption compliance program are essentially the same whether a traditional business organization or NGO is involved.\(^\text{142}\) A separate anticorruption compliance program is not required if an entity has in place an effective compliance program for other legal or policy concerns.\(^\text{143}\) An anticorruption compliance program can serve as an adjunct or a supplement to existing compliance programs.

a. **Proportionate Procedures**

An “organisation’s procedures to prevent bribery by persons associated with it” must be “proportionate to the . . . risks [of corruption] it faces and to the nature, scale, and complexity of the organisation’s activities.”\(^\text{144}\) The procedures must be tailored to meet the organization’s needs. They must be clear, practical, and relevant. Sufficient staff should be in place “to audit, document, analyze, and utilize the results of the [entity’s] compliance efforts.”\(^\text{145}\)

b. **Commitment from the Top**

An organization’s top management must be committed to preventing the prohibited conduct by individuals and entities associated with it.\(^\text{146}\) A “culture” of anticorruption compliance must be “fostered” throughout the organization and extend to its agents, consultants, and representatives.\(^\text{147}\) An effective compliance program must be more than a

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\(^{141}\) Id.

\(^{142}\) As was evident from the analysis in the opinion procedure release previously discussed regarding non-profit involvement with micro-financing in developing countries, many of the proactive measures discussed and recommended were essentially similar to those employed by more traditional business organizations. FCPA Review, 10-02 Op. Dep’t of Justice 5 (2010), available at http://www.justice.gov/criminal/fraud/fcpa/opinion/2010/1002.pdf; see also supra note 44 and accompanying text.

\(^{143}\) An organization’s compliance program should not necessarily be separate from its system of internal accounting controls. An effective system of internal accounting controls includes a range of review and approval guidelines designed to detect and deter questionable conduct. Indeed, the planning, implementation, and monitoring of a compliance program should be closely linked to, if not intertwined with, an entity’s system of internal accounting controls.

\(^{144}\) Bribery Act 2010—Guidance, supra note 139, Principle 1; see also U.S. SENTENCING GUIDELINES MANUAL, supra note 139, § 8B2.1, Applications Notes, § 2(A) (2011).

\(^{145}\) U.S. ATTORNEYS MANUAL, supra note 140, § 9-28.800.

\(^{146}\) Bribery Act 2010—Guidance, supra note 139, Principle 2; U.S. SENTENCING GUIDELINES MANUAL, supra note 139 § 8B2.1(b)(2)(B).

\(^{147}\) Bribery Act 2010—Guidance, supra note 139, Principle 2.
series of policies and procedures. Employees must be “adequately informed about the compliance program and [be] convinced of the [entity’s] commitment to it.” Sanctions must be enforced against senior and lower-level officials as well as employees, agents, and other intermediaries.

Genuine efforts also need to be made to ensure that anyone seeking, in good faith, to secure guidance or to make appropriate disclosures is not subject to retaliation. Procedures need to be put in place so that knowledgeable officials can quickly answer questions and respond to concerns. The procedures must not be cumbersome or perceived as being punitive in nature. Otherwise, guidance will not be sought and corrective action will not be taken.

c. Risk Assessment

The organization must assess the nature and extent of its exposure to potential external and internal risks of corruption of persons associated with it. “The assessment must be periodic, informed, and documented.” Factors and considerations can change over time.

d. Due Diligence

The organization must undertake due diligence procedures, taking a proportionate and risk-based approach. In each situation, the extent of the inquiry should be governed by the circumstances. But regardless of the context, due diligence must always be conducted in good faith. It cannot be perfunctory. “It requires a dispassionate consideration of all relevant factors.”

Due diligence “also entails determining whether the basis for concern is unfounded and, if not, whether effective means are available to avoid the risks associated with the concerns raised.” For example, written agreements by themselves seldom suffice, but they may deter prohibited conduct by incorporating a series of compliance measures and providing a basis for termination.

e. Communication and Training

An organization must ensure that its anticorruption policies and procedures are understood throughout the organization. Ongoing education and training must be proportionate to the organization’s risks. Compliance policies and procedures must be simple, clear, and readily available to individuals acting on behalf of the organization.

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149. See U.S. SENTENCING GUIDELINES MANUAL, supra note 139, § 8B2.1 (b)(6).
150. Id.
151. DEMING, supra note 57, at 650-51.
154. Id. Principle 4; see also U.S. SENTENCING GUIDELINES MANUAL, supra note 139 § 8B2.1(a)(1), (b).
155. DEMING, supra note 57, at 653.
156. Id.
158. DEMING, supra note 57, at 648.
159. Id.
effective, the policies and procedures must be understandable to a person unsophisticated or unfamiliar with the issues.

f. Monitoring and Review

"On an ongoing basis, [a] compliance program must be monitored, regularly reviewed, and modified as necessary to address weaknesses and to be made more effective."\(^\text{160}\) The challenge is to develop a compliance program that effectively addresses areas of concern without becoming unduly burdensome, unresponsive, and unable to adjust to ever-changing needs.

2. NGO Compliance Programs: Challenges

In practice, what do NGO anticorruption compliance programs look like?\(^\text{161}\) Are they in fact similar to their counterparts at business organizations? If not, what accounts for the difference? And what challenges do NGOs face in anticorruption compliance?

According to the survey, anticorruption compliance programs at large NGOs are generally similar to those established by major U.S. corporations.\(^\text{162}\) Typically, they include general information about corruption and an explanation of the FCPA; things to watch for, like red flags; instructions on what to do in certain circumstances; an internal reporting system, including a telephone and internet hotline; and rules on the investigation and punishment of those who violate the NGO’s policies.\(^\text{163}\) This is accompanied by in-per-
son and other forms of training, including, in some NGOs, “electronic training,” with the help of written materials developed at the NGO’s headquarters.164 The goal is to raise the staff’s corruption and fraud awareness and to teach them how to deal with corruption-related situations.165 As one of the survey participants stated, “[i]f our people must pay, they need to get approval from a high-level person and record the payment properly.”166

When asked to compare their compliance programs with those of business organizations, some survey participants saw only one difference—a lack of concern about complying with the accounting and record-keeping provisions of the FCPA.167 Other participants perceived a major distinction between the nature of activities carried out by businesses and NGOs resulting in different compliance risks.168 Yet most participants in the survey stated that the most significant difference is the degree to which there is a lack of funds and capacity. These are two of the principal factors that significantly lower the effectiveness of NGO anticorruption compliance programs.169

To attract donor money, NGOs need to demonstrate that they have reduced their expenses to the absolute minimum. According to the Forbes Charity 200, among large U.S. NGOs, the average charitable commitment, “calculate[d] as how much of a charity’s total expense went directly to the charitable purpose . . . as opposed to management, certain overhead expenses and fundraising,” in 2010 was 86%.170 Some charities survive and operate on much less than 14%.171 For example, the top four charities in the Forbes list,172 in terms of charitable commitment, have an efficiency rate of 100%.173 All four of these charities concentrate their activities on “international needs.” The next eleven charities on the list, ten of which are international in orientation, have a charitable commitment rate of 99%.174

Since most donors give money for specific projects and programs and not for general operations, they want their donations spent on aid and other forms of assistance. This means that there is practically no money for compliance.175 Unrestricted grants that NGOs could use to build and operate compliance programs are scarce, and there are always many competing demands. With the attitude often being, “[t]his stuff does not apply to us,”176 anticroruption compliance rarely tops the list of the most urgent or vital needs to win these funds.177 Lack of reliable information about what is going on in the

164. Id.
165. Id. Participant 1.
166. Id.
167. Id. Participant 4.
168. Id. Participants 1 & 3.
169. Id. Participants 1, 2 & 3.
171. Id.
172. Id.
174. Id.
175. Survey, supra note 74, Participants 1, 2 & 3.
176. Id. Participant 1.
177. Id. Participants 1 & 2.
field also makes it difficult to compete for funds. As one survey participant explained, “to argue for the [FCPA compliance] budget, for funds for training and so on, I would have to present the board with a report justifying the need. It would be difficult for me to come up with such a report due to the lack of information.”

Similarly, only a few donors are prepared to pay for anticorruption training and education. Again, NGOs must take money for these programs from other sources, like the same rarely available unrestricted grants. Some NGOs include anticorruption and antifraud components in the training programs for their procurement officers and internal auditors, but even that does not appear to be prevalent in many NGOs.

Some NGOs do not even train their country leaders in anticorruption and fraud detection matters. With some NGOs having difficulties in “getting local staff with capacity to perform, especially in post-conflict countries where educated people have not been produced for decades,” they often have to start with general education of their local employees before more complex compliance issues, like anticorruption and antifraud, can be addressed in their training programs. Education and skill level of the local staff seems to be major issues for NGOs operating in developing countries. Overall, the majority of the survey participants recognized that the lack of formal anticorruption and other compliance-related training and education represents a major gap in their compliance programs.

An insufficient number of internal auditors and forensically-trained accountants is another consequence of a lack of funding for compliance-related issues. Many NGOs employ staff accountants who conduct audits of their programs, including in overseas offices. But these are regular accountants who have no special training in uncovering fraud or other financial irregularities. The result is that many instances of corruption and fraud may go undetected. Even if they are discovered, the headquarters office may never hear about them, or hear several months later because of problems in the organization’s structure, namely the significant autonomy of country offices and patterns of limited internal communication.

Plus, in an emergency response, such as when a major disaster strikes a country, NGOs delivering humanitarian aid must hire local staff very quickly. In these circumstances, they have no time to do any sort of background or reputational check and no chance to get to know the people involved, which may mean that some of the local staff may sell aid for cash or otherwise misappropriate it. But even when there is no urgency, it may be

178. See supra notes 88-89 and accompanying text.
179. Survey, supra note 74, Participant 2.
180. Id. Participants 1 & 2.
181. Id. Participant 2.
182. Id.
183. Id.
184. Id.
185. Id.
186. Id.
187. Id. Participant 3; see also generally supra notes 88-89 and accompanying text.
188. Survey, supra note 74, Participant 3. An experienced practitioner in the sector noted that in a response to an emergency,
nearly impossible in some countries to have a reliable background check performed even on key local employees. NGOs instead rely on word of mouth to gain a sense of a situation.

Having a very lean administrative structure also means that NGOs often do not have people dedicated specifically to compliance work. Most NGOs have an operations officer and a general counsel who handle all kinds of issues, including compliance. Inadequate understanding among the NGO’s senior staff of “what a compliance program is about” sometimes means that the compliance officer may get a lot of other work sent to him or her, thus limiting the time the officer can spend on compliance issues and reducing the overall efficiency of the program. Only a few large NGOs have one or two dedicated compliance officers. As one survey participant put it, “[o]ne person (myself) is reaching out to [several dozen] field offices.”

This outreach is not always easy. As several survey participants pointed out, it is hard to explain the jurisdictional reach of U.S. anti-bribery laws to foreigners, especially if the local culture is conducive to corruption. Even more difficult is to make these persons comply. The problems may range from foreign employees ignoring the headquarters’ compliance procedures to much more complex situations, like one described by a survey participant:

How do you communicate to the lower level and local employees that we need to comply with law no matter what? We work in dangerous places. Our people travel around countries where bad guys are. If they are stopped at a checkpoint and a police officer asks for $20 before he allows them to continue their travel, or they are under a gun, would you not pay? How do you say, “You need your superior’s approval for such a payment,” if you are under a gun? And then, if you give permission to pay under certain circumstances—will it not undermine the general message of compliance?

Since anticorruption compliance creates extra work for overseas offices, local staff can often be reticent to become actively involved. “People want to do [projects], not paperwork.” Compliance may also strain the NGO’s relationship with local officials. “When we invite a foreign government official to attend our workshop, we require additional information and additional paperwork [to comply with the anti-bribery part of the NGO’s compliance program], and they don’t like it.”

agencies found themselves spending months if not years trying to undo the webs of nepotism and minor exploitation they had inadvertently put in place. Other issues apply to the rapid buildup of international staff where, because of a lack of available experienced personnel, relatively inexperienced agency staffers may find themselves administering relatively large and complex operations.

Walker, supra note 128, at 99.
189. Survey, supra note 74, Participant 2.
190. Id. Participant 3.
191. Id. Participant 2.
192. Id. Participant 3.
193. Id. Participants 3 & 4.
194. Id. Participant 1.
195. Id. Participant 4.
196. Id.
Administering programs funded by different donors, each having different requirements as to how “their” programs must be administered, means that, in practice, NGOs often must comply with many arbitrary requirements.197 As one survey participant put it,

One grant may require the approval by the central staff of all purchases over $10,000 while the other one, of all purchases over $25,000. One grant may require direct reporting of corruption issues; the other may not. These requirements are more difficult to meet as our operations are scattered around many countries.198

Such arbitrary obligations put additional strain on the already lean administrative staff of most NGOs. It is not surprising that some NGO representatives bemoan a bygone time when USAID was their only donor and the NGO had to comply with a single standard.199

These are some of the reasons why compliance programs at NGOs may seem “soft” compared to those of business organizations. With funding and staffing shortages, compliance programs must rely heavily on the personal contacts that the compliance officer, general counsel, or assistant general counsels establishes with the employees in overseas offices. One survey participant stated:

The way I operate, I create a contact, a network of people in the field offices who are conducive to what I do, and I work with them . . . We gather information, reach out and build relationships with local officers . . . I work less formally than a business compliance officer would.200

Another survey participant, whose organization has one of the most advanced global compliance programs in the sector, echoes this statement: “[w]e have compliance coordinators in all regions where we operate . . . But, these are not formal positions. They are just helping us. We are also supported by a number of lawyers and the HR department.”201 Internal auditors may be used to communicate the compliance message to local staff when they “go to the field offices and explain policies, rules, and legal issues.”202 In the end, reliance on personal contacts and informal cooperation tends to weaken the effectiveness of a compliance program as compliance turns into a voluntary, rather than obligatory, matter.

The semi-voluntary character of compliance at some NGOs is underscored by their reluctance to issue firm anticorruption and, sometimes, other compliance-related guidelines for their overseas offices, relying instead on the “good judgment of local senior management.”203 As an alternative to firm guidance, compliance programs may contain a set of recommendations on how to act in certain situations. In the words of one survey participant, “[w]e issued the FCPA guidance but did it cautiously. We like to be consulted in case of a problem rather than issue firm requirements. We also described the record-keeping requirements and asked to inform the regional controller in case of problems.”204

197. Id. Participant 2.
198. Id.
199. Id.
200. Id. Participant 3.
201. Id. Participant 4.
202. Id. Participant 3.
203. Id.
204. Id. Participant 2.
As was mentioned earlier, such consultations are not always possible; therefore, decisions made in loco may not be the ones that the headquarters would prefer.

IV. Conclusion

The dangers of corruption in NGO projects and the consequences of such corruption are ever-present and may cost NGOs their reputation, funding sources, and donors. International NGOs also increasingly fear the risks of violating foreign bribery and other anticorruption laws.

Yet the mood in the international non-profit circles appears to be that of general concern and cautious waiting. One survey participant reported that “[e]verybody in our space is concerned . . . It is a matter of time before the attention [of the Department of Justice] will be turned to NGOs.” Another noted, “[w]e are watching the UK Bribery Act closely as perhaps it applies to NGOs.” Still another survey participant is sure that “USAID will keep pressure on the NGOs it works with,” demanding greater accountability. But there also seems to be a consensus that “without a lawsuit, an indictment, or debarment, nonprofits will do little in this area.”

Special protective legislation is not suggested for NGOs. Unlike most industries, NGOs with a truly charitable nature are unlikely to be targeted by enforcement authorities for foreign bribery violations. A public backlash and considerable political fallout from such an agenda can be expected. Practical considerations such as the receptivity of juries and judges are also likely to discourage the targeting of NGOs in general. But in egregious situations, enforcement authorities will not, and cannot be expected to, overlook clear violations, even for NGOs that undertake the most laudable of missions.

For NGOs that are not fundamentally of a charitable nature, and that compete with more traditional business organizations, the DOJ can be expected to be aggressive in its enforcement efforts when warranted by the facts and circumstances. While it is less clear what enforcement officials will do in other jurisdictions, over time NGOs can and should

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205. See supra notes 88-89 and accompanying text.
206. As an indicator that the time for anticorruption compliance at NGOs has arrived, the roundtable on the FPCA and anticorruption good practices in the NGO sector, organized last November by InsideNGO, an umbrella organization for the international relief and development nonprofit community, attracted representatives from about two dozen NGOs. Survey, supra note 74, Participant 1.
207. Id. Participant 3.
208. Id. Participant 2.
209. Id. Participant 2.
210. Id. Participant 3.
211. Id. Participant 1.
212. The underlying basis for the FCPA and other anti-bribery legislation should apply equally to NGOs. If the NGOs objectives are truly laudable in nature, no basis should exist for the payment of a bribe. Whether it is in the form of exercise of prosecutorial discretion, an absence of the requisite elements to establish a violation, or the duress or necessity exceptions, sufficient flexibility currently exists to address extraordinary situations. Moreover, NGOs have not been subjected to a history of unwarranted prosecutions. To the contrary, an NGO has not been charged to date with a violation of the FCPA. If any special legislation or regulations were to be considered, they would relate to requiring that sufficient resources be dedicated to addressing compliance needs.
be expected to be fully subject to investigations and enforcement actions. In general, NGOs can expect to face increasingly greater scrutiny.

International NGOs are also more likely to be targeted by donors and other funding sources for corruption in their programs and activities. The unique position of many NGOs, being almost solely dependent on donors as well as governmental and quasi-governmental funding sources, dictates the need for greater accountability with a particular focus on anticorruption compliance. Despite the lack of resources and an assortment of challenges, NGOs must find efficient and cost-effective ways to implement and enforce compliance programs that adequately address their corruption risks. The key for the international NGO community is to be proactive and not reactive.
Not Ready for Change? The English Courts and Pre-Contractual Negotiations

FRANCIS N. BOTCHWAY* AND KARTINA A. CHOONG**

Abstract

The law relating to contractual interpretation in England and Wales is leaning increasingly towards a context-based approach. Despite this, pre-contractual negotiations are generally inadmissible as an aid to interpretation. This somewhat anomalous situation has drawn criticism from many commentators. Recently in Chartbrook Ltd. v. Persimmon Homes Ltd., the House of Lords again endorsed the status quo, seeing no reason to depart from tradition. This paper argues that this stance is incompatible not only with the contextual paradigm but also with the approach adopted in other jurisdictions, and needs to be modernized. Further, as domestic courts at lower levels are already admitting such evidence in various circumstances, this paper argues that the courts should remove the rule because it inhibits their ability to do this clearly, efficiently, and fairly. Courts can deal with any concerns about cost and delay by effectively using the Civil Procedure Rules of 1998.

I. Introduction

Disputes about the meaning of express contractual provisions furnish one of the main sources of contemporary contractual litigation.1 In the effort to interpret these provisions, English law tends to exclude pre-contractual negotiations from consideration in spite of an otherwise increasingly context-based approach to contractual interpretation.2 Views as to whether this is the most conducive approach to take have remained divergent. While some jurists and commentators are firmly of the view that courts should never consider extrinsic evidence when construing contracts, others espouse a different perspective on the

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2. See discussion infra Section II.
matter. The House of Lords steadfastly defended the status quo when the opportunity for debate was reopened recently by the case Chartbrook Ltd. v. Persimmon Homes Ltd. This unfortunate stance on the practice in England and Wales needs to be brought in line with the practices in Europe and other major jurisdictions in the world to bring England and Wales in line with commercial reality in the Twenty-First Century.

Section II looks closer at the range of opinions on the issue of contract interpretation. It discusses the reasoning underlying the positions taken by the traditionalists and the reformists. Section III reviews the Chartbrook case and considers the House of Lords’ arguments for the rule’s preservation. It focuses on the lead judgment delivered by Lord Hoffmann, asking what it is about the principle that merits retention in England and Wales but not in Continental Europe or international treaties. In addition, Section III highlights the extent to which Lord Hoffmann’s view of extrinsic evidence derives from his general posture on certainty, discernible in his previous cases. In contrast to this theoretical inflexibility, this paper highlights situations where courts in England, Wales, and elsewhere are already making inroads into the exclusionary rule, using this trend as context to argue why the courts should give explicit recognition to an otherwise prevalent practice. Section IV highlights the need for greater emphasis on the significance of approaching each set of circumstances differently in lieu of a uniform, blanket exclusion. Finally, attention is drawn to circumstances where the exclusionary rule can be waived or excepted. Section V concludes the discussion.

II. The Exclusionary Rule

With the exception of standard form contracts and simple transactions, contracts can be preceded by lengthy and complex negotiations. Contracting parties, despite their utmost efforts at drafting, are sometimes not able to achieve the precision that would insulate them from ensuing conflicts over the meaning of the words used in their contracts. Occasionally, disputes that arise from diverging interpretations result in litigation. A court’s task when called to adjudicate the dispute is to ascertain the common intention of the parties by using the contract language. English law does not seek to identify what the

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3. Formerly the highest appellate court in England and Wales, the House of Lords was replaced in this capacity by the U.K. Supreme Court on October 1, 2009. See U.K. Supreme Court Website, http://www.supremecourt.gov.uk/about/the-supreme-court.html (last visited May 15, 2011).


5. His Lordship’s position in this case, compared with his views elsewhere, especially in Investors Comp. Scheme Ltd. v. W. Bromwich Bldg. Soc’y (ICS), [1998] 1 W.L.R. 896 (H.L.) (U.K.), and in Pepper v. Hart, [1993] 1 A.C. 593 (H.L.) (U.K.), offers interesting material for analysis in legal theory, particularly in Duncan Kennedy’s “indeterminacy” mode or Terry Eagleton’s “self-consciousness or self-reflectiveness” by adjudicators. See generally DUNCAN KENNEDY, A CRITIQUE OF ADJUDICATION (1997); TERRY FRANCES EAGLETON, THE IDEOLOGY OF THE AESTHETIC (1990); JEROME FRANK, LAW AND THE MODERN MIND (1910); AMERICAN LEGAL REALISM (William W. Fisher III et al. eds.) (1993). It can be argued at one level, as we have done in this article, that he was being consistent. At another level, it can be contended that he reflected on his decision in ICS and the hints he gave of the need to review the exclusionary rule, and decided he needed to rein in any excessive exuberance. For a more nuanced model, see Chris Guthrie, Jeffrey J. Rachlinski & Andrew J. Wistrich, Blinking on the Bench: How Judges Decide Cases, 93 CORNELL L. REV. 1, 1 (2007).

parties actually intended by the words they have used or the meaning as understood by the hearer or reader. Rather, the goal is to ascertain what a reasonable person, in the position of the parties, would understand as the intended meaning of the words. To identify this objective meaning, Lord Wilberforce sitting in the House of Lords in the 1971 case *Prenn v. Simmonds,* stressed that a court, as the embodiment of the reasonable person, needs to situate itself in the same factual matrix as that of the parties at the time of the contract. The House gave a ringing endorsement of this contextual stance in both *Investors Compensation Scheme Ltd. v. West Bromwich Building Society (ICS)* and *Bank of Credit and Commerce International SA (In Liquidation) v. Ali (No. 1).* In both cases, Lord Hoffmann explained that although courts should extend the matrix of fact to include “absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man,” the term “absolutely anything” refers only to anything that the reasonable person would regard as relevant.

Thus, because the relevance of the evidence to the objective setting of the contract determines its admissibility, courts have ruled that they cannot consider the parties’ prior negotiations when construing contracts. Prior negotiations are admitted and used “only in an action for rectification.” The logic behind this so-called “exclusionary rule” is that if actual intention is irrelevant in contract interpretation, “pre-contract negotiations as a revelation of actual intention must likewise be equally irrelevant,” lest they undermine the objective basis of the interpretation exercise. Further, the evidence of earlier exchanges has been depicted as unhelpful since the parties’ positions are continually changing until the final decision is made. These exchanges therefore do not convey the common intention of the parties when they make the contract. Only the final document records a consensus, so courts should confine admissible evidence to the factual background known to the parties at the date of contract.

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18. Nicholls, supra note 8, at 582.
21. Staughton, *supra* note 6, at 305-06.

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Above all, it has been claimed that the rule is significant for reasons of practical policy. First, since negotiations leading to major contracts could generate a large amount of material, trawling through the material could add to the length and cost of trials. In addition, the rule promotes certainty because third parties who subsequently acquire the interests of the original contracting parties only have access to the final written document, not to the contents of the pre-contractual negotiations.

There is nevertheless disquiet among academics, jurists, and practitioners about the defensibility and sustainability of the exclusionary rule. This disquiet was deepened when, in the celebrated ICS case, Lord Hoffmann hinted that the boundaries of the exclusionary rule are “unclear” and that there would be occasion to “explore them.” Several commentators took up the challenge to explore or revise the exclusionary rule. Gerard McMeel, for instance, highlighted how the rejection of extrinsic evidence as a tool for construction has resulted in a requirement of judicial “tunnel vision.” This could produce injustice when credible evidence of a prior consensus between the contracting parties is available. This concern is shared by David MacLauchlan, who characterized the approach as conservative and emphasized how extrinsic evidence may sometimes serve as a reliable guide to the parties’ intention at the time of the contract. When it does, Steven Gee opined, a court has the responsibility to put into effect the parties’ true intent and meaning, rather than to dictate terms and hold them bound by something to which they never agreed. Moreover, at the inaugural John Lehane Memorial Lecture, Lord Steyn described the rule as restrictive and called for the adoption of a more radical approach.

Lord Nicholls, also speaking extra-judicially, argued that this area of the law needed to be re-rationalized. Describing the idea that the notional reasonable person should have available to him only “some, but not all, of the relevant facts” as being difficult to justify and even bordering on absurdity, he questioned “why in principle an essentially artificial barrier should be erected against its use” when this could potentially be “the best evidence of all . . . .” The preferable approach, according to Nicholls, is to openly acknowledge that such evidence is relevant and admissible if it holds the potential to assist the reasonable person in interpreting the contract.

24. Id. at 389-90.
25. See id. at 382.
26. Id. at 389.
29. Id. at 294.
33. See Nicholls, supra note 8, at 581.
34. Id.
35. See id. “[W]hen there is evidence which would afford useful insight,” he stridently remarked, “why should the judge have to guess when he can know?” Id.
36. Id. at 583.
37. Id.; see also Felix Frankfurter, Some Reflections on the Reading of Statutes, 47 Colum. L. Rev. 527-546 (1947).

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The palpable lack of consensus on the matter therefore cries for further work. However, Chartbrook may have wasted an opportunity to work through these issues. This discussion turns to that question next.

III. Chartbrook: A Missed Opportunity

A. The Facts

This interesting case involved the interpretation of an overage provision in a contract concerning the development of a site owned by Chartbrook Ltd. in Wandsworth, United Kingdom. In 2001, Chartbrook hired Persimmon Homes Ltd. to build, at Persimmon’s expense, a mixed residential and commercial development on the land. In exchange, Persimmon would be entitled to all sale proceeds less any amount due to Chartbrook. According to the schedule of their written contract, the amount due to Chartbrook was the aggregate of two elements: the Total Land Value and the Balancing Payment. Defined by the schedule as the Additional Residential Payment (ARP), the Balancing Payment was expressed as 23.4% of the price achieved for each residential unit in excess of the minimum guaranteed residential unit value (MGRUV), less the costs and incentives (C&I).

Chartbrook contended that it understood this provision to mean a guaranteed minimum amount and an additional amount based upon a percentage of the amount by which the net residential sales revenue exceeded the guaranteed minimum amount. Using this calculation, the ARP would have been approximately £4.5 million. Persimmon, on the other hand, argued that the reason for dividing the price into Total Land Value and ARP was to give Chartbrook a minimum price for its land and to make an allowance for an increase if the market rose. Hence, to Persimmon, Chartbrook should have received the greater of a fixed percentage of the net sales revenue or a minimum guaranteed amount; following its calculation, the ARP would only be around £900,000, an amount they had already paid to Chartbrook.

Thus, around £3.6 million was riding on the interpretation. Chartbrook brought the case to court to claim the additional amount it insisted was due. Persimmon asserted it could produce evidence that would demonstrate that on two distinct occasions a detailed agreement was reached saying that ARP was to be calculated according to Persimmon’s understanding. It invited the courts to overturn the exclusionary rule in interpreting the

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39. Id.
40. Id.
41. This element did not give rise to any undue complications.
43. Id. at 1110-11.
44. Id. at 1111.
45. In formulaic terms, this was represented as follows: ARP = 23.4% x (Unit Price–MGRUV–C&I).
47. Id.
48. In formulaic terms, ARP was therefore (23.4% x Unit Price)—MGRUV—C&I.
50. Id. at 1115.
contract; Persimmon also pleaded a claim for rectification in the alternative in the event
that the courts upheld Chartbrook’s position.51

Both the High Court52 and the Court of Appeal53 upheld Chartbrook’s interpretation
but the House of Lords unanimously overturned it. Lord Hoffmann emphasized in his lead
judgment how a reasonable person with knowledge of the background would deem the
ARP payable if “the project performs better than is currently anticipated.”54 To him, the
term MGRUV strongly indicated that the deal was meant to be a guaranteed minimum
payment for the value of the land in relation to an individual flat; it also signified the
possibility of a larger payment that may not happen.55 The element of contingency, His
Lordship pointed out, was underscored by Paragraph 3.3 of Schedule 6, which stated the
“date of payment if any of the balancing payment;” this interpretation, found in Persim-
mon’s favor, was determinative of the appeal.56 The House of Lords nevertheless re-
sponded to the issue, raised by Persimmon, of whether a court should only look at the
final version of contractual documents or if it could also look into pre-contractual
negotiations.

B. PRIOR NEGOTIATIONS: THE STATUS QUO DEFENDED

Lord Hoffmann, in what turned out to be his last case as a Law Lord, described the
matter as one of “very considerable general importance.”57 However, he dampened
swiftly any optimism of a fresh and sustained debate by dismissing vigorously the call for a
change in the exclusionary rule. Reaffirming his earlier pronouncement in the ICS case,
he stressed not only that the rule has “been in existence for many years,”58 but that there
are pragmatic reasons for its preservation, including the limited utility of previous negoti-
ations, the need to contain costs, and to promote certainty, particularly where third parties
are concerned.59 Any injustice arising from its application would be tempered by the
availability of rectification. Change was, as the rest of the judges concurred, neither war-
ranted nor commendable. Yet in the case itself the need to admit evidence of pre-contrac-
tual negotiations was necessary. Indeed, Baroness Hale admitted that she relied on the
evidence of pre-contractual negotiations to reach her decision in favor of Persimmon.60
This, without a doubt, lent credence to the basis for the dissenting judgment in the Court
of Appeal where Lawrence Collins LJ observed:

[E]very contemporary document prior to the conclusion of the agreement, and every
piece of paper which throws light on the commercial purpose of the provision, sup-
ports Persimmon’s case that the deal which was on the table was Persimmon’s offer

51. Id.
52. Chartbrook Ltd. v. Persimmon Homes Ltd., [2007] EWHC 409 (Ch.) (Eng.).
53. Chartbrook Ltd. v. Persimmon Homes Ltd., [2008] EWCA Civ. 183 (Eng.) (Lawrence Collins LJ
dissenting).
55. Id. at 1112.
56. Id.
57. Id.
58. Id. at 1121.
59. Id. at 1118.
60. Id. at 1136.
to Chartbrook of either a fixed percentage of the sales revenue or the minimum guaranteed amount, whichever was the greater.61

Lord Hoffmann, however, held strenuously to the exclusionary rule. This is not the first time His Lordship has proceeded this way. Both an examination of cases where Lord Hoffmann played a leading role and his extra-judicial pronouncements indicates that he has held a consistent position regarding the admissibility of extrinsic evidence in the adjudication of contentious executed instruments. Since the 1992 landmark House of Lords decision in Pepper v. Hart62 to admit Parliamentary Hansard as a statutory interpretation aid, Lord Hoffmann has been one of the jurists leading the charge against the excesses of the Pepper v. Hart rule, calling for its limitation or abolition.63 He was the first to write, in a 1997 article, that his experience revealed efficiency concerns and other practical difficulties in relying on the Pepper v. Hart rule.64 He suggested, inter alia, limiting the rule to defensive estoppel situations to prevent a minister from retreating from statements made in Parliament.65 He continued this quest in a number of cases in which the rule was invoked.66

More relevant for this paper is His Lordship’s position in the case Union Eagle Ltd. v. Golden Achievement Ltd.67 When the buyer of a Hong Kong flat paid the deposit ten minutes after the contractually mandated 5:00 P.M. deadline, the seller exercised his option to rescind the contract and require the buyer to forfeit the deposit. The resulting litigation ended up in the Privy Council, where Lord Hoffmann rejected the call to apply equitable principles of unconscionability to remedy the contract on practical business considerations.68 He said:

[I]t is of great importance that if something happens for which the contract has made express provision, the parties should know with certainty that the terms of the contract will be enforced. The existence of an undefined discretion to refuse to enforce the contract on the ground that this would be ‘unconscionable’ is sufficient to create uncertainty. Even if it is most unlikely that a discretion to grant relief will be exercised, its mere existence enables litigation to be employed as a negotiating tactic.69

This statement illuminates that Lord Hoffmann’s goal in continuing to uphold the exclusionary rule was to protect the sanctity and certainty of contracts and business expectations and to avoid the manipulation of the negotiation process. These goals were the motivation behind his decline to revisit the exclusionary rule in Chartbrook.

64. Lord Hoffmann, The Intolerable Wrestle with Words and Meanings, 114 S. AFR. L.J. 662, 668-69 (1997).
65. Id. at 669.
68. Id. at 517.
69. Id. at 519.
In *Chartbrook*, His Lordship relied on the following speech by Lord Blackburn in the 1877 case *Inglis v. Buttery*\(^70\) to argue that the exclusionary rule has a long history:

[W]here parties agree to embody, and do actually embody, their contract in a formal written deed, then in determining what the contract really was and really meant, a Court must look to the formal deed and to that deed alone. This is only carrying out the will of the parties. The only meaning of adjusting a formal contract is, that the formal contract shall supersede all loose and preliminary negotiations—that there shall be no room for misunderstandings which may often arise, and which do constantly arise, in the course of long, and it may be desultory conversations, or in the course of correspondence or negotiations during which the parties are often widely at issue as to what they will insist on and what they will concede. The very purpose of a formal contract is to put an end to the disputes which would inevitably arise if the matter were left upon verbal negotiations or upon mixed communings partly consisting of letters and partly of conversations. The written contract is that which is to be appealed to by both parties, however different it may be from their previous demands or stipulations, whether contained in letters or in verbal conversation.\(^71\)

It is regrettable that His Lordship made no mention of the lead judgment delivered by Lord Hatherley in the same case. While Lord Hatherley did comment on the exclusionary rule, he did not articulate it as strongly as Lord Blackburn did. Besides, Lord Hatherley stated at the outset:

There has been a good deal of evidence adduced with the view of expounding the contract, not for the purpose of explaining the meaning of particular technical phrase used in the contract, which is a purpose for which it is quite legitimate to use external evidence; but where the words of the contract are not themselves in any way technical, but are plain and simple language, at all events, so plain and simple as to require no aid of testimony specially to explain them,—in that case it is not legitimate to introduce parol testimony to say what the meaning of the contract is.\(^72\)

Lord Hatherley clearly made an exception for the admissibility of “external evidence” for the purposes of explaining technical phrases used in the contract. If His Lordship’s view was not overlooked in subsequent cases and by Lord Hoffmann in particular, the law on the exclusion of pre-contractual negotiations would have been very different. In *Chartbrook*, the interpretive issue was clearly technical: ARP and MGRUV. In Lord Hatherley’s view, this is clearly a basis for allowing evidence of pre-contractual negotiations. In *Chartbrook*, Lord Hoffmann endorsed fully Lord Blackburn’s view of the exclusionary rule to the exclusion of Lord Hatherley’s opinion because it gelled with Lord Hoffman’s disposition against the admissibility of extrinsic evidence.

\(^70\) *Inglis v. Buttery*, (1878) 3 App. Cas. 552. In *Inglis*, Lord Blackburn famously restated with approval Lord Gifford’s earlier judgment in the Court of Appeal.

\(^71\) Id. at 577.

\(^72\) Id. at 558.
Therefore, it was inaccurate in Chartbrook to trace the rule to Inglis and claim that “[t]o allow evidence of pre-contractual negotiations to be used in aid of construction would therefore require the House to depart from a long and consistent line of authority.”

C. “Horse by Another Name”

Indeed, the force of the House of Lords’ argument is further weakened because some courts already admit pre-contractual negotiations when construing contracts. They do so under various nomenclatures.

1. Unity of Transaction

The first is called “Unity of Transaction.” In the general construction of contracts, the courts refer to, and invariably rely on, documents that are considered one continuous transaction. Courts take these documents together with the contentious document as one unit that consolidated the transaction. Throughout the Nineteenth Century, courts have relied on documents other than the contract to interpret the contract. In the 1812 case Barton v. Fitzgerald, it was stated, inter alia, that “a true rule of construction [was] that the sense and meaning of the parties in any particular part of an instrument may be collected ex anteecedentibus et consequentibus; every part of it may be brought into action in order to collect from the whole one uniform and consistent sense.” To this effect, courts have read together, for instance, a company’s memorandum and articles of association, a lease and counterpart, and a bill of sale and mortgage deed.

In recent times, courts have continued with the principle of relying on related documents to interpret a contract. One notable instance was the aforementioned ICS case where a brochure that gave a background explanation to an assignment of rights to sue in a class action for negligent mortgage advice was accepted as important background that helped resolve a dispute in the contractual document. Speaking for the majority in the House of Lords, Lord Hoffmann stated that we “should start with the assumption that the layman who read the explanatory note and did not venture into the [contractual document] itself was being given accurate account of the effect of the transaction” and that the explanatory document was “significant” in interpreting the contract. If explanatory notes relating to a contract are so important in the construction of a contract term, it is difficult to appreciate the exclusion of a communication or document that preceded the final execution of the contract. In an indication of the pervasive role technology-related matters would play in the interpretation of contracts in the new millennium, the Court of

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74. Other texts have described this as “documents forming part of the same transaction” or a “composite transaction.” See LAURENCE KOFFMAN & ELIZABETH MACDONALD, THE LAW OF CONTRACT, at XXI (6th ed. 2007), and KIM LEWISON, THE INTERPRETATION OF CONTRACTS 49 (3rd ed. 2004).
75. Barton v. Fitzgerald, (1812) 15 East 530, 541 (U.K.).
80. Id.
Appeal held in *Harbinger UK Ltd. v. GE Information Services Ltd.* that end user agreements for the use of computer software must be taken into consideration in construing the original contract for the supply of the software by the manufacturer.81 It can be argued that the end user agreement was attached to the original agreement as a “schedule,” and therefore was part of the contract. It is also true, however, that the two agreements (between the manufacturer and the distributor and between the distributor and the end user) were separate and involved third parties. Interestingly, the Supreme Court itself, the successor to the House of Lords, ruled recently that even “without prejudice” communications were admissible in evidence as “justice clearly demands it.”82 The principle is clear: courts will rely on related documents to interpret a contentious contractual provision.

2. **Matrix of Fact**

Lord Wilberforce in the landmark case *Prenn v. Simmonds*83 defined the matrix of fact as the process by which courts look “beyond the language and see what the circumstances were with reference to which the words were used, and the object, appearing from those circumstances, which the person using them had in view.”84 Although this definition by itself is capacious enough to encompass pre-contractual exchange,85 Lord Hoffmann later described it as an “understated description of what the background may include.”856 Taking together Lord Wilberforce’s bold statement emphasizing the antiquity of isolating agreements from their respective backgrounds and circumstances and Lord Hoffmann’s indication of the insufficiency of “matrix of fact,” it appears the logical conclusion is that reasonable evidence of pre-contractual negotiations forms part of the background matrix to be considered.87 This view is reinforced by Lord Hoffmann’s emphatic statement that “absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man” must be included in the background material.88 His Lordship added, “there is no conceptual limit to what can be regarded as background.”89 The matrix of fact therefore includes the “genesis” of the transaction, its “aims” or goals, and all relevant background facts, as well as the operation of the law at the time of the contract.90 The evidence, for example, that a particular law influenced the parties can easily be gleaned from the pre-contractual negotiations.

84. Id. at 1384.
85. McMeel, supra note 28, at 275.
Specific elements of prior negotiations that courts have excluded include drafts of agreements,\textsuperscript{91} legal opinions,\textsuperscript{92} and comfort letters.\textsuperscript{93} As noted above, the reasons given for the exclusionary rule include the assertion that the pre-contractual negotiations evidence is not helpful. This is because the parties’ positions remain malleable or are continuously changing as negotiations progress and so it is difficult to ascertain a party’s precise position until the final agreement. This is very similar to the argument made for the exclusion of Hansard as a statutory interpretation aid.\textsuperscript{94} It was argued that the speeches in Parliament were not helpful to a court in illuminating sufficiently the confusion or ambiguity in particular legislative provisions.\textsuperscript{95} As Lord Reid averred, to embark on a search for illumination from Parliamentary speeches would amount to “looking for a needle in a haystack [when] more often than not the needle is not there.”\textsuperscript{96} Unlike MPs in a multi-hundred, multi-issue chamber, parties in contractual negotiations often represent two sides and mainly speak with a unanimity that is not easily achievable in the parliamentary setting. Also, positions or views in negotiations are usually well considered and target a specific goal or response. That Hansard is still admissible with all the tentativeness, malleability, abruptness, and political posturing or bargaining that goes with it, albeit under somewhat restrained circumstances, is the strongest argument for the reasonable admissibility of pre-contractual negotiations.

More importantly, sometimes this information is crucial in determining the outcome of the case, as in \textit{Chartbrook} itself. Baroness Hale admitted as much when she disingenuously said, “I have to confess that I would not have found it quite so easy to reach this conclusion had we not been made aware of the agreement which the parties had reached on this aspect of their bargain during the negotiations which led up to the formal contract. On any objective view, that made the matter crystal clear.”\textsuperscript{97} A strict application of the exclusionary rule, therefore, has the potential to bring injustice to contract parties.\textsuperscript{98}

3. \textit{Rectification}

Courts have frequently stated that pre-contractual negotiations can be admitted to rectify a contract. Rectification is a remedy in equity that allows courts to correct mistakes made by a contract party.\textsuperscript{99} Rectification has been invoked to address inconsistency in the terms of a contract, to correct wrong designation of parties, and to effectuate the intention

\begin{itemize}
  \item \textsuperscript{92} Rahan v. Gerson Berger Ass’n, [1986] 1 W.L.R. 526 (C.A.).
  \item \textsuperscript{94} See Nicholls, supra note 8, at 590.
  \item \textsuperscript{95} Id.
  \item \textsuperscript{96} Lord Reid, \textit{The Judge as Law Maker}, 12 J. Soc. Pub. Tchrs. L. 22, 28 (1972-73).
  \item \textsuperscript{98} In the \textit{Chartbrook} case, Persimmon would have had to pay an additional £3.6 million had evidence of the parties’ prior negotiations not been available to the court. \textit{See id.} at 1101. In any event, the court is already allowed to look at evidence of how the market works, or any custom that is commonly regarded as binding on everyone in the market. United Nations Convention on Contracts for the International Sale of Goods art. 9, Apr. 11, 1980, 15 U.S.C.A. App. (West 1997), 1489 U.N.T.S. 3 (CISG).
\end{itemize}
of the parties. The threshold for the burden to prove mistake is very high and success in rectification is “notoriously” difficult; this is to avoid jeopardizing the certainty and predictability of contracts. Commonly, however, to prove mistake “reference must be made to documents preceding the document to be rectified, such as drafts, offer documents, [and] promotional material issued to induce people to contract.” All of these documents constitute the background and context of the contract. It is difficult to appreciate the excision of documents or evidence of negotiations that preceded the contract from drafts, promotional materials, or previously agreed to text of the contract. Perhaps it is for this reason that the lawyers for Persimmon pleaded for the rectification remedy as an alternative to their preferred view of the construction of the contentious contractual provision. Their plea for rectification compelled the courts to examine the background, including pre-contract negotiations, in an unstinting manner. This strategy led Lawrence Collins LJ in the Court of Appeal and Baroness Hale in the House of Lords to conclude their analyses and reasoning in favor of Persimmon.

Lord Nicholls described this practice in his days as barrister:

[T]he practice was that when the parties' pre-contract negotiations furnished some insight into their actual intentions, one or other of the parties would include a rectification claim in the proceedings. By this means, whatever the outcome of the rectification claim, the evidence of the parties' actual intentions would be before the court. The hope was that, either consciously or subconsciously, the judge's thinking on the interpretation issue would be influenced by this evidence.

The courts, therefore, assisted by astute lawyers, resort to pre-contractual negotiations under a different name.

In practice, “all but the most negligent of counsel” will plead rectification alongside interpretation to ensure that pre-contractual negotiations come before the court to influence the judge’s thinking on interpretation. It therefore seems paradoxical and illogical that though such evidence, admitted for the rectification purpose, affects how a judge views the outcome of the interpretation issue it is not directly admissible for the purpose

100. Id.
102. M. Clarke, VITIATING FACTORS, in FURMSTON, supra note 7, at 935.
104. Id.
105. See id.
106. Nicholls, supra note 8, at 578.
107. In Arrail v. Costain, Lord Denning admonished the High Court judge for allowing himself to be influenced by evidence of pre-contractual negotiations rightfully admitted in plea of misrepresentation and “non est factum.” Arrale v. Costain, [1976] 1 Lloyd’s Rep. 98, 101 (C.A.) (U.K.). Lord Denning then wondered if courts have not been unconsciously influenced by the evidence of pre-contractual negotiations admitted under misrepresentation, rectification and other “legitimate” grounds. Id.
109. Nicholls, supra note 8, at 578.
of the latter. Neither an explanation nor a justification has been offered for the dissonance. Yet, if left intact, parties will continue to rely upon rectification as a method of ensuring that courts have access to pre-contractual negotiations.

4. The “Private Dictionary” Rule

Practice in the lower courts, too, appears to be moving towards the admissibility of pre-contractual negotiations to aid the interpretation of disputed provisions. Courts can use pre-contractual negotiations to determine whether a word with multiple possible meanings that parties have allegedly negotiated to have only one particular meaning has in fact been used in that one way. This is also known commonly as the “private dictionary rule,” that is, where the parties are said to have given their “own dictionary meaning to the words as the result of their common intention.”

In *The Karen Oltmann*, a provision in a two-year charter party provided that “[c]harterers [were] to have the option to redeliver the vessel after 12 months’ trading subject [to] giving 3 months’ notice.” After nineteen months of trading, the charterers gave three months notice of their intention to redeliver the ship. A dispute arose regarding the meaning of “after 12 months.” Kerr J held that the Court was entitled to examine the pre-contractual negotiations. Having done that, His Lordship came to the conclusion that the parties had meant that “after 12 months” meant “on expiry of” twelve months. About six years later, the Court of Appeal in *The Pacific Colocotronis* admitted evidence of exchange or request by the master of the ship, concluding that the contract was for “lightening” and not for “discharge” and that assistance was meant to be sufficient to prevent further risk of oil pollution. In taking the view that “the negotiations, and what occurred during them, are ‘permissible’ factors to take into account in order to construe the words of this contract,” Eveleigh LJ drew support from Lord Wilberforce’s statement in *Prenn v. Simmonds*:

The time has long passed when agreements, even those under seal, were isolated from the matrix of facts in which they were set and interpreted purely on internal

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113. BEALE, supra note 99, at 879.
115. Id. at 710.
116. Id.
117. Id.
118. Id.
linguistic considerations . . . [w]e must . . . enquire beyond the language and see what the circumstances were in reference to which words were used, and the object appearing from those circumstances, which the person using them had in view.\textsuperscript{122}

When the same court again allowed pre-contractual negotiations to be admitted to ascertain the meaning of the disputed term “preferred supplier status” in \textit{ProForce Recruit Ltd. v. Rugby Group Ltd.},\textsuperscript{123} it was said to have established a principle that extrinsic evidence could be admitted on the basis that the parties’ common intention was being identified.\textsuperscript{124}

\section*{D. \textit{O}ther \textit{J}urisprudence and \textit{J}urisdictions}

Not only domestic courts are amenable to the inclusion of extrinsic evidence. Jurisdictions outside of England and Wales and international jurisprudence are also firmly on the side of admitting evidence of pre-contractual negotiations in interpreting contracts. In \textit{Chartbrook}, Lord Hoffmann referred dismissively to the civil law practice of admissibility\textsuperscript{125} but the practice is much more universal than he was inclined to acknowledge. Article 8 of the U.N. Convention on Contracts for the International Sale of Goods (CISG) is a codification of the international position regarding admissibility of pre-contractual negotiations in the settlement of contractual disputes.\textsuperscript{126} It allows for the admissibility of prior statements and negotiations to establish the intent of the parties or to establish what a reasonable person, given the background of the contract and placed in similar circumstances, would understand the parties to have intended by their statements or conduct.\textsuperscript{127} Section 3 of article 8 states unequivocally, “in determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.”\textsuperscript{128} Article 4, sections 1 and 2 of the UNIDROIT (Revised) Principles of International Commercial Contracts and CISG have similar terms, but UNIDROIT goes further in article 4, section 3 to list not only negotiations and conduct of the parties, but also the nature and purpose of the contract as well as the conduct of the parties subsequent to the contract.\textsuperscript{129} Although the United Kingdom is not a party to CISG, it has been

\begin{thebibliography}{99}
\bibitem{122} Id.
\bibitem{123} \textit{ProForce Recruit Ltd. v. Rugby Group Ltd.}, [2006] EWCA Civ. 69, at ¶ 30 (Arden LJ).
\bibitem{127} CISG art. 8.
\bibitem{128} Id.
\end{thebibliography}
ratified by more than seventy-four countries, including major trading countries such as the United States, Australia, and most European countries.\textsuperscript{130}

Even the United States, the world’s biggest economy, has essentially done away with the exclusionary rule, inspired by CISG and its own domestic jurisprudence. The Uniform Commercial Code (UCC), the Restatement (Second) of Contracts, and a number of cases have held admissible evidence of pre-contractual negotiations as a vital instrument in contract interpretation.\textsuperscript{131} In Germany, the doctrine of \textit{culpa in contrahendo} encompasses liability incurred during pre-contractual negotiations even if the negotiations do not result ultimately in a contract.\textsuperscript{132} Although the remedy is not entirely within the law of contract, it allows for the reception of evidence of the negotiations.\textsuperscript{133} The \textit{empfangs-theorie} permits courts to admit evidence of correspondence, including electronic communication, to establish the intention of the parties to contract and prove that a party suffered a loss because of another party failing to complete or honor the contract.\textsuperscript{134} In an action in \textit{culpa in contrahendo} where the terms of a contract between two merchants was ambiguous, the court admitted evidence of the negotiations, including the parties’ telegraphic communication, to ascertain the terms and to apportion liability.\textsuperscript{135} Articles 1362–1369 of the Italian Civil Code, 1258 and 1282 of the Spanish Code, and the codes of many other countries in Europe all permit the admission of conduct, usages, or contractual negotiations in the determination of either the subjective common intent of the contracting parties or the objective intent as measured by a reasonable person.\textsuperscript{136} The emerging \textit{aquì} in European contract law as recorded in the 1998 revision of the Principles of European Contract Law all encourage the admission of all relevant background circumstances in interpreting contracts.\textsuperscript{137} Article 5:102 mandates a non-exhaustive list of seven circumstances to take into account in contractual interpretation.\textsuperscript{138} The first is “the circumstances in which [the contract] was concluded, including the preliminary negotiations.”\textsuperscript{139} Others include “good faith and fair dealing, usages, and the nature and purpose of the contract.”\textsuperscript{140} This list is reflective of the CISG and UNIDROIT provisions on the subject of interpretation. In the United Kingdom itself, Scottish law admits the circumstances listed in article 5:102, excepting the conduct of the parties subsequent to the completion of the contract.\textsuperscript{141}

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\textsuperscript{133}. Id.

\textsuperscript{134}. Bürgerliches Gesetzbuch [BGB] [Civil Code] Jan. 2, 2002, 1 Bundesgesetzblatt [BGBl.] § 130 (Ger.).

\textsuperscript{135}. Entscheidungen Des Reichsgerichts in Zivilsachen [RGZ] [Federal Civil Senate] Apr. 5, 1922, 104, 265, no.19 (Ger.).

\textsuperscript{136}. OLE LANDO & HUGH BEALE, PRINCIPLES OF EUROPEAN CONTRACT LAW (PARTS I & II) 293 (2000).


\textsuperscript{138}. See generally id.

\textsuperscript{139}. Id. § 102(a).

\textsuperscript{140}. Id. § 102(c), (f)-(g).

\textsuperscript{141}. See Bank of Scot. v. Dunedin Prop. Inv. Co. (1998) S.C. 657, 665 (where prior negotiations, or “communications,” were admitted by the Court of Session).
It is further noteworthy that even in common law jurisdictions which adopt an objective theory of contract like New Zealand, the courts have ruled that “while the degree of assistance to be derived from prior negotiations in ascertaining the presumed intention of the parties will vary greatly from one contract to another, courts should not disqualify themselves from obtaining that assistance when it is available.” It has been suggested that such evidence may be admissible for the purpose of interpretation. Importantly, Lord Hoffmann himself acknowledged in Chartbrook that the admission of extrinsic evidence does not represent an inconsistency with the objective theory of contractual interpretation. But for the reasons mentioned above, he declared that “there is no clearly established case for departing from the exclusionary rule.” In so proceeding, the benefit of uniformity in international transactions is devalued at a time when interpretation of contract is crucial to international trade. For all the reasons in section III, Chartbrook was a missed opportunity to provide a much-needed clarification, if not rationalization, of the law.

IV. Charting The Way Forward

The previous discussion points to the feasibility of change as well as the need for it. That said, the policy reasons highlighted by the courts will have to be carefully considered if extrinsic evidence is to be admitted on a basis wider than what is currently allowed or practiced. On the issue of costs, however, commentators have rightly pointed out that it seems anomalous that costs are deemed a hindrance when it comes to construction but not so when prior negotiations are admitted for the purposes of rectification, in interpreting oral contracts, or in establishing additional obligations in a collateral contract. The position of third parties, too, should not be an impediment to a more inclusionary approach. Third parties have made the choice to involve themselves with the contract so they need to accept that the courts may look at prior negotiations as an aid to interpretation to increase accuracy and the likelihood of a just outcome. While this paper does not presume to delineate the precise circumstances under which courts can waive or set aside the exclusionary rule, approximations can be made with existing law to allow pre-contractual negotiations to be admitted.

145. Id. ¶ 41.
146. Steyn, supra note 15, at 8.
152. Schwartz & Scott, supra note 1, at 933.
One such situation is where the parties reach *consensus ad idem* prior to executing the final agreement.\(^{155}\) In other words, each party was aware of the position of the other and agreed with it.\(^{154}\) Each party had notice and did not object so they have accepted the other party’s point.\(^{155}\) The closest approximation is the mechanics of offer and acceptance.\(^{156}\) An offer is made, it is accepted or rejected or counter-offer made, or the offer lapses. That can be the end of the negotiations. But if the offer or counter-offer is accepted and that acceptance is communicated to the offeror, then that process can be part of the background negotiations that should be accepted in evidence to interpret disputed provisions.

The second circumstance where courts should admit pre-contractual negotiations is where the term in contention is a custom of the trade or a term of art. Courts may not have the relevant expertise to ascertain the content and validity of the particular custom or term. A more complicated situation is where the parties waive or agree not to follow a particular stricture or requirement of the trade custom; not only is expert evidence needed, but the negotiations or communications that led to the acceptance or waiver of the term are needed as well. The courts have held that for a custom to be upheld, it must be lawful, certain, reasonable, in existence for a long time, and must be known to the parties in the case.\(^{157}\) To ascertain any of these elements, courts might need pre-contractual negotiations.\(^{158}\) The exclusionary rule should not impede this quest.

Courts should take the same approach with the private dictionary rule. When the parties have agreed to the specific meaning of the term in dispute, courts should find that meaning even if they must use pre-contractual negotiations. The same position should be held when the term in dispute is a technical one. As already noted, Lord Hatherley made this point in his judgment in the *Inglis* case.\(^{159}\)

Courts should also admit pre-contractual negotiations when the relevant information is electronically stored or available.\(^{160}\) This would help assuage the cost concerns of defenders of the rule. These defenders are legitimately concerned about the cost implications of waiving the rule,\(^{161}\) particularly the cases where the witnesses have to be called to give oral testimony.\(^{162}\) If the information needed is electronically available, the cost will be minimal. If justice in the case requires that pre-contractual negotiations must be examined, it would be contrary to the calling and core mission of the judiciary not to do so. It is

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156. See Linda Mulcahy, Contract Law in Perspective 57-81 (5th ed. 2008).


158. Staughton, supra note 6, at 312.


162. Id.
perhaps for these reasons that the courts, Lord Hoffmann in particular, accept reliance on rectification, factual matrix, and background of the contract in dispute. Courts should move beyond the complexities involved with applying these terms by admitting pre-contractual negotiations.

In the end, the essence of this paper’s argument turns on evidence—whether pre-contractual negotiations should be admitted, and if so, under what circumstances or conditions should it be admitted to aid the interpretation of contentious contractual provisions. For classical legal writers like Bentham, all or any rational material that would help determine the case must be admitted. The only restraint should be the weight given to a particular piece of evidence. He, like John Wigmore, distinguished the science of evidence from the law of evidence, and suggested that the latter is a sinister invention of lawyers. This position appears to have influenced the U.S. Federal Rules of Evidence when it stated the goals of the Rules of Evidence as "the ascertainment of the truth and the just determination of the proceedings."

In reality, however, there are clear and reasonable policy reasons for the law of evidence and its exclusionary tendencies. For example, admitting everything could lead to long delays in the just determination of the proceedings and therefore the denial of justice. Lord Hoffmann advanced similar policy grounds for the exclusion of pre-contractual negotiations in the Chartbrook case. If the pre-contractual negotiation is relevant to removing the cloud of doubt and controversy surrounding the meaning of the contested provision, and it satisfies any of the conditions outlined previously in this article, it should be admitted.

The issue then is one of relevance, and to some extent management and weight. Lord Simon offered a generally acceptable definition of relevant evidence as one “which makes the matter which requires proof more or less probable.” The simplest definition of relevance is that offered by the U.S. Federal Rules of Evidence. Relevant evidence “means evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable than it would be without the evidence.” Although relevance is one of logic and not of law, it has been absorbed into law by the combination of the probative value of a particular piece of evidence and its admissibility. The exclusion of pre-contractual negotiations is therefore a throwback to the distinction between the logic or probative value of the evidence and its admissibility, which is...

164. Id. at 21.
166. Bentham, supra note 163, at 740. For insights into the views of the classical writers on evidence, see generally Peter Murphy, Evidence, Proof, and Facts: A Book of Sources (2003).
167. See Fed. R. Evid. 102.
172. See Peter Murphy, Murphy on Evidence 9 & 30 (11th ed. 2009); Colin Tapper, Cross and Tapper on Evidence 77 (10th ed. 2004).
a question of law. It is judge-made law that excludes pre-contractual negotiations, not the logic or the probative properties of the evidence. This paper calls for a reintegration of the logic and the law in the handling of pre-contractual negotiations in the interpretation of contracts. For, as Lord Steyn stated, “a judge ruling on a point of admissibility involving an issue of relevance has to decide whether the evidence is capable of increasing or diminishing the probability of the existence of a fact in issue.” This can be done by first ascertaining the probative value of the evidence, then proceeding to determine the weight to be attached to it.

The weight of any piece of evidence is “a qualitative assessment of the probative value which the admissible evidence has in relation to the facts in issue,” that is, whether the evidence is strong enough to persuade the judge that it is enough by itself or taken together with other factors to dispose of the issue at hand. The determination of weight to be derived from relevant documents is usually a matter of degree. The assessment is based on a range of factors integral or external to the fact at issue. These include timeliness, reliability, and truthfulness. Admittedly, it is difficult to separate admissibility from weight, but to foreclose any possibility of the probative value of pre-contractual negotiations because of the challenge of weight allocation is not coterminous with the management responsibilities of the judge under the Civil Procedure Rules of 1998.

The Civil Procedure Rules of 1998, preceded by the Woolf Civil Procedure Report of 1996, have given judges considerable powers to manage civil trials in ways that promote justice. Rule 32.1 is relevant for our purposes; it provides that the court may control the evidence by giving directions as to:

a) the issues on which it requires evidence;

b) the nature of the evidence which it requires to decide those issues; and

c) the way in which evidence is to be placed before the court.

The court has discretion regarding what to admit and the nature of the evidence to be admitted. There is no absolute discretion to exclude. On the contrary, Rule 32.2 provides that the “court may use its power to exclude evidence that would otherwise be admissible.” The rule to exclude pre-contractual negotiations as stated in Chartbrook is not founded on the civil procedure rules, and its absolutist conception is not consistent with the discretionary formulation of Rule 32. The admission of evidence of pre-contractual negotiations, as advocated in this paper, based on relevance and weight will be in accord with the modernized management ethos of the Civil Procedure Rules.

175. Murphy, supra note 172, at 35.
177. Murphy, supra note 172, at 79.
179. Id. at 32.1.
180. Id at 32.2. In *Great Future Int’l Ltd. v. Sealand Housing Corp.*, the court stated that the power to exclude evidence in the exercise of case management must be used with great circumspection. *Great Future Int’l Ltd. v. Sealand Housing Corp.*, [2004] EWHC 124.
V. Conclusion

Interpretation is integral to contract law. It is thus unsurprising that the admissibility of prior contractual negotiations has generated passionate debate among academics, jurists, and practitioners. Despite the debate, the House of Lords in Chartbrook unwaveringly defended their earlier stance that courts should not admit this category of evidence when construing contracts. Though the rule has a long history on the precedential pedestal, it is indisputable that the Supreme Court has the power to change the law, and it has done so in the past. For example, the Lords changed the rule granting immunity to legal practitioners from client suits, introduced foreseeability into the strict liability tort in Rylands v. Fletcher, and in Pepper v. Hart changed the rule that prevented the use of Parliamentary Hansard as a statutory interpretation aid. More recently, the Lords have relaxed the rule of causation in cases like Fairchild v. Glenhaven Funeral Services Ltd. and Chester v. Afkar. These cases demonstrate that if a rule is impeding the development of the law or inflicting pain and injustice, the courts will not hesitate to change it.

Yet the House of Lords has shown a remarkable reluctance to adopt a modern approach to the exclusionary rule even though the status quo has led occasionally to an undesirable end. Apart from the rule’s supposedly long pedigree, justification has been based on the limited value that such evidence holds and the need to preserve certainty and contain costs. However, as discussed, these justifications conceal another important reason for the rule’s retention—Lord Hoffmann’s fidelity to his earlier interpretations on related matters. This paper further observed that the rule runs counter to those adopted in international documents and many other jurisdictions, and is already punctured by a large number of exceptions and qualifications at the domestic level, leaving its boundaries currently uncertain.

This paper argued that where appropriate, the exclusionary rule can and should be waived or set aside. This approach includes circumstances where consensus ad idem is reached prior to the execution of the final agreement, where the term in contention is a custom of the trade or a term of art, where the parties agreed to the specific meaning of the term in dispute, and where the relevant information is electronically stored or available. Most importantly, the paper argued that courts should admit extrinsic evidence based on its relevance and weight within the parameters set by the Civil Procedure Rules of 1998.

This paper concludes by concurring with Lord Justice May in his lead judgment in McPhilemy v. Times Newspapers Ltd. that a judge’s power to manage cases:

includes excluding all peripheral material which is not essential to the just determi-
nation of the real issues between the parties, and whose examination would be dispro-
portionate to its importance to those issues. It does not, [however], extend to
excluding potentially important evidence which is central to a legitimate substantial defence.\textsuperscript{188}

That statement aligns with the celebrated U.S. Supreme Court Justice Felix Frank-
furter’s view that “if the purpose of construction is the ascertainment of meaning, nothing
that is logically relevant should be excluded.”\textsuperscript{189}

\textsuperscript{188} McPhilmey v. Times Newspaper Ltd., [1999] 3 All E.R. 775, 791. Arden LJ took a similar position in
\textit{Static Control Components (Europe) Ltd v. Egan} when she said, “I am not aware that the fears expressed as to
the opening of the floodgates have been realised. The powers of case management in the civil procedure
rules could . . . be used to keep evidence within its proper bounds.” \textit{Static Control Components (Europe)

\textsuperscript{189} Frankfurter, \textit{supra} note 37, at 527.
Abstract

Reorganization trustees play a crucial role in bankruptcy procedure. The trustees try to resurrect deteriorating businesses by managing remaining resources for the benefit of beneficiaries, usually unsecured creditors, and shareholders. More or less, a trustee’s role is similar to that of the officers or managers of a solvent company. Fiduciary duty arises between the residual claimers and the stakeholders on one hand, and the operator and the trustee on the other hand. Astonishingly, under current U.S. bankruptcy law, the reorganization trustee’s fiduciary duty is not well defined, although this duty has been widely litigated. The vagueness is primarily due to misinterpretation of the Mosser case, adjudicated by the U.S. Supreme Court. Fortunately, multitudes of academic literature on fiduciary duty in corporate law explain the application issues and clarify the vagueness of trustee fiduciary duty. But fiduciary duty is highly context-specific. Corporate fiduciary duty cannot be arbitrarily applied to the bankruptcy context without necessary modification.

In China, the unclear definition of the trustee fiduciary duty has greatly dampened the efficacy of the reorganization mechanism of the new bankruptcy law. Given the pressures of the current global financial crisis, it is imperative to amend the duty so it is more viable and practical. Given that the current Chinese reorganization mechanism is transplanted from U.S. bankruptcy regulation, retrospection to its origin is helpful in improving the trustee fiduciary duty. This article also explores the use of the case directive to facilitate the adaptation and increase the flexibility of such duty in practice.

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I. Introduction

Reorganization is a tool that permits insolvent corporations to enter into a debt restructuring process and avoids liquidation of the firm’s assets. The bankruptcy court oversees this process. During reorganization, a trustee may be appointed to operate and financially restructure the firm. Since the restructuring process involves decisions that substantially change the rights of the various stakeholders, the trustee’s actions are subject to much scrutiny. Creditors and shareholders are seldom pleased with the decisions of the trustee, because the insolvent firms tend to continue to flounder. Even when the trustee’s business decisions are logical and well thought out, many stakeholders feel as

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1. For the simplicity and continuity of this article, the author will use “reorganization” and “trustee” rather than “Chapter 11 case” and “Chapter 11 trustee” respectively. When the author mentions reorganization and trustee for U.S. bankruptcy law, it has the same meaning as the case in Chapter 11.


3. See Clifford J. White III & Walter W. Theus, Jr., Chapter 11 Trustees and Examiners After BAPCPA, 80 Am. Bankr. L.J. 289, 305-06 (2006) (noting it is impossible to have a debtor in possession (DIP) and a trustee in one reorganization case simultaneously).


though their rights have been violated. This dissatisfaction often leads to stakeholder litigation. A popular cause of action is negligence in breach of the fiduciary duty of care.

In the United States, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) is believed to have led to a high frequency of trustee appointments. Unfortunately, BAPCPA is silent on the trustee’s liability for breach of duty of care, creating uncertainty for the stakeholders of the insolvent firm.

The courts have attempted to balance the interests of the trustees with that of the creditors and shareholders, but the courts have not been uniform in the standard of review applicable to this breach. A handful of circuit courts have found trustees personally liable for negligence, while other courts have held that trustees should not be subjected to personal liability unless they are found to have acted with heightened negligence, with recklessness, or fraud. The U.S. Supreme Court has not provided any guidance on the subject, remaining silent on the issue.

But, many have found partial guidance from Mosser v. Darrow, heard by the U.S. Supreme Court in 1951.

At the other end of the earth, China continues to dismantle its inefficient economic systems formed in an earlier time under its “Planned Economy.” The Law of the Peo-


7. See Primack, supra note 6, at 1309.

8. See White & Theus, supra note 3, at 297-98 (the authors believe that the significant modifications of section 1104 will invite more Chapter 11 trustee appointments by offering judges more latitude in making appointment decisions).


11. Dodson, 207 F.3d at 761.

12. See Allard, supra note 9, at 416; see also Dodson, 207 F.3d at 763; In re Chi. Pac. Corp., 773 F.2d 909, 917-18 (7th Cir. 1985); Ford Motor Credit Co. v. Weaver, 680 F.2d 451, 461-62 (6th Cir. 1982); Boullion v. McNamara, 639 F.2d 213, 214 (5th Cir. 1981); Sherr v. Winkler, 552 F.2d 1367, 1374 (10th Cir. 1977); Smallwood v. United States, 358 F. Supp. 398 (E.D. Mo. 1973), aff’d, 486 F.2d 1407 (8th Cir. 1973) (these courts don’t follow the six other circuits, which found personal liability for mere negligence).

13. Allard, supra note 9, at 428-29.


16. See ARAALDO M. GONÇALVES, CHINA'S SWING FROM A PLANNED SOVIET-TYPE ECONOMY TO AN INGENIOUS SOCIALIST MARKET ECONOMY: AN ACCOUNT OF 50 YEARS (2006), available at http://ssrn.com/abstract=949371 (discussing the transformation from a planned economy to a market economy in China). “Planned economy” is an economic system in which the government controls the economy. Its most extensive form is referred to as a “command economy,” “centrally planned economy,” or “command and control economy.” Under such a system, “resource prices are in many cases distorted, failing to reflect the real value, as many types of resources are still priced by the state, operating on the inertia of the old planned economy.” Id. at 31.
Many Chinese lawyers and practitioners anxiously awaited the New Bankruptcy Law, as the then-current laws failed to regulate the bankruptcy of organizational entities such as education and partnership enterprises. In 2005, the New Bankruptcy Law was promulgated and is now applicable to any type of business organization.

Major components of the new law include reorganization and a “bankruptcy administrator” (Po Chan Guan Li Ren, hereinafter “trustee”). transplanted from the West. However, two years after its proclamation, legal professionals have found the New Bankruptcy Law lacking as it does not properly address the trustee’s liability.

Article 27 of the New Bankruptcy Law stipulates, “[a] bankruptcy administrator shall be diligent and dutiful, and shall faithfully perform its duties.” The specific duties are emu-

21. See Zhu Hong, supra note 18.
22. See Law on Enterprise Bankruptcy (China), supra note 17.
23. Although in the New Bankruptcy Law the legislature uses the word “administrator,” it is widely believed that the “trustee” mechanism is introduced from U.S. bankruptcy law, and its role is equivalent to a “trustee.” See Zhu Hong, supra note 18; see also Wu Jianmin, Xin qi ye po chan fa de chang xin qian xin fa xi (新企业破产法的创新点分析) [The Analysis of the Innovations of the New Bankruptcy Law], 20 SHANG YE SHI DAI [COM. TIMES] 65, 66 (2007) (China); Yang Jian, Po chan guan li ren zhi da ping xi (破产管理人制度评价) [Accessing the Bankruptcy Trustee Mechanism], 512 SHANG YE XIAN DAI HUA [MARKET MODERNIZATION] 291, 291 (2007) (China).
24. See Yang Zhengyu, Guan yu shen li qi ye po chan an fang xi (关于审理企业破产案件确定管理人报酬的规定的理解与适用) [The Understanding and Application of the Provisions of the Supreme People’s Court on the Designation of Administrators During the Trial of Enterprise Bankruptcy Cases], 11 REN MIN SI FA [PEOPLE JUSTICE] 21, 21 (2007) (China) (in this Chinese Supreme Court Journal, most of the articles are written by judges. This article discusses the process of making an explanatory judicial order by the Supreme Court on trustee’s compensation. In fact, foreign legislation is the main source of reference in the procedure).
26. See Law on Enterprise Bankruptcy (China), supra note 17. This English translation is from a commercial legal database provider rather than an official. However, there is no official English version of the New Bankruptcy Law.
merated in Article 25, while Article 27 serves as the catchall provision that allows for private suits. The vagueness of these statutes and other factors discussed herein diminish the efficacy of the trustee mechanism. The dysfunction of the trustee mechanism in China necessitates a retrospective analysis of the trustee mechanism under U.S. bankruptcy law. This article will examine trustee liability in reorganizations under U.S. bankruptcy law and related problems under China’s New Bankruptcy Law. Further, this article proposes solutions to the contemporary problems of the New Bankruptcy Law.

Part II of this article provides a summary and explanation of the judicial decisions regarding the bankruptcy trustee’s fiduciary duties in the United States. Part III analyzes the effect of imposing corporate fiduciary duties on a trustee and suggests further tailoring for the unique situation of the trustee. Part IV discusses the difficulties, created by improper legislation, that the Chinese reorganization trustee faces, including the lack of incentives for trustee participation, the lack of properly qualified trustees, and the disincentives for creditors to support the bankruptcy mechanism. This section will show how these problems create high practice risk and unpredictability of private enforcement. To solve the excessive risk problem and uncertainty problem, Part V proposes to reintroduce U.S. law, and the propositions developed from Parts II and III of this article, which are based on past literature of the United States, so that the New Bankruptcy Law can have a more complete and reasonable paragon from which to transplant. Part VI discusses the need to improve the trustee’s fiduciary duty mechanism from a broader macroeconomic perspective and suggests using the “Case Directive” to facilitate the implementation.

II. The “Crazy Quilt”

A. WHAT IS THE “CRAZY QUILT”?

The “Crazy Quilt” is the term used in the Report of the National Bankruptcy Review Commission to epitomize the state of the law related to a trustee’s personal liability. Although there are a few provisions on trustee duties, no laws, including the Bankruptcy Code, provide a personal liability standard for bankruptcy trustees. This lack of a stan-

27. Id. art. 25 (stipulating that a bankruptcy administrator shall perform the following functions and duties:
   (1) Taking over the assets, seals as well as the account books and documents of the debtor;
   (2) Investigating into the financial status of the debtor and formulating the financial statements;
   (3) Deciding the internal management of the debtor;
   (4) Deciding the daily expenditure and other necessary expenditures of the debtor;
   (5) Deciding, before the first creditors' meeting is held, to continue or suspend the debtor's business;
   (6) Managing and disposing of the debtors' assets;
   (7) Participating actions, arbitrations or any other legal procedures on behalf of the debtor;
   (8) Proposing to hold creditors' meetings; and
   (9) Performing any other functions and duties that the people's court believes it should perform.

In the case of any separate provision on the bankruptcy administrator's functions and duties in the present Law, it shall prevail). This provision is very ambiguous. It is still very hard to tell whether these nine are duties or rights.


29. Id. at 860-61.
standard has led many to seek interpretation from the U.S. Supreme Court case Mosser v. Darrow. But Mosser has not solved the problem because some circuit courts have held trustees liable for mere negligence, extraordinary negligence, and/or fraud, while others have found judicial immunity for trustees whose acts fall within the scope of their authority. The misinterpretation of Mosser increases the unpredictability of a trustee’s personal liability in a reorganization case. The circuit courts’ various interpretations of Mosser on the standard of liability for bankruptcy trustees have led to what the Commission refers to as “a crazy quilt” of decisions.

B. The Mosser Case and Its Progenies

Around 100 A.D., the famous Chinese general Ts’ao Ts’aö was defeated in a battle that took place in enemy territory. After the battle, his troops were dispersed and a bounty was placed on his head. To avoid being discovered, the General Ts’aö fled to an old friend’s home, taking his personal bodyguard with him.

While resting at his friend’s home, General Ts’aö overheard his friend and his friend’s father say, “You can use the rope to tie. The rope in the barn is stronger and it is impossible to escape, even for a bull. I will stay here to sharpen knives. It’s the time to pay him back.” Believing his friend was planning to do him harm, General Ts’aö and his bodyguard jumped into action and killed the eighteen people that were in the home. Unfortunately, after the killings the General discovered a half-tied hog in the backyard and an unfinished banquet that was being prepared in his honor.

The relationship between Mosser and subsequent circuit court cases follows the same logic as the above anecdotal story. The uncompromising execution based upon misinformation has resulted in irreversible loss and a great mess. In Mosser, a former trustee, Paul Darrow, was sued by his successor, Stacy Mosser, for permitting two former employees, Jacob Kulp and Myrtle Johnson, to trade in securities of the debtor’s subsidiaries. Kulp and Johnson were investigated by the Securities and Exchange Commission (SEC) for breach of loyalty for self-dealing in the companies’ bonds. The SEC Special Master recommended surcharging Darrow. The District Court surcharged the trustee, but on appeal the Seventh Circuit reversed the decision, holding that a trustee could not be

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30. See Primack, supra note 6, at 1301-05.
32. See Primack, supra note 6, at 1306-09 (talking about the cases on trustee liability heard by circuit courts under the influence of misinterpretations of the Mosser case).
35. Id.
37. Id.
39. Id.
40. Id. at 270.
surcharged unless he was guilty of “supine negligence.” The Supreme Court reversed the Seventh Circuit’s decision and found Darrow personally liable for the indiscrete actions of Kulp and Johnson. Justice Jackson delivered a narrow opinion for the Court. In Mosser, Darrow knowingly contracted with Kulp and Johnson, resulting in the underlying breach. Such action was beyond the trustee's authority and therefore Darrow’s willful and deliberate act breached the trustee’s fiduciary duty. The Court provided very important guidance in judging the standard of trustee’s duty in reorganization, stating:

Trustees are often obliged to make difficult business judgments, and the best that disinterested judgment can accomplish with foresight may be open to serious criticism by obstreperous creditors aided by hindsight. Court[s] are quite likely to protect trustees against heavy liabilities for disinterested mistakes in business judgment. But a trusteeship is serious business and is not to be undertaken lightly or so discharged. The most effective sanction for good administration is personal liability for the consequences of forbidden acts, and there are ways by which a trustee may effectively protect himself against personal liability.

The Court discussed the trustee’s willful and deliberate breach of his fiduciary duty. This decision should be read narrowly, as the Mosser Court did not address a trustee’s personal liability with regard to negligent actions. In dicta, Mosser has provided guidance and a starting point for later courts. But later courts have misconstrued the opinion of Mosser. Like General Ts’ao, the lower courts have misunderstood the U.S. Supreme Court’s message in Mosser and have incorrectly applied a broad brush in their formulations of a standard of fiduciary duty for the reorganization trustee.

Different interpretations of the Mosser ruling have led to different results in the later courts, even within the same circuit. The Fifth Circuit in Boullin v. McClanahan ruled that trustees are protected by derived judicial immunity. But in In re Miller Smyth, III, the Fifth Circuit held that “trustees should not be subjected to personal liability unless they are found to have acted with gross negligence.” The Tenth Circuit in Sherr v. Winkler held trustees will only be held liable for willful and deliberate acts. More interestingly, the court opined:

Mosser v. Darrow . . . established the rules that a trustee or receiver in bankruptcy is (a) not liable, in any manner, for mistake in judgment where discretion is allowed, (b)

41. Id. at 272.
42. Id. at 270.
43. Primack, supra note 6, at 1302.
44. Mosser, 341 U.S. at 272.
45. Id.
46. Id. at 273-74.
47. Id. at 270; Dodson v. Huff (In re Smyth), 207 F.3d 758, 761 (5th Cir. 2000).
48. Primack, supra note 6, at 1304.
49. Id. at 1306.
51. Id.
52. Dodson, 207 F.3d at 762.
53. Sherr v. Winkler, 552 F.3d 1367, 1375 (10th Cir. 1977).
liable personally only for acts determined to be willful and deliberate in violation of his duties and (c) liable, in his official capacity, for acts of negligence.\textsuperscript{54}

The U.S. Supreme Court did not expressly provide any such rules.\textsuperscript{55} Some academics have doubted whether the Supreme Court implied such beliefs in its dicta.\textsuperscript{56} The inconsistent lower court rulings regarding the standard of the trustee’s fiduciary duty confuse both legal professionals and trustees alike. Unfortunately, the revision of bankruptcy law in 2005 still leaves this issue untouched.\textsuperscript{57} One vital goal of any commercial law regime is certainty and finality of transactions.\textsuperscript{58} It is imperative to consolidate and harmonize past court decisions with academic insights to construct a reasonable and widely acceptable standard that is a valuable reference for courts, trustees, and the legislature.

\section*{C. Two Different Perspectives and One Confusion}

\subsection*{1. Why Bifurcated?}

After \textit{Mosser}, later court decisions can be classified into two schools, those applying the “negligence standard” and those applying the “heightened standard.”\textsuperscript{59} The courts that follow the negligence standard believe that trustees should be found in breach of a fiduciary duty when the trustee acts negligently.\textsuperscript{60} The courts that follow the heightened standard are more lenient and will only find a breach if the trustee acts with gross negligence or commits willful and deliberate acts.\textsuperscript{61} The circuit courts do not provide proper rationale as to why they opt for either standard.\textsuperscript{62} But it is not too difficult to speculate on the reasons. As mentioned in the introduction of this article, protecting innocent and hard-working trustees and providing adequate protection to the estate and creditors are the issues at stake in these court decisions.

For policy reasons, the heightened standard gives trustees protection from “criticism by obstreperous creditors aided by hindsight.”\textsuperscript{63} The crucial question here is whether the heightened standard is a \textit{sine qua non} to protect innocent and hard-working trustees properly. Will trustees be in jeopardy or be unfairly treated if we apply the lower negligence standard? Is there any other option that will bring less adjudicative confusion and inconsistency and fit better into the common law fiduciary duty system? This article will try to answer these questions by examining the common law fiduciary duty from a theoretical perspective in Part III.

\begin{thebibliography}{99}
\bibitem{54} Id.
\bibitem{56} See, e.g., Primack, \textit{infra} note 6, at 1306.
\bibitem{58} See, e.g., \textit{In re} Kontrick, 295 F.3d 724, 732 (7th Cir. 2002) (specifically recognizing the “Bankruptcy Code’s goal of promoting certainty and finality for debtors”).
\bibitem{59} Compare Dodson v. Huff (\textit{In re Smyth}), 207 F.3d 758, 762 (5th Cir. 2000) (heightened standard), and Boullion v. McClanahan, 639 F.2d 213, 214 (5th Cir. 1981) (heightened standard), \textit{wth} Sherr v. Winkler, 552 F.2d 1367, 1375 (10th Cir. 1977) (negligence standard).
\bibitem{60} See, e.g., Sherr, 552 F.3d at 1375.
\bibitem{61} See, e.g., Dodson, 207 F.3d at 762; Boullion, 639 F.3d at 214.
\bibitem{62} See, e.g., Dodson, 207 F.3d at 762; Boullion, 639 F.3d at 214, Sherr, 552 F.3d at 1375.
\bibitem{63} See Mosser, 341 U.S. at 273-74 (1951). This consideration can be found in the \textit{Mosser} case, even though it is not a “heightened standard” case.
\end{thebibliography}
2. Absolute Judicial Immunity

Given the U.S. Supreme Court’s ambiguous stance on willful and deliberate acts, later courts have developed the “absolute judicial immunity” doctrine.64 Although there are subtle differences among the applications of the absolute judicial immunity doctrine,65 the application condition of judicial immunity has been misunderstood. The absolute judicial immunity doctrine only applies when trustees are acting within the scope of their duties or executing a specific bankruptcy court order and are sued by a third party, rather than by any bankruptcy parties in interest.66

According to the doctrines of judicial and sovereign immunity, judges and government defendants are immune from any lawsuits when they are challenged regarding actions performed within the scope of their duties.67 In *Gregory v. United States/U. S. Bankruptcy Court*, the court found that a trustee merely executing the bankruptcy judge’s orders is protected from any lawsuit regarding the execution of those orders.68 This immunity is called quasi-judicial immunity.69 There should not be any doubt cast on this immunity, because trustees executing court orders are just like judicial clerks enforcing judges’ orders. Following this rationale, if trustees voluntarily or involuntarily incur third party liability while acting within the scope of their duties (such as entering into or breaching a contract), the estate should bear the legal consequences rather than the trustees.70 This follows the same logic as that of the management’s agent immunity in daily business operation of a solvent firm; because management was hired by the corporation, the actions of management are regarded as the actions of the corporation. Some literature recognizes the legitimacy of this immunity, although it has many names.71

Such immunity should not be broadened to include the conduct of the trustee that is not expressly approved by the court.72 This is because the inherent relationship of the trustee and the stakeholders is one of trust, and the trust between the fiduciaries and the

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65. In the *Howard* opinion, the court held that:
   
   It is axiomatic that judges are absolutely immune from civil liability for damages for their judicial acts . . . Absolute judicial immunity has been extended to those non-judges whose duties and functions are ‘an integral part of the judicial process.’ Absolute immunity has been specifically conferred on trustees in bankruptcy. Because a trustee’s immunity is derived from that afforded to the bankruptcy judge, a trustee will enjoy absolute immunity so long as he does not act in the clear absence of all jurisdiction, or at least acts under the supervision of the bankruptcy judge.

66. *Howard*, 101 B.R. at 422-23. But in the *Boullion* case, the judge found a “trustee acting at the direction of a bankruptcy judge is clothed with absolute immunity against tort actions grounded on his conduct as trustee.” *Boullion*, 639 F.2d at 214.
68. *Id.*
69. *Id.* at 1500 n.1.
70. *In re Chi. Pac. Corp.*, 773 F.2d 909, 916 (7th Cir. 1985) (Wood, J., holding that trustee owed no fiduciary duty to the third party (vendors) and thus could not be sued in his personal capacity).
71. See Bogart, supra note 15, at 717 (discussing the derived judicial immunity that kicks in when trustees act within the scope of their duties and are sued by a third party).
72. *Id.* at 720.
beneficiaries deserves the protection of the fiduciary rules. According to Frank Easterbrook and Daniel Fischel, “a ‘fiduciary’ relation is a contractual one characterized by unusually high costs of specification and monitoring.” This is especially true in the reorganization trusteeship context as a bankruptcy trustee may be selected by the parties in interest, creditors, and shareholders, or by the courts. The trustee is paid based on their management of the insolvent business. If trustees can claim immunity from a breach of duty of care or duty of loyalty, the fiduciary relation between trustees and parties in interest will be rendered meaningless.

Admittedly, trustees do have immunities. But those immunities are available only when trustees act in a judicial agent capacity, or an organizational agent capacity towards a third party. Similarly, the board of directors of a company enjoys the protections of the business judgment rule, but not absolute immunity. Arbitrarily inserting absolute immunity into the fiduciary relationship, which is a contributory cause to the series of “Crazy Quilt” decisions, will invite inconsistency of adjudications. There is a significant amount of literature, including the Report of the National Bankruptcy Review Commission, which suggests that corporate fiduciary duties should be transplanted into the bankruptcy trustee context. Does the corporate fiduciary duty fit into the bankruptcy trustee context? And if so, do the duties need to be tailored?

III. Corporate Fiduciary Duty, an Elixir?

A. A CONTROVERSIAL SOLUTION: CORPORATE LAW’S STANDARD OF REVIEW

In reorganizations, trustees have a multitude of tasks, such as assuming or rejecting contracts, conducting a sale, avoiding preferential or fraudulent transactions, accounting for property, and examining and objecting to claims. Given that the business is insolvent, a trustee’s work can have greater risk than that of management of a solvent firm. The trustee must operate the firm’s daily management while dealing with the many problems that arise under the firm’s deteriorating financial situation. It is not a sagacious choice to leave such an important job unregulated or subject to the highly repugnant

77. See, e.g., Bogart, supra note 15, at 717.
78. Id. at 717-20.
80. See, e.g., Primack, supra note 6, at 1299; see also Alexander Wu, Motivating Disclosure by a Debtor in Bankruptcy: The Bankruptcy Code, Intellectual Property, and Fiduciary Duties, 26 YALE J. ON REG. 481, 481 (2009).
82. Id.
present judicial review standards.\footnote{For examples of these unsettled judicial review standards, see Dodson v. Huff (In re Smyth), 207 F.3d 758, 762 (5th Cir. 2000); Boullin v. McClanahan, 639 F.2d 213, 214 (5th Cir. 1981); Sherr v. Winkler, 552 F.3d 1367, 1375 (10th Cir. 1977).} To clear up the mess of the “Crazy Quilt” of decisions, the Report of the National Bankruptcy Review Commission suggested:

A Chapter 11 trustee of a corporate debtor only should be subject to suit in the trustee’s representative capacity and subject to suit in the trustee’s personal capacity only to the extent that the trustee has violated the standard of care applicable to officers and directors of a corporation in the state in which the Chapter 11 case is pending.\footnote{National Bankruptcy Review Commission, supra note 28, at 842. This provision was not adopted during the 2005 bankruptcy law revision. See generally Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-9, 119 Stat. 23 (2005).}

The Committee believes that incorporating corporate fiduciary duty into the trustee fiduciary duty system would clear up the current mess.\footnote{National Bankruptcy Review Commission, supra note 28, at 842.} Other literature also supports the proposition that incorporation of the corporate director’s standard of review into the bankruptcy trustee context is the best solution to solve “Crazy Quilt” problem.\footnote{See, e.g., Primack, supra note 6, at 1319-20; Wu, supra note 80, at 499-502.} Corporate fiduciary duties have had a long period of review by the courts and are therefore systematical and comprehensive duties. Considering the highly similar functions and responsibilities between corporate directors and trustees in reorganization, it is the optimal solution to the confusion regarding trustees’ fiduciary duties. But there is still a lot of academic debate on whether the solution is viable.\footnote{See, e.g., Primack, supra note 6, at 1320.}

The proponents of the incorporation of a corporate law standard of review believe that it will provide trustees enough latitude in reorganization while also protecting the estate and creditor by requiring trustees to make informed, reasonable decisions.\footnote{See, e.g., Bogart, supra note 15, at 736-44.} Opponents attack the incorporation of corporate fiduciary law in two ways by arguing that: (1) the incorporation would create fifty different fiduciary standards for Chapter 11 trustees and (2) the contractual explanation of corporate fiduciary duty does not make sense in the reorganization trustees’ scenario.\footnote{See, e.g., Bogart, supra note 15, at 737.} But these attacks are vulnerable and rebuttable.

First, the creation of fifty different fiduciary standards for Chapter 11 trustees does not really matter. Fiduciary duties are contextual\footnote{See, e.g., Gordon Smith, The Critical Resource Theory of Fiduciary Duty, 55 Vand. L. Rev. 1399, 1400 (2002); A. DeMott, Beyond Metaphor: An Analysis of Fiduciary Obligation, 1988 Duke L. J. 879, 879 (1988).} and therefore are “one of the most elusive concepts in Anglo-American law.” Thus there is no unified corporate fiduciary duty.\footnote{Although there are some widely recognized directive corporate fiduciary duty model acts, such as the Model Business Corporation Act, they are not valid and enforceable law. See Model Bus. Corp. Act § 8.31 (2008) (introducing a general standard of corporate fiduciary duty).} The facts speak for themselves. After about 180 years of practice, generations of legal professionals have not found a unified corporate fiduciary duty that can replace a context-specific approach.\footnote{See S. Samuel Arsht, The Business Judgment Rule Revisited, 8 Hofstra L. Rev. 93, 93, 96-97 (1970).} Currently, no one can assert what specific adverse effects will be in-
vited by applying state corporate law fiduciary duty. Additionally, in a bankruptcy case it is barely news that judges look into specific applicable state law to decide specific matters, such as whether contracts are assumable or assignable. State laws work perfectly in the bankruptcy context as long as they have been tailored properly. There are no adverse dynamics between codified bankruptcy law and state corporate fiduciary laws.

Second, viewing the relationship of fiduciaries as one of contract is not a complete approach. Although law on the fiduciary duty is “messy,” many U.S. scholars have successfully crafted a unified theory of fiduciary duty.94 The contractual explanation of corporate fiduciary duty is but one of these approaches and is not perfect—even if it is the most widely endorsed theory in academia.95 Professor Roberta Romano commented on this theory as a “valuable contribution to our understanding of fiduciary duty law” and one that still needed to be fully elaborated.96 There is an array of compelling theories that can be used to explain the fiduciary relationship, such as “critical resource” theory and “trust-vulnerability” theory.97 Why should the contractual explanation be the only justification for the existence of fiduciary duty? Additionally, courts typically do not attempt to explain why fiduciary duties are imposed in formal fiduciary relationships. From the judiciary’s perspective, many of these relationships have been considered fiduciary in nature for centuries, and any attempt to explain that status seems unnecessary. Therefore, whether contractual explanation makes sense in a reorganization trustee scenario should not be controlling in the pursuit of bankruptcy law certainty.

In sum, the Report of the National Bankruptcy Review Commission’s suggested approach to the incorporation of corporate fiduciary duty into the bankruptcy trustee context is a viable solution to standardizing judicial review. Further, current opponents’ arguments are not theoretically compelling. But the questions that must be answered are whether the differences between corporate directors’ functions in a solvent firm and trustees’ functions in an insolvent firm matter in incorporating corporate fiduciary duty to reorganization trustees’ duty and whether the different dynamics between management and its beneficiaries in both solvent and insolvent firms can be ignored.

**B. Different Works, Same Duty? The Difficulty of Applying the Same Standard**

As mentioned previously, fiduciary duties should be measured contextually.98 Thus, it is inappropriate to apply a strict standard to a possible breach of duty without attention to the facts. When looking to incorporate corporate duties, the bankruptcy trustee’s situation must be considered. Changes should be made to the application of the corporate duties to allow for an efficient relationship between the trustees and stakeholders.

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94. See, e.g., Smith, supra note 90, at 1400.
95. See, e.g., Easterbrook & Fischel, supra note 74.
98. See Smith, supra note 90, at 1400.
Operational strategies of a trustee and director are dissimilar. Although most daily work performed by reorganization trustees and directors in a solvent firm are not significantly and essentially different, the nuances between different working situations and decision procedures still matter in deciding whether they deserve the same standard of review.

First, directors manage a company in good or bad financial situations, while trustees by the nature of the situation are managing failing businesses. In such a situation, there are fewer opportunities and it is more difficult to find creditors that will loan money to the floundering firm. Deficits are found on the books. Further, if former management affected fraudulent transactions that contributed to the current failing state of affairs, such transactions are likely to be well hidden from discovery. Is it fair to impose the same standard of review against these struggling reorganization trustees? Second, making a business decision in a solvent firm is easier than in a bankruptcy. For example, it is much easier for a succeeding or performing enterprise to raise capital. After the famous case of Smith v. Van Gorkom,99 the business judgment rule has been shaped into one that shields directors from more exacting levels of review once some conditions, such as proper outsourcing or ample meeting time, are met.100 Unfortunately, these specified conditions usually include hiring expensive outside consultants, such as investment banks, to justify important management decisions.101 This expensive action may be too luxurious for trustees in reorganization because there are limited funds available. Trustees must find cost-saving ways to resurrect the deteriorating business rather than diminishing creditors’ bankruptcy dollars with meaningless outsourcing to protect themselves from exacting judicial review.102 If courts impose the prerequisites of the business judgment rule on reviewing trustees’ acts in reorganization, it will exacerbate the intensive tension between trustees and beneficiaries. Trustees might lower their practice risks by squandering beneficiaries’ resources. If the estate ends up in liquidation, then the beneficiaries are worse off. Third, in reorganization, trustees are facing indignant creditors, who are ready to sue when they perceive any sloppy business decisions being made by the trustee. Collective action problems103 in reorganization cases occur far less often than in solvent firms, because creditors, unlike shareholders, cannot “vote with their feet.”104 Therefore, creditors

102. See Kenneth E. Scott, Corporation Law and the American Law Institute Corporate Governance Project, 35 STAN. L. REV. 927, 927 (1983) (criticizing outsourcing and time wasting procedure as redundant, even for corporate directors).
must act quickly and actively; otherwise, they probably will end up with nothing. If trustees cannot be awarded more protection, they will face more negligent lawsuits than corporate directors do.

Corporate fiduciary duties are the best example for reorganization fiduciary duties to learn from because of their sophistication and applicability to reorganization fiduciary duties. But given the differences of their tasks and fiduciary-beneficiary dynamics, corporate fiduciary duties need to be better tailored to the needs of reorganization. Corporate fiduciary duties should provide an optimal foundation for the reorganization fiduciary duty to build upon. Some revisions are necessary. Through taking one more step, a more suitable standard of review can be established.

**C. THE PATH OF HOW TO TAILOR**

How to tailor the corporate fiduciary duty is the last problem that must be tackled to incorporate it properly into the reorganization trustees' fiduciary duty mechanism. The key to this last problem is how to keep the appropriate tension between protecting innocent, hard-working trustees while providing adequate protection for the estate and creditors. As mentioned earlier, there is no significant difference between the daily operations of a trustee in reorganization and a corporate director. Therefore, we can incorporate corporate fiduciary duties as a foundation for trustee fiduciary duties. By doing so, this solves the estate and creditors' protection problem by providing private parties, such as creditors and investors, with a tool for private enforcement. To restrict the discretion of adjudicators in determining whether a violation has occurred, thus protecting the honest trustees, the business judgment rule can be used. But is the business judgment rule suitable for trustee fiduciary duty?

If management’s actions meet the standard of conduct set by common law, the business judgment rule would apply. The standard of conduct applicable to directors and officers of U.S. corporations is set forth in Section 4.01(a) of the American Law Institute’s Principles of Corporate Governance. It is a fairly demanding standard, but the standard of review applied to the performance of these duties is less stringent. When directors’ and officers’ decisions are called into question, as long as all four of the conditions of the business judgment rule are met judges will not question management’s decisions. The four conditions are: (1) directors must have made a decision; generally, the rule is inappli-

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105. See Primack, supra note 6, at 1299.
106. See Kraakman et al., supra note 103, at 39.
107. Id. at 40.
108. See Weng, supra note 100, at 127-30.
109. Section 4.01(a) of American Law Institute Principles of Corporate Governance reads:

> A director or officer has a duty to the corporation to perform the director’s or officer’s functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.

American Law Institute, Principles of Corporate Governance: Analysis and Recommendations § 4.01(a) (1994).
110. See Melvin Aron Eisenberg, Corporations and Other Business Organizations 545 (8th ed. 2000).
111. Id. at 540.
The standard of conduct seems highly consistent with the trustee scenario. But, as mentioned before, the third condition, “reasonable decision making process,” will invite some trouble.

The business judgment rule is applicable in some important situations, such as during a takeover; and, when certain procedural requirements are met, management can entrench themselves from more exacting judicial review. But this strategy does not seem to be the best for trustees of an insolvent firm. It is improper to excuse all trustee decisions under the business judgment rule, as many agency problem-preventing mechanisms, such as the exit mechanism, are not an option in reorganization. Nevertheless, trustees should be more prudent on crucial issues to protect the estate and creditors from sloppy decisions. Some courts have held that trustees are liable for mere negligence through this reasoning. If there are no special requirements for trustees in making important decisions, the balance of protection between the estate and creditors, on the one hand, and trustees, on the other hand, will be broken. The disproportionate protection will disincentivize trustees to act appropriately and leave beneficiaries unable to protect themselves through litigation.

Further, the business judgment rule must not have judicial approval as a prerequisite since the purpose of the business judgment rule is to prevent judges, who typically have no business experience, from meddling in fiduciaries’ business decisions. Even the most learned judges cannot assert that they know the market and business better than trustees. It is much wiser to have courts scrutinize how trustees came to make a decision rather than to scrutinize the business decision itself.

Only in very rare cases will a bankruptcy judge decide to specifically pre-approve a trustee’s acts. For instance, a court would not like to authorize the specific steps the trustee took in conducting a sale. Therefore, it is practically unviable and theoretically unreasonable to require court approval for the business judgment protection. A better approach that is both low-cost and effective would be to require disclosure.

Disclosure plays a fundamental role in controlling agency problems. Although mandated disclosure is criticized as ineffective in many situations, it would work perfectly by...
ad hoc disclosure in reorganization. Mandated disclosure is less efficient when: (1) disclosees do not receive information; (2) disclosees do not read disclosed information, do not understand it when they read it, or do not use it even if they understand it, (e.g. consumers don’t read and understand the Truth-in-Lending Act (TILA) disclosures); and (3) disclosees’ decisions are not improved by the mandatory disclosures. But these concerns are unwarranted in reorganization. First, interested parties in bankruptcy are more active than other disclosees in acquiring information related to their interests, because the cost of being inert will result in fewer bankruptcy dollars if the reorganization fails. And the chances are high that the reorganization will fail. Second, interest groups not only will read any ad hoc disclosure, but will also evaluate the quality of the trustee’s decision. In most commercial firm reorganizations a large portion of creditors are businessmen or bankers. They are very sensitive to any bad decision. Sometimes, they are even more sophisticated in the business than the trustees themselves. Third, although disclosure will not improve beneficiaries’ decisions because beneficiaries are bonded with the distressed operating business, it will assist in raising a red flag if there are any fraudulent activities. This will allow interested parties to petition the bankruptcy court ex ante to prevent bad business decisions or ex post for discovery in a lawsuit for breach of fiduciary duty. Most importantly, ad hoc disclosure can be viewed as part of a reasonable decision making process and can avail the protection provided by the business judgment rule. Thus, through the protection of the business judgment rule and disclosure, trustees will be capable of making decisions that have the appropriate amount of risk.

Having tackled the core question—the standard of review—we turn our attention to the duties of loyalty and immunity. Fortunately these are not very complex issues. Mosser states that no court will excuse any intentional breach of duty. On this point, there is no difference between the literature and the courts’ application of the rule. Any willful and deliberate infringement on the beneficiaries should be regarded as a breach of fiduciary duty. Given that the breach of duty of loyalty is always a deliberate, intentional, and self-interested act, the business judgment rule is inapplicable. Immunity only exists when either the: (1) trustee causes damage to a third party while acting within the scope of its duty; or when (2) the trustee’s acts are specifically approved by the courts. No immunity is applicable when trustees negligently or purposely cause beneficiaries damage, even if under the courts’ general approval.

mandated disclosure rests on false assumptions about how people live, think, and make decisions. Second, it rests on false assumptions about the decisions it intends to improve. Third, its success requires an impossibly long series of unlikely achievements by lawmakers, disclosers, and disclosees. That is, the prerequisites of successful mandated disclosure are so numerous and so onerous that they are rarely met).
IV. Trustee in Reorganization of the New Chinese Bankruptcy Law: An Improved Vehicle, But Only Half Way

A. Legislative History

Chinese bankruptcy legislation has evolved through three stages. In the first stage, before 1984, known as the Planned Economy period, no bankruptcy law was promulgated. During the Planned Economy period, all transactions were organized by the government per the plan made at the beginning of each period. Enterprises focused on assigned tasks rather than profitability. As a result, business organizations could not go into bankruptcy voluntarily or be forced into involuntary bankruptcy.

The second stage occurred from 1984 to 2007. After the “Open Door” policy became effective in 1978, most of China’s state-owned enterprises (SOEs) were suffering serious debt problems. In an attempt to transform the Planned Economy into a “Market Economy,” the legislature promulgated the first Chinese bankruptcy regulation. In 1984, the Trial Implementation created a legalized SOEs market exit mechanism instead of an administrative market exit mechanism.

Over the next several years, the ratio of private economy to national economy skyrocketed. And since the Trial Implementation did not apply to private firms, the 1991 legislature incorporated Chapter XIX into civil procedure law, which allowed for bankruptcy of private companies. Both the Trial Implementation and Chapter XIX came out with a strong administrative influence. Although the Trial Implementation has a reorganization mechanism that subordinates commercial credit claims to employee payment claims and government property rights, the reorganization management “Liquidation Group” consists of government officials who know more about how to reallocate and comfort employees than how to run business. Because of this lack of professionalism and financial focus, twenty-one years of the Trial Implementation led to no successful reorganizations. All reorganizations unanimously failed.

After a nearly thirty-year incubation period, the New Bankruptcy Law was enacted in 2006 and implemented in 2007. This is the third stage. The New Bankruptcy Law is widely considered as the first modernized and market economy oriented bankruptcy law.

130. Id. at 1.
132. Law on Enterprise Bankruptcy (for Trial Implementation) (China), supra note 20.
133. Law on Civil Procedure (China), supra note 19.
136. The Trial Implementation was officially effective from 1986 to 2007. See Law on Enterprise Bankruptcy (for Trial Implementation) (China), supra note 20.
It is the first time that commercial credit claims have been ranked ahead of employee payment claims and states’ property rights. The New Bankruptcy Law transplanted the bankruptcy trustee and reorganization mechanisms from U. S. Bankruptcy Code. But they are not well tailored to fit the Chinese judiciary.

B. Dilemmas of Trustee Mechanism and Where They Come From

1. The Dilemmas

Because of the institutional defects of the bankruptcy trustee mechanism, few professionals wish to be trustees. This lack of interest has led to a shortage of trustees for the bankruptcy courts. Most trustees are professionals from law firms and accounting firms. In Fujian province, where there were 367 law firms and 4,163 lawyers in 2007, only twenty-five law firms and fifty-nine individual lawyers applied for trustee candidacy. Of these, only fifteen law firms and nine individual lawyers were selected to serve as trustee. The average number of bankruptcy cases for a province of Fujian’s size is above 200 per year.

Further exacerbating the problem, trustees’ skills are far from satisfactory. Given that the practice risk is extremely high and that payment for a trustee is uncertain, professionals that do enter into the field intend to stay. As a result, trustees prefer to solicit opinions from the courts to make up for their meager professional skills and to protect against creditors’ complaints. This turns bankruptcy courts into de facto trustees.

Many bankruptcy judges complain that their workloads are far heavier since the proclamation of the New Bankruptcy Law. From the perspective of the financially interested parties, the new reorganization trustee mechanism is not much better than the Liquidation Group. Under the New Bankruptcy Law, creditors have no say as to the selection of a trustee. Nor do bankruptcy courts. According to the China Supreme Court, bankruptcy courts have no latitude in...
selecting trustees; all trustees are picked randomly out of a candidate pool. The worst part is that due to the incompleteness of the trustee fiduciary duty mechanism, it is very tough for creditors to sue successfully trustees for sloppy and unprofessional management. If the court grabs a bad apple creditors have no choice but to take it. The reorganization trustee mechanism is in jeopardy.

2. The Causations of Dilemmas

The three reorganization problems of lack of participation, a lack of professional skills, and creditors’ disfavor of the mechanism greatly dampen the efficacy of the reorganization trustee mechanism. These problems are deeply rooted in China’s legal tradition. High practice risk and the unpredictability of private enforcement create these dilemmas. If these two issues can be resolved, the reorganization trustee mechanism will be a real advanced mechanism in increasing the value of an insolvent firm.

High practice risk is created by the uncertainty in bankruptcy administration. With potential liabilities being greater than potential rewards, professionals have little interest in working as a trustee. Further, for these professionals to improve their skills, they must invest time and money. But if professionals cannot rely on a return on their investment, they will not make that investment. Also, when making a decision for the insolvent firm the trustee is more likely to make the easiest and safest decision, which is not always in the best interest of the insolvent firm. Given that different professionals have different marginal product of capital, which means that the better the professional is, the higher the payback will be, a job with uncertain compensation and potential high litigation risk cannot acquire the best professional for the job. If the payback is low and uncertain, only the less trained and less compensated professionals will apply for this job. That is what is happening in China.

In practice, cash is always a significant problem for an insolvent firm. It is not uncommon for trustees to cover some of the firm’s payments for a brief period. But the New Bankruptcy Law has no provisions that regulate this kind of payment. Given that a firm in reorganization is clouded by previous bad business operation, bankruptcy judges tend to limit the trustee’s compensation at the beginning of a reorganization case. According to Article 5 of the “Provisions of the Supreme People’s Court on the Decision of Administrators’ Compensation during the Trial of Enterprise Bankruptcy Cases” (Provisions of Administrator Compensation), the amount of compensation cannot be changed unless a creditor’s meeting rejects it. The meager compensation is problematic when trustees...
pay for the firm's expenses out of their own pockets. Sometimes, when reorganization fails, the firm cannot afford to compensate the trustee. Even if trustees employ Article 12 of Provisions of Administrator Compensation and terminate the reorganization procedure, trustees may still be left empty-handed.

But the major deterrent to participation is the unpredictable legal liability. Although the New Bankruptcy Law has enumerated “duties” for trustees, the sloppily drafted catchall provision deters many professionals from practicing. Section 9 of Article 25 states that bankruptcy trustees shall perform “any other functions and duties that the people's court believes it should perform.” The many different interpretations of this provision invite chaos. Some judges have gone so far as to conclude that this puts a duty on the trustee to find placement for the firm's former employees. To add to the confusion, the New Bankruptcy Law, which adopts fiduciary duty from U.S. corporate law, provides that a bankruptcy trustee shall be diligent and dutiful, and shall faithfully perform its duties as well. This vague provision causes problems for the judiciary. If a bankruptcy court reads Article 27 too broadly, then any bad decision will open the trustee to liability. Coincidently, China's new corporate law of 2005 also introduced context-specific fiduciary duties in one simple and sloppily drafted provision that has already drawn a lot of attention from academia. Unlike corporate management, bankruptcy professionals are not able to walk away easily from the chaos unless not applying for trustee candidacy.

158. See You Bingning, supra note 142, at 34.
159. Id.
160. In the New Bankruptcy Law, art. 25 reads:

A bankruptcy administrator shall perform the following functions and duties:

1) Taking over the assets, seals as well as the account books and documents of the debtor;
2) Investigating into the financial status of the debtor and formulating the financial statements;
3) Deciding the internal management of the debtor;
4) Deciding the daily expenditure and other necessary expenditures of the debtor;
5) Deciding, before the first creditors' meeting is held, to continue or suspend the debtor's business;
6) Managing and disposing of the debtors' assets;
7) Participating actions, arbitrations or any other legal procedures on behalf of the debtor;
8) Proposing to hold creditors' meetings; and
9) Performing any other functions and duties that the people's court believes it should perform.

In the case of any separate provision on the bankruptcy administrator's functions and duties in the present Law, it shall prevail. See id. art. 25.
161. Id.
162. See, e.g., You Bingning, supra note 142, at 35; see also Yang Jian, supra note 135, at 291.
164. See Weng, supra note 100, 138-40.
Similarly, creditors are dissatisfied with the vagueness of trustee liability. The unclear trustee fiduciary duty provisions limit private enforcement. When creditors look to the New Bankruptcy Law for a legal remedy, they find the enumerated “duties” in Article 25 ambiguous and unhelpful in differentiating between duty and function. For instance, Section 4 of Article 25 states that a trustee shall decide “the daily expenditure and other necessary expenditures of the debtor.” This section defines the trustee’s function rather than the trustee’s duty. If this is a functional definition rather than a standard of conduct, plaintiffs cannot employ it to sue the trustee. The only provision that can be identified as a duty is in Article 27. Contrary to the trustees’ concerns, the interest groups are concerned with what happens if the bankruptcy court narrowly applies the provision. Considering how difficult it is to litigate successfully, interested parties will not feel safe handing the firm over to a trustee who will not be held culpable for negligent or self-benefitting acts.

In sum, high practice risk and unpredictable private enforcement issues are the root causes of the reorganization trustees’ dilemmas. Tackling these two issues is the linchpin in solving these dilemmas. It is obvious that the two issues share the same problem of incompleteness that stems from the current trustee fiduciary duty legislation. Therefore, the best solution is to revise the trustee liability provisions in the New Bankruptcy Law. The trustee fiduciary duty mechanism and its externalities can properly tackle the above problems and help encourage trustees to apply for candidacy.

V. The Solution: Second Time Transplantation

The reorganization trustee mechanism has been developing for over seventy years since the promulgation of the Chandler Act of 1938. The past lessons and successes of this reorganization trustee vehicle have helped to shape an effective and neutral management method for insolvent firms. Although the trustee fiduciary duty mechanism is not perfect in the United States, as discussed in the first and second sections of this Article, it is much more complete than China’s New Bankruptcy Law Article 27.

If the mechanism that is transplanted from foreign law is called into question, there are two factors we should review: the difference of application environment and the completeness of transplantation. Trustee fiduciary duty in reorganization is highly context-specific and technical. It is specially devised for unique reorganization cases. Reorganization is a carefully and deliberately designed institution used to resolve business failures rather than indigenous cultural failures. Therefore, when discussing the applicability of a foreign country’s reorganization institution, it is necessary to reduce the impact of domestic culture to a minimum. If this presumption stands, the solution to improving China’s trustee fiduciary duty in reorganization dilemmas will be obvious and simple: China must retro-

165. See Ma Canli & Su Jie, *P`o chan guan li rén ch`éng xìn yì w`éi y`uán jiè ji` qi` duì w`o guì p`o chan li` de qi` shí* [Research of Bankruptcy Trustees’ Fiduciary Duty and Its Inspiration to Chinese Bankruptcy Legislation], 7 *ZHONGGUO SHANG FA NIAN KAN* [CHINESE COMMERCIAL LAW ANNUAL REVIEW] 443, 450 (2007).
166. You Bingning, *supra* note 142, at 34.
167. *Id.*
spect the completeness of the former transplantation. The conclusion of such retrospect is undisputable, judging from the meager provisions. It is highly possible that the legislature did not thoroughly examine all of the U.S. case law and scholarly literature on trustee fiduciary duty in reorganization. The result is a huge vacuum area of trustee fiduciary duty in reorganization after the bankruptcy legislation. Based on the U.S. case law and scholarly literature, a complete and logical trustee fiduciary duty mechanism can be erected. As analyzed earlier, the tailored corporate fiduciary duty will be a reasonable solution under reorganization trustee context.

Introducing tailored corporate fiduciary duties to the New Bankruptcy Law would provide a better guideline for incumbent trustees, potential trustee candidacy applicants, and interested parties. A clearer legal framework brings better predictability. By increasing the predictability of the trustees' liability, trustees' practice risk will be lower, encouraging better-trained professionals to apply for trustee candidacy. Solving this major problem will greatly ameliorate the dilemmas trustees face, although more compensation and designation-related legislative actions are imperative in the future.

VI. Beyond the Solution

A. Are You Prepared?

In 2006, there were only 4,253 bankruptcy cases in China. No official data has been released regarding the number of reorganization cases. We do know that China has significantly fewer bankruptcy cases than the United States; one can assume that this is the

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171. The trustees' liability issue is the most prominent problem and needs to be tackled first. To focus discussions on the trustees' liability issue, other causes of trustees' dilemmas will not be discussed in this article.

same for reorganization cases. With so few reorganization cases, is the revision of the trustee fiduciary duty necessary? It is probably not important in the short run, but it is certainly important in the long run. The result of the following macroeconomic analysis will demonstrate the necessity of the revision and explain the answers.

Since China pegged the value of the Yuan to the U.S. dollar to keep its exporters competitive amid falling demand due to the global recession at the beginning of 2008, Chinese currency has been under pressure due to the appreciation imposed by the United States. Although “G-20 leaders recently declined to endorse a U.S. push to pressure China to allow the Yuan to rise," the Chinese Yuan has still appreciated by twenty-one percent since July 2005. The State Council of China conducted a pressure test in the first quarter of 2010 to study the relationship between appreciation limitation and export. The results showed that three to five percent of additional appreciation would eradicate all profitability of manufacture-oriented exports. But since the pressure test, the Yuan has already appreciated by three percent. Facing low profitability, many export-orientated enterprises stopped business expansion. Capital that was earmarked for production has instead been invested in the real estate market, which is considered the safest and most lucrative investment, resulting in the inflation of a real estate bubble. This should be a warning sign to the Chinese economy. Some bubble pre-burst signs have already been noticed by economic analysts. If the real estate bubble were to burst, many enterprise investors would have to seek bankruptcy protection.


Export-oriented enterprises are still capable of making a profit so long as they can absorb the currency influence. If they have successfully entered into a reorganization procedure by then, many such enterprises could still keep their last hope to reverse their firms’ decline. Such a situation would lead to a boom in bankruptcy practice, similar to what happened in the United States in the late 1980s. With hundreds of thousands of export-oriented enterprises engaging actively in China’s real estate market now, a burst in the real estate bubble would create the need for many qualified trustees to resurrect their businesses.

Therefore, given the high odds of a real estate bubble burst, trustee fiduciary legislation is actually a pressing issue. If China is lucky enough to weather the currency war and avoid a real estate bubble, a sound trustee fiduciary duty mechanism probably would not be needed immediately. But if China cannot weather the crises, ex ante consideration and evaluation are always the sagacious legislative strategy.

B. Solution’s Solution: Legislation Plus A Brand New Method—Case Directive

Although we have already discussed possible solutions to complete China’s trustee fiduciary duty mechanism of the New Bankruptcy Law, there is still an essential issue that needs resolution given the different legal traditions between the United States and China. Great care must be given when transplanting case law statutes to a civil law country. First, the legislature should clarify whether Article 27 governs trustees’ functions or duties to prevent further confusion. Second, current problematic provisions should be replaced by more specific trustee fiduciary duty provisions to overcome the shortcoming of oversimplified and sloppily drafted provisions. The improved provisions should explicitly differentiate between a trustee’s duty of care and duty of loyalty. Third, the New Bankruptcy Law should set the standard of review for the duty of care to the business judgment rule. Last but not least, trustee immunity should be articulated to avoid vagueness.

In bankruptcy, where there is legislation, of course, there will be efforts to circumvent it. This is absolutely true in the fiduciary duty context. Given that the duty is a context-specific one, it is impossible for the legislature to exhaust all possible application scenarios. In adjudication, there will be legal gaps left for judges to fill. Although in the past decades China’s legal reform achievements have been stunning, it is not a wise choice to
leave excessive discretionary powers to an asymmetrically developing judiciary. This legislation gap would invite inefficiency and corruption of the judiciary. But recourse of flexibility and certainty is out of the capability of *lex scripta*. A new adjudication method is currently being tested and developed in China’s corporate courts.

Admittedly, case law is more efficient than statutes in reacting to the rapid changes in the business world. In 2005, the Supreme Court of China mandated high courts to compile a “Case Directive” and distribute it to the lower courts to unify adjudication standards. This task is primarily undertaken by research departments of local high courts and intermediary courts. The departments compile and publish periodical cases uploaded to an intranet by adjudication departments. Courts embrace publications from the higher courts, as they set very important parameters used to evaluate lower courts’ judges’ work with the “Double R Rate,” which is the remand and reverse rate. By following these cases, the Double R Rate significantly dropped. Additionally, if a case from a higher court is obviously unsuitable due to social changes, lower court judges tend to rule inconsistently to reflect such social changes. Usually, some of these cases will be selected and compiled as well for higher court reference. Although following precedent is not stipulated by law, it is already a common adjudication practice in the Chinese judiciary. Given the challenge of the recent economic reforms, most of the cases compiled are focused on business disputes. Although there are still disputes about whether this is a trend towards de facto case law, it will greatly alleviate the inflexibility of statute law. The optimal way to fill possible statutory gaps regarding trustee fiduciary duty in reorganizations will be to periodically and especially compile the Case Directive with trustees’ duty cases. Organized legislation, supplemented by the Case Directive on trustees’ fiduciary duty, is the most comprehensive and viable solution to implementing the second adaptation of trustee duty. After tackling the trustee liability issue, China’s judiciary will be better prepared for the potential wave of future bankruptcies.

189. See, e.g., Xiao Yang, Zhong guo si fyi gi de cheng ji yi fuzhi qu shi (中国司法改革的成绩与发展趋势) (The Achievements & Developing Tendency of Contemporary China’s Legal Reform), 13 REN MIN SI FA (PUBLICATION) 4 (2007); see also Xia Jinwen, supra note 188, at 17.
190. See Weng, supra note 100, at 140.
192. Interview with anonymous judges at Zhejiang High Court & Shanghai Fist Intermediary Court (Nov. 22, 2010).
193. Id.; see, e.g., Weng, supra note 100, at 135-36 (discussing how the evaluation effects judges).
194. Id.; see, e.g., Weng, supra note 100, at 135-36 (discussing how the evaluation effects judges).
195. Interview, supra note 192.
198. See Interview, supra note 192.
199. See Hu Yunpeng & Yu Tongzhi, supra note 197, at 3.
Taking the Hong Kong Tour Bus Hostage Tragedy in Manila to the ICJ? Developing a Framework for Choosing International Dispute Settlement Mechanisms

AMY LAI*

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Prologue

It was a hot, sunny day in late August.1 Six Hong Kong families, along with their tour guide, waited for the tour bus near Fort Santiago, Manila.2 Amy Leung wiped away the sweat from her husband Ken’s face. This was the last day of the family’s trip to Manila. The couple talked about how they were going to miss their son, Jason, at the moment playing with his two sisters. Jason, eighteen, had just graduated from high school in Canada and was spending the summer with his family in Hong Kong.3 This four-day trip in Manila would draw his summer vacation to a close before he headed back to Toronto for college.4 Always a nice, quiet child and a conscientious student, Jason was loved by his friends and teachers.5 But he neither expected nor desired the love, attention, and blessings that the Hong Kong people were about to shower on him.

It was an oppressively hot August day. Beads of sweat gathered on Rolando Mendoza’s sunburned face as he stared quietly at the approaching Hong Kong tour bus. Mendoza, fifty-five, was dark-skinned and well built,6 looking like the police officer he used to be. Mendoza likely still remembered the pride beaming on the faces of his wife and children as he was named one of Jaycees International’s Ten Outstanding Policemen of the Philippines years ago.7 At this moment, however, reliving past glory only added to his pain. Mendoza planned for that pain to be over very soon, once he had regained the honor he believed the Philippine government had taken from him.8 Though he was desperate to draw attention to the injustice he had suffered, Mendoza probably did not expect that his reputation would outlive him, or desire that his short-term fame would lead to long-lasting infamy.

Months have passed since the Hong Kong hostage tragedy occurred in Manila on August 23, 2010.9 Amy Leung lost her husband and two daughters in the tragedy, and has been taking care of Jason, seriously injured in the incident, ever since.10 The tension created by this horrible event has become part of the Philippines’ foreign relations with Hong Kong and China because so many questions have been left unanswered, from Mendotoza’s innocence and the actions of the Philippine police during the hostage situation to whether and how the victims will be compensated.

2. Id.
4. See id.
5. Id.
8. See id.
9. See THE MISSISSAUGA NEWS, supra note 3.
10. Id.
This article has two purposes. First, it seeks to study, from an organized international law perspective, an incident that deeply affected many Hong Kong people and has been the focus of much media attention. Second, given the meager scholarship on international dispute settlement methods, this article attempts to use the Manila hostage tragedy to explore the factors that should determine which settlement methods are used to resolve international disputes while reinforcing the role of the International Court of Justice (ICJ) in promoting world order.

Part I of this article offers a detailed description of the hostage tragedy and its aftermath. Part II explains why, even assuming that the ICJ had jurisdiction over the dispute between China/Hong Kong and the Philippines, the Court would have difficulty in finding any meaningful standards to adjudicate it. Part II also examines the advantages and disadvantages of various dispute settlement methods—including negotiation, mediation, and adjudication—while focusing on the specific facts of this incident. It argues that, while certain factors weigh in favor of the ICJ as the proper forum for adjudicating these types of disputes, the lack of detailed, robust legal standards for adjudication at present means that such disputes should be resolved by other methods, such as the filing of direct claims through diplomatic channels. Part III explores further how the framework that has evolved in Part II helps nations decide whether to submit their cases to the ICJ. By making reasonable decisions and submitting the right cases, nations can avoid burdening the Court and reducing its efficiency. Overall, this article reinforces the significance of the ICJ as an international adjudicatory body that promotes world order, though it probably would not serve as a proper forum for the hostage tragedy in Manila.

I. The Manila Hostage Tragedy: Unanswered Questions and Unserved Justice

On the morning of August 23, 2010, Rolando Mendoza, clad in camouflage jacket and pants and armed with a .45 caliber handgun and an M16 rifle, took over a Hong Kong tour bus near Fort Santiago, Manila. The bus was about to take two tour guides and twenty Hong Kong tourists on a sightseeing tour on the last day of their trip. While serving as the Chief of the Mobile Patrol Unit at the Manila Police District, Mendoza won seventeen awards and commendations from the Philippine National Police (PNP) and was declared one of the Ten Outstanding Policemen of the Philippines by Jaycees International. But in 2008 he was charged with extortion; the next year, he was found guilty of grave misconduct and was subsequently dismissed from his position by the Office of the Ombudsman without a proper hearing.
A. The Calm before the Storm

Mendoza introduced himself to the people on the bus and told them that he had been wrongfully dismissed from the police force and had lost all of his benefits. He then promised not to hurt anyone, saying, “Be co-operative. If you co-operate, no harm.” He ordered the bus driver to head for Quirino Grandstand in Rizal Park, a major landmark of Manila. Once the bus arrived at Quirino Grandstand, Mendoza handcuffed the driver to the steering wheel and taped a piece of paper on the door that listed his grievances and demands. When the Philippine Chief Inspector became aware of the hostage taking and walked over to the bus, Mendoza made the same claims and demanded reinstatement with benefits to his previous position.

Around 10:30 a.m., the Hong Kong tour guide on the bus informed the Hong Thai Travel Agency in Hong Kong of the situation by telephone. An hour later, Mendoza freed the Filipino tour guide and six tourists: an elderly woman who complained of stomach pains, her diabetic husband, and a woman and her two children, as well as a third child the woman managed to take with her by lying to Mendoza that he was her relative. Two Filipino photographers who happened to be on the scene boarded the bus to serve as volunteer hostages in exchange for those releases. By noon, Mendoza released the two photographers as well, and allowed food and drinks to be brought to the people on the bus. With his guns hanging over his shoulders, he looked calm and cheerful as he walked down and strolled alongside the bus, chatting to the people who brought the refreshments. By then, live coverage of the hostage crisis had been provided not only by media channels in Manila and Hong Kong, but also by Western channels that carried the news across the world.

In the afternoon, Mendoza’s brother, wife, and daughter arrived. His wife tried to speak with him, but he refused. He then posted more handwritten signs on the window:

without conducting a trial, found Mendoza and four other policemen guilty of misconduct and ordered their dismissal from the service. The five policemen responded with a motion for reconsideration to appeal the implementation of their dismissal order. Mendoza submitted handwritten requests dated March 15 and 22, 2010 for an early resolution of his case. Id.

15. Liu, supra note 1.
16. Id.
17. Id.
18. Id.
19. Id.
22. Id.
23. Id.
24. Liu, supra note 1.
26. Liu, supra note 1.
27. Id.
“Big deal will start around 3 p.m. today. Big mistake to correct a big wrong decision”28 and “3 p.m. Deadlock.”29 At 2 p.m., his brother, who was also a police officer, attempted to crash the police barrier and approach the bus.30 The police stopped him and, upon finding that he was armed, took his gun and admonished him.31 Around 6 p.m., two negotiators and Mendoza’s brother walked to the bus to deliver a letter from the Office of the Ombudsman that promised to review his case.32 Mendoza was infuriated and called the letter “garbage.”33 His brother then told Mendoza that the police had taken his gun and asked Mendoza “not to give up” until the police returned the gun to him.34 Mendoza fired a shot in the air, hitting the bus window. The negotiators then withdrew with the brother.35 One negotiator recommended to his superiors that the brother be arrested and charged with obstructing the police.36

As darkness fell, it started to thunder and rain.37 Mendoza agreed to an interview with a radio network through his cell phone; when the reporter asked what his “last decision” was, Mendoza replied that he did not have a decision anymore.38 Noticing that the Manila Police District SWAT team was arriving, he demanded that they withdraw or he would kill the passengers.39 Turning to the television inside the bus, Mendoza saw footage of the police pinning his brother down to the ground before handcuffing him and forcing him into a car.40 As if to retaliate against the police, he handcuffed the tour guide to the handrail of the bus door and herded other hostages to the side of the bus where members of the SWAT team were crouched outside.41 He cursed and shouted: “My police brother is being treated like a pig. . .If they don’t release my brother, I will shoot this [tour guide]!”42

B. “Storming” the Bus

At 7:25 p.m., Mendoza fatally shot the tour guide, and then aimed his pistol at the other passengers.43 The driver watched him shoot a couple of passengers and begged Mendoza

30. Liu, supra note 1.
31. Id.
32. Id.
33. Id.
34. Id.
35. Id.
36. Id.
37. Pao, supra note 21.
38. Liu, supra note 1.
39. Id.
40. Id.
41. Id.
42. Id.
to spare his life. 44 Mendoza shouted at him and forced him to drive the bus. The bus lurched a few feet forward before the SWAT team shot its tires. 45 A few passengers ran toward Mendoza to stop him, but he stepped back and shot them. 46 Meanwhile, the driver used a nail cutter to free himself from his handcuffs and jumped out of the window. 47 He ran toward the surrounding crowd, yelling, “They’re all dead!” 48

The SWAT commander, upon hearing what the driver said, ordered the team to storm the bus. 49 The drawn-out assault that followed was very different from a quick and efficient “storming” break-in. First, the team pounded the windows with sledgehammers, but the glass proved far stronger than expected; though the team managed to smash some windows, they failed to break their way in. 50 Then, the team fastened a rope around the bus door to force it open, but as they tried to pull the door open, the rope snapped. 51 More than forty-five minutes after the initial shots, the first policeman was able to get into the bus through its safety door, but he withdrew immediately when he found Mendoza still alive and shooting in the bus. 52 The PNP Special Action Force ran up to the rear of the bus, but then retreated to avoid crossfire from the SWAT team. 53 After another half hour, the SWAT team threw tear gas into the bus, driving Mendoza to the front of the bus and into their sights. 54 They shot him in the head and his body fell through the broken door. 55

C. Nine Lives, One Incomplete Report, and Three Forums

Eight people died in addition to Mendoza. 56 Of the seven tourists who survived, four were slightly injured, two suffered more critical injuries, and one fell into a deep coma. 57 The plight of the Leung family, in particular, stirred the emotions of thousands of Hong Kong people. Although Amy Leung survived, her husband and two daughters died in the tragedy. 58 Media channels continually aired interviews in which the tearful woman lamented the death of her family members: “Part of me wanted to be killed together with my husband, but then I [thought] of my children. I [thought] that at least one of us should save ourselves to care for them.” 59 In another interview, she stared blankly at the camera, asking, “Why did [the] authorities not rescue us? There were so many of us on the bus.

44. Liu, supra note 1.
45. Id.
46. Id.
47. Id.
48. Id.
49. Id.
50. Id.
51. Id.
52. Id.
53. Id.
54. Id.
55. Id.
57. Id.
58. Id.
Why did no one come to rescue us? It’s so cruel . . . The gunman did not want to kill us, but when negotiations failed, he opened fire. Why [couldn’t] the government give the money? I don’t understand why they couldn’t give [him] money.”

Her son, Jason, who suffered a severe head injury and fell into a coma, began the long road to a full recovery in mid-October after finally regaining consciousness.

Both the Chinese and Hong Kong governments expressed deep sorrow for the tragedy. The Hong Kong government abruptly placed the Philippines on its travel blacklist and advised all of its citizens to exclude the Philippines from their travel itinerary. The Chief Executive of Hong Kong complained that he was unable to get in touch with President Benigno Aquino III of the Philippines by telephone during the siege and criticized the ways the hostage situation was handled. Beijing urged the Philippines to submit a “comprehensive, precise, objective” investigatory report. President Aquino promised a “thorough investigation.” While unimpressed with how the crisis was handled, he nonetheless defended the actions of the police and blamed the media for worsening the situation by giving Mendoza a bird’s-eye view of the situation.

The tragedy was clearly a result of many factors. Experts criticized the Philippine police generally for their lack of planning and lack of an effective strategy in the negotiation with Mendoza; they also criticized the poorly equipped SWAT team for what they deemed a risky, inefficient assault. For example, a security analyst criticized the police for 1) their lack of equipment and training; 2) not taking the opportunity to disarm or shoot Mendoza before the situation escalated, especially when he left the bus and strolled around without holding his guns—strong indicators that he had let down his guard; 3) not satisfying Mendoza’s demands, if only temporarily, to persuade him to release his hostages; 4) not controlling the media; and 5) using his brother in the negotiation.

But the investigatory report that the Philippine government released on September 20, 2010 only singled out individuals for blame, including the Mayor of Manila City and the Manila Police Chief, who left for a nearby restaurant for a meal shortly before Mendoza started shooting. The report accused the Mayor of trying to wait out the situation and

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60. Id.
61. See, e.g., THE MISSISSAUGA NEWS, supra note 3.
66. Id.
67. Id.
69. Id.
the Chief of defying presidential orders to use an elite commando unit instead of a local SWAT team in the attempt to storm the bus.71

The Hong Kong government took a diplomatic stance by praising the investigation committee for recommending action against its own officials, but demanded a definitive explanation of how the eight victims were killed.72 Hong Kong people, on the other hand, did not hesitate to express their deep dissatisfaction with the report for leaving too much unexplained. One legislator, for instance, commented on the report’s failure to rule out the possibility that friendly fire from the police killed some of the tourists, as Philippine officials previously had conceded that police bullets might have hit some victims.73 One survivor complained about the report’s failure to explain how Jason Leung, untouched by bullets, nevertheless suffered a severe head injury.74 A group of Hong Kong lawmakers issued a motion to the Philippines demanding a formal apology as well as appropriate compensation.75 Nevertheless, the Philippine government did not take further action after releasing the investigatory report.76

Who is responsible for this tragedy and how are they to be judged? There are three possible forums for judgment. First, a traditional courthouse might be used to try the Mayor of Manila and the Police Chief on the administrative and criminal charges stated in the investigation report.77 The second forum is the media, which often turns into a courtroom, especially in cases where the traditional system has become corrupt. Newspapers in Hong Kong and the Philippines critiqued not merely the professional standards of the Philippine police, but also the Aquino administration.78 Finally, the third forum is each individual’s conscience, which acts as his own judge. For instance, a Philippine Daily Inquirer columnist expressed how “deeply, deeply ashamed” he felt over the incident.79 While some Filipino citizens were indifferent or defensive, others expressed their condolences toward families of the victims, shame about their government, and even appealed to God to help redeem their nation.80

D. THE ICJ AS THE FOURTH FORUM?

Because the tragedy appeared to be caused by the collective actions of many parties, especially the government negotiators and the SWAT team, the trial of several individuals would not likely remedy the losses of the victims or mend the damage to relations between the Philippines and Hong Kong and China, despite the wishes of President Aquino. Moreover, neither the media nor the conscience of his people would serve such purposes.

71. Id.
72. See id.
73. See id.
74. Id.
76. See id.
77. Lee, supra note 70.
It is not a surprise, then, that some Filipino citizens might feel that the ICJ would be a proper forum for this dispute.

The next section explains why, even assuming that the ICJ had jurisdiction over this dispute, the Court would have difficulty in finding any meaningful standards to adjudicate it. It examines the advantages and disadvantages of various dispute settlement methods. The section argues that, while certain factors weigh in favor of the ICJ as the proper forum for adjudicating this dispute and other similar incidents, the present lack of detailed, robust standards for adjudication means they should be resolved by other methods. Part II develops a framework that guides nations to choose among different dispute settlement methods and whether to resort to the ICJ as a forum of adjudication.

II. Adjudicating the Hostage Tragedy by the ICJ? The (In)Applicability of Legal Standards

The ICJ, sometimes known as the World Court, has been the “principal judicial organ of the United Nations” since 1946. Under the “statute” of the Court, a multilateral agreement annexed to the Charter of the United Nations, the ICJ furthers the United Nation’s mandate to facilitate the peaceful resolution of international disputes by acting as a neutral dispute settlement mechanism. "The Court fulfills this role not only by its function of adjudication of international disputes. . .but, far more often, disputes which are an element of the routine interaction of international relations.” Its statute gives the Court the power to render binding judgments in “Contentious cases” initiated by one state against another. Moreover, Article 96 of the U.N. Charter entitles both the General Assembly and Security Council to “request the International Court of Justice to give an advisory opinion on any legal question.” Other U.N. organs as well as political settlements between the disputing states compliment the Court’s judicial activity.

As with any court, the ICJ must have jurisdiction over the dispute before it as a precondition to issuing a judgment. Consent of the parties may grant jurisdiction to the Court. Parties may demonstrate their consent in one of three ways: 1) by special agreement or compromise, in the context of a particular case; 2) by treaty, such as a multilateral agreement that specifies reference of disputes arising under it to the court; or 3) by advance
consent to the so-called “compulsory” jurisdiction of the court on terms specified by the state concerned. 87

Despite what Filipino citizens have suggested, it would be highly unlikely for the ICJ to hear the dispute concerning the alleged negligence or recklessness of the Philippine police in their negotiations with the hostage taker and in their assault of the bus. The ICJ does not have compulsory jurisdiction over China, though it does have it over the Philippines. 88

It must be noted, however, that both China and the Philippines have entered into the International Convention Against the Taking of Hostages (Convention). 89 Under this multilateral Convention, if the parties fail to settle on the interpretation or application of the Convention through negotiation and fail to reach an agreement on the organization of arbitration, then a party may refer the dispute to the ICJ. 90 In addition, China and the Philippines could agree to submit the dispute to the ICJ by special agreement or compromise, though this would be highly unlikely. 91

But even assuming the ICJ has jurisdiction, other methods of international dispute settlement may be preferable in resolving similar hostage incidents. Various settlement methods are set forth in Article 33 of the U.N. Charter, including negotiation, inquiry, mediation, conciliation, arbitration, judicial settlement, and resorting to the United Nations or other international dispute settlement organizations. 92 “This list of methods reflects a ‘spectrum or continuum of techniques’ ranging from the so-called ‘diplomatic means,’ which give control of the outcome primarily to the parties themselves, to the so-called ‘legal means,’ which give control of the outcome primarily to a third party or parties.” 93 This section first explains why third-party dispute settlements are preferable to negotiation for resolving the Manila hostage dispute. Then, it looks at why formal ICJ adjudication is preferable to less formal third-party settlement methods. Finally, this section delves into why the lack of detailed, robust international standards applicable to this dispute makes formal ICJ adjudication very difficult. As a result, the best option for China/Hong Kong is to make a direct claim to the Philippines via diplomatic channels, without going through any adjudicatory processes.

A. Third-Party Dispute Settlements v. Negotiation

Third-party settlements are preferable to a negotiation between China and the Philippines over the Manila hostage dispute. As Professor Louis Sohn points out, “[i]t is an axiom of international diplomacy that the most efficient method of settling international

91. Id. ¶ 2.
disputes is through negotiations between the two governments concerned, without any meddling of third parties, other states or international organizations,” and that “in most instances negotiations lead to a solution.”94 Indeed, “negotiation permits each state maximum control over both the dispute settlement process and the outcome...”95 Conversely, for “any kind of third-party involvement,” especially ICJ adjudication, there is the “risk of reducing a disputing state’s flexibility” to do what it wants and, worse still, of “trapping it into an undesirable outcome.”96 In addition, negotiation, which favors compromise and accommodation, is arguably “most likely to preserve good long-term cooperative relations between the parties...”97 Finally, “negotiation is generally simpler and less costly than alternative dispute settlement methods.”98

The Philippine government should have been able to negotiate with Hong Kong on matters related to the hostage tragedy, but President Aquino’s conduct resulted in an impasse in the governments’ relationship, thwarting the possibility of a productive outcome.99 The President shirked responsibility first by defending the police’s actions and laying blame on the media and then by singling out the Mayor of Manila City and the Manila Police Chief, among others, for blame.100 Unless the Philippine government now promises to investigate the questionable conduct of its negotiators and SWAT team which considering President Aquino’s stance is unlikely, it will be very hard for the Philippine government to regain the trust of the Hong Kong people, salvage its own image, or preserve a good long-term cooperative relationship between Hong Kong and the Philippines. As a result, more complicated, formal dispute settlement methods need to be undertaken, even if they take more time and are less flexible.

B. **FORMAL ICJ ADJUDICATION V. OTHER THIRD-PARTY SETTLEMENTS**

The next step is to examine the pros and cons of formal ICJ adjudication and see why this method is preferable to other third-party settlement procedures, such as mediation or arbitration, in resolving the current dispute. First, adjudication, whether through the ICJ or arbitral tribunals, is better than other methods under certain circumstances. Adjudication is impersonal and allows concessions without any loss of face.101 Because it involves a formal third party decision, neither government is held directly responsible for the outcome. In disputes where governments have, for various reasons, found it difficult to concede or even compromise by means of negotiations or mediations, adjudication is a politically useful way to “dispose” of such problems without taking direct responsibility for concessions.102 Hence, adjudication is particularly useful in disputes involving difficult factual or technical questions where the parties are prepared to compromise but cannot because of the complexity of the situation.103

94. *Id.* at 477.
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*
99. See *Hong Kong Warns Against Philippines Travel After Deaths*, supra note 65; *Lee*, supra note 70.
100. See *Lee*, supra note 70.
102. *Id.* at 489.
103. *Id.* at 492.
Second, ICJ adjudication is often preferable to arbitral tribunals. Disputing nations have to agree on the organization of the arbitral tribunal and the selection of arbitrators, which can be difficult. Compared to arbitral tribunals, the decisions of the ICJ wield greater authority because of the ICJ’s position as the most senior and principal judicial organ of the United Nations.\textsuperscript{104}

The impersonal, dispositive, and authoritative nature of ICJ settlement could prove very advantageous in the Manila hostage dispute. Since the tragedy, President Aquino has turned away from apparent aloofness toward expressing sympathy, revealed by the shift of his blame from the media to a few of his own government officials.\textsuperscript{105} Nevertheless, when confronted with the questionable conduct of the negotiation and SWAT teams, how the victims were killed, and how Jason was injured, he has been unresponsive and evasive, and made no further concessions or conciliatory gestures.\textsuperscript{106} The Hong Kong and Chinese governments, in an attempt to preserve their relationships with the Philippines, have been torn between displays of diplomacy and expressions of anger and dissatisfaction.\textsuperscript{107} ICJ adjudication would help both the Philippines and Hong Kong to “save face.” The Philippines could avoid the embarrassment of having to admit to more wrongdoing by its government officials and Hong Kong could avoid directly accusing the Philippines for its delayed investigations. In addition, the ICJ could resolve complicated, technical issues concerning the poorly equipped SWAT team, how the victims were killed, and whether Jason was injured by Mendoza’s bullets or police sledgehammers. By involving the ICJ, China and the Philippines could move beyond unsatisfactory conversations and break out of their impasse.

C. Re-examining the Hostage Tragedy Impasse: Why Not the ICJ?

Adversarial adjudicatory processes are still very much the exception in international relations.\textsuperscript{108} First, states may be more receptive to intermediate, non-adjudicatory approaches because they are less public. Adjudication can be openly judgmental by labeling one party a “lawbreaker” rather than providing for a shared acceptance of responsibility.\textsuperscript{109} Second, adjudicating the dispute jeopardizes states’ ongoing relationship, and keeps the focus on the past rather than the future. The adversarial nature of adjudication can also lead to a “win-lose” decision that may escalate the conflict.\textsuperscript{110} Third, the law may not be clear and may also lead to uncertainty in terms of outcomes. This is true particularly in disputes that involve the application of international law, where there may be uncertainty regarding the existence of binding legal obligations that govern the dispute.\textsuperscript{111}

To illuminate why, assuming ICJ jurisdiction over the Manila dispute, China should not take the dispute with the Philippines before the Court and why the Court probably would not agree to hear the case anyways, it is necessary to study the above three factors in relation to this incident. The following subsection shows that the first two factors weigh

\textsuperscript{104} Id. at 492-93.
\textsuperscript{105} Id.
\textsuperscript{106} Id.
\textsuperscript{107} Id.
\textsuperscript{108} Id.
\textsuperscript{109} Id.
\textsuperscript{110} Id.
\textsuperscript{111} Id.
heavily in favor of taking the current dispute to the Court. Yet, the third reason—the existence of applicable law—strongly weighs against that course of action.


The fact that intermediate, non-adjudicatory dispute settlement approaches might be less public is not a strong reason for China and the Philippines to avoid bringing the dispute before the ICJ. The hijacking of the tour bus was already public. The gunman’s actions drew world attention: the media channels in Manila and Hong Kong began reporting on the crisis before noon on August 23 and major Western channels provided live coverage of the crisis. While Mendoza aimed to air the “dirty laundry” of what he deemed to be a corrupt government that unfairly took away his job and benefits, the media, quite ironically, assisted him in his quest by showing the questionable conduct of a number of Philippine officials. Because its “dirty laundry” has already been aired, the Philippine government should deal with the incident openly and let a third party determine whether the government was as culpable as many in Hong Kong/China believe. Any further evasive act reflects badly on the government and serves to confirm strong suspicion that it was incapable and corrupt.

Furthermore, if the Philippine government was found to be responsible, then the Philippines would have an opportunity to repent openly for the tragedy. In Honest Patriots: Loving a Country Enough to Remember Its Misdeeds, Donald W. Shriver, Jr. studies the significance of being an “honest patriot.” Shriver argues that a nation cannot reform itself unless its citizens confront their nation’s wrongdoing through public concrete gestures to put their past behind them. Shriver also cites William Sloane Coffin who contends that “bad patriots” are “uncritical lovers” and “loveless critics” of their nations, while “good patriots” carry on “a lover’s quarrel with their country.” Open ICJ adjudication would force indifferent or defensive Filipinos to confront their government’s wrongdoings during the tragedy, hopefully turning them into “good patriots.” Also, adjudication could provide relief to those citizens that felt ashamed and prayed to God for redemption. Above all, it would redeem the Philippines in the eyes of the world.

2. Retrospective or “Win-Lose” Situation? The Necessity of Breaking a Chain of Abuses

Rather than jeopardizing the ongoing relationship between Hong Kong/China and the Philippines, adjudication would strengthen those relationships by breaking the chain of human right abuses surrounding the Manila hostage incident. The tragedy arguably be-

112. Papa, supra note 4.
113. Id.
114. DONALD W. SHRIVER, JR., HONEST PATRIOTS: LOVING A COUNTRY ENOUGH TO REMEMBER ITS MISDEEDS (Oxford Univ. Press 2005). Shriver’s book studies how people in Germany and South Africa have openly repented for the wrongs they did to their fellow countrymen Jews and the black people, and how American citizens need to do similar acts of remembrance and repentance for African Americans and Indian Americans. Nevertheless, the general argument concerning public repentance applies broadly to the mistreatment of foreign citizens in one’s nation.
115. See id.
116. Id. at 3.
117. See id.
gan when the Philippine government denied Mendoza a fair hearing. The abuse of human rights escalated with Mendoza’s violence toward the bus passengers and the police’s negligent and inhumane treatment of the hostages as they attempted to capture Mendoza. Given the contentious history of Hong Kong and the Philippines, the Manila hostage tragedy has the potential to escalate the hatred felt by some Hong Kong citizens toward Filipinos and led to further human rights abuses. Hopefully, ICJ adjudication would prevent this, resulting in a “win-win” situation instead of hurting the relationship between the two countries.

Formal adjudication would serve to soothe Hong Kong people's anger toward the Philippines, which has been directed against Filipino domestic workers. It would discourage Hong Kong people from mistreating the workers or firing them without reason. In the 1970s, Ferdinand Marcos, then-President of the Philippines, began his nation’s export of labor in an attempt to improve its poor economy. The increased labor exportation and the inflow of foreign currency, on which the nation became increasingly dependent, coincided with the economic rise of Hong Kong in the late 1970s and early 1980s. According to the Hong Kong Human Rights Monitor, discrimination against these domestic workers, or “Filipino maids,” by their employers was common even before the hostage incident. Not long after the tragedy, unions that represent Filipino maids announced that they had received several reports of angry employers firing the maids in retaliation.

Soothing Hong Kong people’s anger is especially urgent considering that the forced return of unemployed Filipino domestic workers to the Philippines would burden its poor and unstable economy, aggravating its human rights conditions. Filipino domestic servants would have worse working conditions than in Hong Kong. The Philippine government has previously professed respect for human rights, including the rights of women. A non-governmental organization, the Coalition Against Trafficking in Women, convinced the Philippine Congress to enact a statute in 2003 to eliminate and punish the

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118. See Papa, supra note 7; see also supra text accompanying note 9.
123. TREND, supra note 119.
124. Id.
125. See REVISED PENAL CODE, art. 202, Act No. 3815, as amended (Phil.).
trafficking of women and children. Nonetheless, violence against women has remained an issue in the nation. Thus, forcing unemployed Filipinas to return to their impoverished nation might aggravate violence against Filipinas by encouraging more trafficking of women and pushing more women into prostitution.

In conclusion, a proper ICJ decision would hopefully lead to a “win-win” situation by compensating the Hong Kong victims and their families and restoring the Philippines’ reputation as one of the most attractive tourist destinations in Southeast Asia. Since the tragedy, Hong Kong has placed the Philippines on its travel blacklist, leading to a loss of tourism revenue. A nation where a vast majority of its population lives in substandard conditions and social welfare and income maintenance programs are virtually nonexistent cannot afford these losses. ICJ adjudication could break the chain of human rights abuses and end the disastrous consequences of this tragedy.

3. Unclear Laws: The Lack of Detailed, Robust Standards for Adjudication

Though these factors weigh in favor of ICJ adjudication, the uncertainty of the law, specifically the lack of detailed, robust international legal norms, is a strong factor that weighs against using the ICJ as a forum. If the ICJ has compulsory jurisdiction over the case, the dispute can be adjudicated on the basis of the human right norms laid out by the Universal Declaration of Human Rights (Declaration). Also, the International Convention Against the Taking of Hostages provides an opportunity to refer the dispute to the ICJ. As this subsection shows, the Court would very likely have difficulty finding detailed, robust human rights standards for adjudicating this dispute. The International Convention Against the Taking of Hostages might provide a viable, but far less direct method of taking the case to the ICJ. Thus, China/Hong Kong should make a direct claim to the Philippines via diplomatic channels instead of going through any adjudicatory processes.

a. The Universal Declaration of Human Rights: Or Was It Ordinary Negligence?

In the U.N. Charter, the drafters declared the purpose of the United Nations to be not only the maintenance of peace and security, but also the promotion of respect for human rights and fundamental freedoms. On December 10, 1948, the General Assembly adopted and proclaimed the Declaration so that every Member State would strive, “by progressive measures, national and international, to secure their universal and effective recognition and observance.” Article 3 of the Declaration states that “[e]veryone has

127. See, e.g., MEREDITH RALSTON & EDNA KEEBLE, RELUCTANT BEDFELLOWS: FEMINISM, ACTIVISM AND PROSTITUTION IN THE PHILIPPINES 89, 94-95 (Kumarian Press 2009). Such factors as poverty, colonialism, and the local sexist culture have led to a firm establishment of the sex industry. With the withdrawal of the U.S. military bases from the Philippines, sex tourism took the place of military prostitution.
129. RALSTON & KEEBLE, supra note 127, at 84-86.
130. U.N. Charter pmbl.
the right to life, liberty and security of person,” while Article 5 states that “[n]o one shall be subjected to torture or to cruel, inhuman or degrading treatment or punishment.”

The Philippine government’s handling of the crisis raised strong suspicions of violations of Articles 3 and 5 because, as experts commented, poor negotiation skills and the poorly equipped SWAT team subjected the people on the bus to unnecessary torture and led to the deaths of eight passengers. Indeed, these concerns were mirrored in a letter to Claro S. Cristobal, Philippine Consulate General, dated August 24, 2010, by the Hong Kong Human Rights Monitor, which urged that an in-depth independent inquiry of the tragedy be conducted by human rights experts and credible forensic autopsy experts.

Some scholars argue that if the ICJ tries to enforce human rights treaties, it supplants the role of the Human Rights Council and other U.N. treaty monitoring bodies, which “produce ‘soft law’ that may have persuasive,” but not controlling, authority. Nevertheless, this highly restrictive view of the ICJ’s role is unwarranted. The Declaration, being an extension of the U.N. Charter, should function “as a source of law in international human rights decision-making.” Article I of the Charter states that one of the main purposes of the United Nations involves “promoting and encouraging respect for human rights and for fundamental freedoms for all without distinction as to race, sex, language, or religion.” Because the Charter does not define those rights and freedoms, the Declaration constitutes an extension of the Charter by specifying what they are. Moreover, the Declaration and what it embodies has attained the status of customary international law. According to Article 38 of its statute, the ICJ, whose function is to decide disputes submitted to it in accordance with international law, shall apply international conventions, whether general or particular, establishing rules expressly recognized by the contesting states, international custom, as evidence of a general practice accepted as law, general principles of law recognized by civilized nations, or judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law. Because the ICJ looks upon the Declaration as an authoritative document containing the basic principles of law and established principles of human rights, the ICJ could enforce the Declaration in the Manila dispute.

132. Id. arts. 3, 5.
133. See id.
134. Open Letter from Hong Kong Human Rights Consul General Claro S. Cristobal, Philippine General Consulate in Hong Kong, (Aug. 24, 2010), available at www.hkhrm.org.hk/resource/letter24aug2010consul.doc. The letter demanded a detailed report about the police’s conversations with Mendoza, justifications for the ways that the negotiations were handled, and for the strategies undertaken by the SWAT police, as well as evaluations of whether the current policies and training for the SWAT team in handling hostage incidents comply with international human rights standards. The letter also urged the Philippine government to conduct full investigations of the accusations that had been leveled at Mendoza, his brother, and the bus driver and fair trials for the driver and Mendoza’s brother.
137. U.N. Charter art. 1, para. 3.
138. Porter, supra note 136, at 150.
139. Id. at 152
140. Statute of the International Court of Justice art. 38, ¶ 1.
141. See Porter, supra note 136, at 153-38.
Nevertheless, the Declaration does not provide standards that are robust or detailed enough for the ICJ to adjudicate the Manila dispute. The Philippine government’s handling of the crisis, including its poor negotiation skills and the poorly equipped SWAT team, might only indicate only ordinary or gross negligence, not necessarily human rights violations. Although negligence and human rights violations are not mutually exclusive and often related, the lack of detailed, robust international legal standards would likely pose a tremendous difficulty for the ICJ. The Court, relying upon minute, disputable facts of the tragedy, would have to conduct a fact-dependent inquiry to determine whether the Philippine government indeed denied the hostages their “right to life, liberty and security of person,” and whether its police force subjected the hostages to “torture or to cruel, inhuman or degrading treatment or punishment.” 142 The lack of detailed, robust standards in the Declaration combined with the fact-dependent inquiry would lead to uncertain adjudication outcomes. Unless more detailed, robust standards are laid out, similar hostage incidents should not be taken to the ICJ; even if they are, the Court might well refuse to adjudicate them.

b. International Convention Against the Taking of Hostages: A Far Less Direct Method

Alternatively, the International Convention Against the Taking of Hostages, to which both China and the Philippines are parties, might provide an opportunity--albeit a far less direct one--for China to take the dispute to the ICJ. Article 16, paragraph 1 states that if the parties have failed to settle on the interpretation or application of the Convention by negotiation, then one party can request that the case be submitted to arbitration; if the parties are unable to agree on the organization of the arbitration within six months of this request, one party “may refer the dispute to the ICJ in conformity with the Statute of the Court.” 143 A key article pertinent to the interpretation of the Convention is Article 3, which states that “[t]he State Party in the territory of which the hostage is held by the offender shall take all measures it considers appropriate to ease the situation of the hostage, in particular, to secure his release and, after his release, to facilitate, when relevant, his departure.” 144

While the Philippine police made the right decision to attempt negotiation with Mendoza, they acted inappropriately by arresting his brother, who they later suspected to be Mendoza’s accomplice, and using him as a negotiator. The Philippine government did not do anything wrong by refusing to yield to his demands. 145 Scholars and negotiation specialists have argued that instead of yielding to terrorist demands to free hostages, a government should safeguard its fundamental interests to retain public faith and avoid creating incentives for additional hostage taking in the future. 146 If the Philippine government had offered Mendoza money to save the hostages, only to retract the offer once the hostages were safe, it would cause its people to lose their faith in the government; if the

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143. U.N. International Convention Against the Taking of Hostages, supra note 90.
144. Id. art. 3, ¶ 1.
146. See id.
government did not retract the offer to Mendoza, then its actions would likely lead to more hostage taking. Nevertheless, the government must look for options that it would find acceptable and that the terrorists would prefer to the use of force.147 It failed in this endeavor when Mendoza rejected its promise to review his case.

The fatal act was not the government’s failure to settle with Mendoza, however, but its failure to establish what scholars describe as a “true working relationship” with him, one that is “forward-looking and problem-solving” and not “condemnatory.”148 Handcuffing Mendoza’s brother, whom they treated as his accomplice, would seem reasonable in normal circumstances. But because the police reasonably knew that their act of handcuffing Mendoza’s brother and forcing him into the car would be shown on the television on the bus, they were openly condemning Mendoza’s conduct.149 Based on the official report, this display marked the turning point in the incident and led Mendoza, who was hitherto calm and understanding, to open fire on his victims.150

The Convention provides China and opportunity to take the dispute to the ICJ. The Philippine government violated Article 3 by failing to take “all measures it considers appropriate” to secure the release of the hostages. The government itself accused its Chief of Police of failing to use the better-equipped police commando unit to storm the bus and conduct a timely rescue of the victims.151 Unfortunately, the Philippine government has not commented upon its arrest of Mendoza’s brother. Therefore, since the Philippine government apparently cannot agree with Hong Kong/China on what the Article 3 “appropriate measures” were, China could act under Article 16 to request that the case be submitted to arbitration. If they are not able to agree on the organization of the arbitration within six months of this request, China may then refer the dispute to the ICJ. This method of taking the dispute to the ICJ, while seemingly viable, is very indirect. Again, the ICJ would lack robust, detailed international norms to adjudicate the dispute on such grounds. Hence, China/Hong Kong should instead make a direct claim to the Philippines through diplomatic channels.

III. The ICJ or Other Settlement Mechanisms? Applying the Framework to Disputes

Despite the lack of clear laws or robust, detailed legal standards in adjudicating the Manila hostage tragedy, it is understandable that the public has instinctively thought of the ICJ as a possible forum of dispute settlement. After all, international adjudication symbolizes the rule of law in international affairs. If many states are willing to submit their disputes to impartial settlement and show respect for the ICJ, the public will take this as a sign that international law is worthy of respect and will support it accordingly.152 Nevertheless, Lauterpacht writes, “if States were to submit all their justiciable disputes to

147. Id. at 305.
148. See id. at 271.
149. See id.
150. Lee, supra note 70.
151. Id.
152. E.g., Bilder, supra note 93, at 493.
the ICJ, that tribunal would be unable to cope with the burden of the work.”153 While the ICJ “may not efficiently and quickly respond to the demands of its clients” because of its limited resources, over the past years it has taken a series of measures to simplify its procedures to become more accessible.154 In addition, disputing parties should lessen the burden of the ICJ by making reasonable, intelligent decisions on whether to submit their cases to the Court.

The last section of the paper will look briefly at two cases, the Moscow theatre hostage crisis in 2002 and the ongoing detainment of three American hikers by the Iranian government. It will elucidate how disputing parties should use the framework developed in Part II, especially factors concerning applicable laws and foreseeable mutual benefits to disputing states, to determine whether to submit their disputes to the ICJ or to resort to less formal dispute settlement methods.

A. Moscow Theatre Hostage Crisis

On October 23, 2002, armed Chechens who claimed allegiance to the Islamist militant separatist movement in Chechnya took a large Moscow theatre hostage to demand the withdrawal of Russian forces from Chechnya.155 The leader told the hostages that the militants had no grudge against foreign nationals and promised to release anyone who showed a foreign passport.156 The Russian negotiators refused to accept this offer and insisted that everyone be released.157 After two-and-a-half days, Russian Spetsnaz forces pumped a toxic agent into the theatre’s ventilation system and raided it, which led to the death of more than one hundred hostages, including nine foreigners.158 The rescue operation allegedly violated the Chemical Weapons Convention Treaty.159 After the tragedy, former hostages sought compensation for physical and emotional suffering but the Moscow city authorities denied their claims.160 In 2003, plaintiffs from Russia, the Ukraine, the Netherlands, and Kazakhstan turned to the European Court for Human Rights (ECHR), which accepted the case.161

The foreign nationals, shunned by the Moscow authorities, made the correct decision to bring the dispute to the ECHR. If they had not turned to the ECHR, then their

154. Id. at 209. These measures include revising certain provisions of the Court’s rules, providing practical methods for the increasing number of decisions that it rendered each year, and cooperating with dispute parties to reduce the number and volume of written pleadings and the length of oral arguments. These would need to be complemented by efforts of U.N. Member States to provide the Court with more funds.
156. Id.
157. Id.
158. Id.
nations should have initiated a claim before the ICJ on their behalf, even though the ICJ does not have compulsory jurisdiction over Russia.162 The Moscow situation is similar to the Manila hostage tragedy in that the Russian authorities rejected the claims by the victims and that the incident attracted attention from international media, which eliminated any opportunity to keep it private. But unlike Manila there was no uncertainty about applicable laws in the Moscow case. Russia allegedly violated the Chemical Weapons Convention Treaty.163 A violation of the Treaty means that the Organization for the Prohibition of Chemical Weapons could request an advisory opinion from the ICJ.164 If Russia consented to the jurisdiction of the ICJ, then the dispute could be disposed of through open, impersonal adjudication.165 If Russia did not consent and if the ICJ decided that it did not have jurisdiction to hear the dispute, then the initiation of claims by the disputing states would hopefully pressure Russia to negotiate with the victims and compensate them, benefiting its foreign relations. None of this has happened during the years since the incident occurred, likely because the ECHR provided a far more convenient forum than the ICJ for such purposes.

B. Iran and the Three American Hikers: An Unfinished Story

After the positive example of the Moscow theatre hostage crisis, it is interesting to see how the factors examined in Part II apply to one of the latest crises—Iran’s detention of three American hikers. On July 31, 2009, three Americans were arrested by Iranian border guards while they were hiking in Iraqi Kurdistan.166 The exact circumstances of their detention are unclear. Not only were the Americans denied access to counsel, but all contact with their families was cut off until May 2010, when their mothers went to Iran to stay with them for two days.167 In August 2010, the Iranian government reiterated its belief that the trio should stand trial for “illegal entry,” although it was considering other charges, such as intentionally acting against Iranian security.168 On September 14, 2010, female detainee Sarah Shourd was released, but the two male hikers are currently still in Evin Prison.169

If the United States wants to bring a claim against Iran on behalf of the detainees after their release, it should not resort to the ICJ, but instead should consider other dispute settlement methods. Neither the United States nor Iran falls under the compulsory jurisdiction of the ICJ.170 But the ICJ has jurisdiction to hear the dispute because both parties signed the 1955 Treaty of Amity, Economic Relations, and Consular Rights (Amity

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162. International Court of Justice Website, supra note 88.
163. Marcus, supra note 159.
165. See id.
167. Id.
168. Id.
169. Id.
170. International Court of Justice Website, supra note 88.
Article XXI of the Amity Treaty stipulates that any dispute between two states “as to the interpretation or the application of the” treaty shall be submitted to the ICJ, unless they “agree to settlement by other specific means.”

Like the hostage incidents in both Manila and Moscow, this case has drawn a lot of media attention, so there is little reason to try to keep it private. Nevertheless, other factors weigh against the submission of the claim to the ICJ. Like Manila, there is much uncertainty concerning what laws govern the detainment of American hikers by Iran. The ICJ may decide to give as much consideration to Iran’s security laws as to the Declaration’s human rights values. Hence, the outcome of the adjudication would be very uncertain. In addition, because of the already difficult relationship between the two nations, taking the case to the ICJ may not be beneficial for either party. The United States should use less formal methods like negotiation, mediation, or making a direct claim via diplomatic channels to reach a better outcome.

Epilogue

When Jason Leung began to gradually regain consciousness in late October 2010, Hong Kong citizens cried for joy on the Facebook pages they had set up to give him blessings during the two months he was unconscious. The celebratory atmosphere has not drowned out the anger and frustration they feel toward the Philippine government, nor the urgent, steady call for the Hong Kong government to pursue the case on behalf of the victims and their families. On a local level, this hostage tragedy has united the Hong Kong populace and made them rethink their lives, treasure their relationships with their families, and reaffirm their faith in humanity. On a global level, it remains to be seen how the dispute will finally be resolved. This article has argued that, even if the ICJ had jurisdiction over the dispute, it would be not be a proper forum because of the uncertainty of applicable laws. Nevertheless, the incident provides a good opportunity for lawyers and scholars specializing in international law to reexamine dispute settlement methods, develop a framework guiding the methods’ applications to different crisis situations, and promote the significance of international law and world order through the ICJ.

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172. Id.
174. See id.
I. Introduction

In the very first case of the International Criminal Tribunal for the former Yugoslavia (ICTY), *Prosecutor v. Tadić*, a prosecution witness who had requested and received anonymity testified that Dusko Tadić had unlawfully imprisoned him and that “he had seen Mr. Tadić commit beatings, rapes, and murders.” Because of his protected status, the witness was effectively shielded from impeachment and cross-examination. Mr. Tadić’s defense counsel violated the anonymity order, discovering both the witness’s identity and the fact that the story had been fabricated. The witness claimed he lied because government forces had threatened to execute him unless he claimed to be an eyewitness. Following this revelation, the prosecution dropped the charges the witness was trying to prove.
This was the ICTY’s first case. Cases that follow offer similarly troubling examples. In Prosecutor v. Milošević,8 “the tribunal preliminarily accepted 245 intercepts into evidence based on the testimony of a single witness known as B-1793 who testified in closed session as to their authenticity.”9 The court hired an expert to spot-check fifteen of the intercepts,10 and after a determination by the expert that there had been no evidence of tampering,11 the court admitted all of the intercepts deemed relevant into evidence.12 In a third case, Prosecutor v. Kupreskić,13 the Trial Chamber convicted two of the five defendants on the uncorroborated, serious-inconsistency-laden testimony of a thirteen-year-old girl who first identified the black-faced attackers weeks after the incident.14

In each of these cases, the laws of evidence failed the accused. This article attributes these failures to both judges’ overconfidence in their ability to weigh competing pieces of evidence in the specific context of the ad hoc tribunals’ procedural system and the lack of sufficient codification of evidentiary rules in these tribunals. Not wanting to be shackled by technical rules, the courts started out with only ten vague evidentiary principles.15 While flexibility is necessary to accommodate the new and unique problems faced by international criminal trials, the lack of robust admissibility standards, a characteristic of civil law systems, does not mix well with the common law adversarial approach. Trials have been dreadfully slow, and although changes have been made along the way to speed things up, some alterations have come at the expense of the rights of the accused and the legitimacy of international criminal justice.

Part II of this article provides a general background by exploring the precedential value of Nuremberg to international criminal evidence, why international criminal evidence is different from other kinds of evidence, and the general anatomy of proceedings in the ICTY. Part III explores the differences between common law and civil law systems and how those differences play out in the ad hoc tribunals. Part IV discusses general theories of evidence while Part V discusses specific evidentiary issues in the ICTY. The conclusion this article reaches is that the rights of the accused, as well as the legitimacy and

11. See Prosecutor v. Milosevic, Case No. IT-02-54-T, Final Decision on the Admissibility of Intercepted Commc’ns., (June 14, 2004), available at http://www.icty.org/x/cases/slobodan_milosevic/tdec/en/040614.htm (quoting expert who found that “[g]enerally speaking, the linguistic and technical examinations revealed no evidence of tampering or editing”).
12. See id. (admitting 220 of 245 intercepts).
expediency of the trials in general, would be better served by a more substantial codification of rules and the use of investigative judges to gather and pre-screen evidence.

II. General Background

A. Nuremberg: Really a Precedent?

In international criminal law, reference is sometimes made to the “Nuremberg precedent.” Those trials have certainly been of great general relevance to the modern international criminal tribunals, but their relevance is less apparent in the context of evidence in these contemporary courts. Granted, Nuremberg and Tokyo are not completely unhelpful in this area. One feature common to those tribunals and the current ones is the relatively flexible approach to the admission of evidence. For example, the International Military Tribunal for the Trial of German Major War Criminals (IMT) Charter Article 19 provides, “the Tribunal shall not be bound by technical rules of evidence. It shall adopt and apply to the greatest extent expeditious and non-technical procedure, and shall admit any evidence which it deems to have probative value.”

Similarly, Rule 89(C) of the ICTY Rules of Evidence and Procedure broadly states, “[a] Chamber may admit any relevant evidence which it deems to have probative value.”

While Nuremberg’s evidentiary approach was criticized—including by Justice Pal, who complained that it left judges without any real guidance—it supporters rationalized the approach with the realities that there were a large number of potential defendants and that they needed to be tried expeditiously. It also freed the judges from the often-constricting rules of evidence used in common law systems. Since the historical trials were tried without juries, judges thought it made little sense to import common law rules designed to guard a jury from hearing potentially unreliable or prejudicial information. Judges, they asserted, did not need to be guarded in the same fashion.

While this liberal approach to admissibility has carried over into the jurisprudence of the ad hoc tribunals, the similarities end there. The ICTY has relied heavily on oral evidence, having fewer formal rules regarding admissibility. See, e.g., John Hatchard, Barbara Huber & Richard Vogler, Comparative Criminal Procedure 75 (1996); see also infra Part III.A.


17. ICTY Rules Dec. 8, 2010, supra note 15, at Rule 89(C). A casual reader of the U.S. Federal Rules of Evidence may note that Rule 402’s declaration that “[a]ll relevant evidence is admissible” is not any narrower than the provision in the IMT or ICTY. See Fed R. Evid. 402. Rule 402’s broad statement is followed by the highly qualifying “except as otherwise provided.” Id. However, the vast technical rules and exceptions to these rules are not present in these international tribunals: hearsay is frequently admitted, and there are few formal rules regarding admissibility. See, e.g., John Hatchard, Barbara Huber & Richard Vogler, Comparative Criminal Procedure 75 (1996); see also infra Part III.A.

18. “In prescribing the rules of evidence for this trial the Charter practically discards all the procedural rules devised by the various national systems of law . . . to guard a tribunal against erroneous persuasion, and thus left us . . . to guide ourselves[,]” United States v. Araki, Dissenting Opinion of Justice Pal, in 21 The Tokyo Major War Crimes Trial 139 (R. John Pritchard & Sonia Magbanua Zaide eds., 1981).


20. Id. at 96.

21. President Webb’s ruling for the trial at the International Military Tribunal for the Far East stated, “[W]e are not a jury, but judges; . . . we can be trusted to hear things that might prejudice a jury but which would not influence us.” The Tokyo Major War Crimes Trial, supra note 18, at 7204.

22. “The principle . . . is one of extensive admissibility of evidence—questions of credibility or authenticity being determined according to the weight given to each of the materials by the Judges at the appropriate
testimony, while the prosecution at Nuremberg built its case primarily around documentary evidence. For the first Chief Prosecutor at Nuremberg, Robert Jackson, “the Teutonic penchant for meticulous record keeping would greatly ease [the] task of proving the criminal charges.” This treasure trove of thousands of documents, however, is likely unique to the Nazis; a similar paper trail is unlikely to be present in future post-conflict situations. First, modern tribunals often act without the full cooperation of a state, which may be reluctant to hand over damning documents. Also, modern militant groups are less likely to give direct orders to kill or abuse, and even where written records are available—which is not always the case, as much of the relevant physical evidence will have been destroyed or lost—the chain of command on paper may differ significantly from the actual one. Finally, to the extent that Nuremberg’s high degree of reliance on documentary evidence led to a comparatively lesser emphasis on the accused’s right to a full answer and defense, post–World War II developments in international human rights law might prevent such evidentiary and procedural approaches from being pursued again.


23. See Rosemary Byrne, Assessing Testimonial Evidence in Asylum Proceedings: Guiding Standards from the International Criminal Tribunals, 19 INT’L J. REFUGEE L. 609, 614 (2008). Indeed, Chief Prosecutor Robert Jackson’s preference was to exclude live testimony completely and rely solely on documentary evidence. See Patricia M. Wald, To “Establish Incredible Events by Credible Evidence”: The Use of Affidavit Testimony in Yugoslavia-War Crimes Tribunal Proceedings, 42 HARV. INT’L J. 535, 538 (2001) [hereinafter Incredible Events by Credible Evidence]; see also Telford Taylor, The Anatomy of the Nuremberg Trials: A Personal Memoir 135-36, 148 (1992) (describing Colonel Storey—head of the Document Division—as “obsessed by his trove of documents . . . to a degree that distorted his conception of the trial . . . [Chief Prosecutor] Jackson was, if anything, even more opposed than Storey to any departures from the documentary approach; as he later declared, he had decided ‘to put on no witnesses we could reasonably avoid.’”). In the end, only 113 witnesses, including nineteen defendants, testified in the proceedings before the Nuremberg Tribunal. See Richard May & Marieke Wierda, Trends in International Criminal Evidence: Nuremberg, Tokyo, the Hague, and Arusha, 37 COLUMN. J TRANSNAT’L L. 725, 744 (1999). In the ICTY, it is common for a single trial to have that many witnesses. See Incredible Events by Credible Evidence, supra note 23, at 535 (noting that “some trials have featured over 200 witnesses, and seven of the ten trials [that were] completed [by 2001] have had over 100 live witnesses.”).

24. Taylor, supra note 23, at 57. Affidavit testimony was allowed subject to the right of cross-examination or written interrogatories, though the court never laid down a generally applicable rule to this effect. Incredible Events by Credible Evidence, supra note 23, at 539.

25. See May & Wierda, supra note 19, at 95.

26. See Incredible Events by Credible Evidence, supra note 23, at 539-40, 532 (“Obviously documents, where available, remain a most desirable form of proof, but because neither the [ICTY] nor ICTY-friendly States have as ready access to incriminating documents as the Allied High Command had, they have never become the staple of ICTY cases that they were in Nuremberg.”); see also Patricia M. Wald, The International Criminal Tribunal for the Former Yugoslavia Comes of Age: Some Observations on Day-to-Day Dilemmas of an International Court, 5 WASH. U. J. L. & POL’Y 87, 98 (2001) (noting that “the paper trail in many of these cases is sparse and episodic as contrasted to the meticulously maintained archives the Allies had at their disposal at Nuremberg”)[hereinafter The ICTY Comes of Age].

27. Moranchek, supra note 9, at 478.


29. Moranchek, supra note 9, at 478.

30. See Rod Dixon, Developing International Rules of Evidence for the Yugoslav and Rwanda Tribunals, 7 TRANSNAT’L L. & CONTEMP. PROBS. 81, 84 (1997) (quoting Professor William J. Fenrick, former Senior Legal
B. Why International Criminal Evidence is Different

It may not be immediately obvious why evidence before an international tribunal should be any different from evidence before a national one, or why evidence before an international criminal tribunal should be any different from evidence before other international bodies. After all, given that “the task of establishing the veracity is as old as the legal process itself,” what could modern international criminal tribunals have to add? There are several important distinctions.

First, there are no model rules of evidence for international tribunals, despite the wishes of some. And unlike the U.S. Federal Rules of Evidence, the ICTY Rules of Evidence are few in number and quite vague. Second, the extent of the atrocities committed is unlike the factual circumstances encountered in national prosecutions. Proving mass atrocity is not the same as proving many small atrocities. The elements of the various crimes will often require more sophisticated forms of proof and will involve standards and terminology that have not been used in prosecutions before.

Third, the judges that are making these rules generally come from a wide variety of states. There are inevitable divisions between judges from common law systems and judges from civil law systems, as well as between judges from nations within each of those systems. Each judge will bring his or her own notions of what constitutes a fair trial,
which can vary widely between judges. Resolution of otherwise banal issues can consequently be difficult and awkward.

Fourth, standards set by the numerous non-criminal international tribunals have little precedential value because a substantial deprivation of liberty is not in play; the International Court of Justice, European Court of Human Rights, and Inter-American Court of Human Rights only have jurisdiction over states and cannot impose criminal penalties. And while the Committee Against Torture has set forth principles on the effects of torture and post-traumatic stress on the presentation of testimony, the Committee does not hear oral evidence and only has declaratory powers.

C. GENERAL ANATOMY OF PROCEEDINGS IN THE ICTY

ICTY proceedings will be quite familiar to those from common law systems because the criminal procedure generally tracks that of criminal cases in the United States. The trials are adversarial and public, and the order of events usually takes the form of preliminary motions followed by opening statements, presentation of evidence, closing arguments, deliberations, and sentencing. After arrest and initial appearance, the rules provide for broad discovery, including reciprocal disclosure requirements. This de-

36. See Rules of Evidence, supra note 14, at 763 (“[W]hen the Rules do not, on their face, provide an answer, judges must revert to their instincts and experience which will, in turn, vary with their origins and training.”).

37. “Anyone who has watched three arbitrators, each of a different nationality and none of them having the same nationality of any of the arbitrating parties or their counsel, coming from both civil and common law systems, huddled in a whispered conference over an objection interposed by counsel for a party to a question being put by his adversary to a witness, will recognize the distinct clumsiness, if not downright embarrassment, inherent in the process of trying to make evidentiary rulings in international proceedings.” Charles N. Brower, The Anatomy of Fact-Finding Before International Tribunals: An Analysis and a Proposal Concerning the Evaluation of Evidence, in FACT-FINDING BEFORE INTERNATIONAL TRIBUNALS: ELEVENTH SOKOL COLLOQUIUM 147, 149 (Richard B. Lillich ed., 1992).


39. See Byrne, supra note 23, at 620-21.


43. See id. at Rule 84.

44. See id. at Rule 85. The presentation of evidence at trial also tracks the common law model. See Moranchek, supra note 9, at 494 (“[T]he ICTY’s criminal procedure largely track[s] the adversarial model by incorporating a party-driven sequence of examination-in-chief, cross-examination, re-examination, rebuttal and rejoinder . . . . ”). But there are some important departures from this common law model. See infra Part III.


46. See id. at Rule 87.

47. Id. at Rules 100-06; see also Falvey, supra note 41 at 504-05 (describing trial procedures).

48. See, e.g., ICTY Rules Dec. 8, 2010, supra note 15, at Rule 66(A) (“[T]he Prosecutor shall make available . . . . ”) copies of the supporting material which accompanied the indictment . . . as well as all prior statements.
fense disclosure requirement is unusual for common law systems and is the result of a February 2008 amendment, but such open discovery likely reduces surprise and delay at trial, and undoubtedly also affects certain strategic matters.

There are some important features of the ICTY proceedings that will be less familiar to common law lawyers, however. For instance, one controversial example is the ability of the prosecutor to appeal an acquittal. This ability raises concerns of double jeopardy—which the ICTY’s own rules prohibit—and has been widely criticized. As part of the Statute itself, however, only the U.N. Security Council can amend this provision.

A second feature unfamiliar to those in the United States is the absence, at least initially, of the plea-bargaining or immunity granting that are hallmarks of U.S. criminal cases. Rule 101(B) states, “the Trial Chamber shall take into account . . . any mitigating circumstances including the substantial cooperation with the Prosecutor by the convicted person before or after conviction.” While this rule may have had the same practical effect on the defendant as actual plea-bargaining in terms of sentencing, other benefits of a true plea-bargaining system—such as the saving of time and resources, the finality of the disposition, and the moving along of overcrowded dockets—could be lost.
In this respect, however, the practice of the tribunals has undergone a dramatic revolution.60 While the initial rules did envisage the possibility of a defendant pleading guilty, the rules gave no further guidance on what happened next.61 The ICTY statute does not clearly envisage common law style plea-bargaining, and the practice was explicitly rejected initially.62 The advent of completion dates motivated the tribunals to adopt docket-clearing strategies, however, including plea-bargaining, and subsequent amendments required that plea agreements be informed, voluntary, and supported by the facts of the case.63 Thus, while the practice was initially considered a distasteful and unnecessary device64—like the practice in some civil law systems65—it is now common.66 Contrary to other aspects of the tribunals’ procedures, then, which have migrated towards a civil law approach, the significant expansion of plea bargaining marks a shift towards the common law paradigm.67 Not only is the practice common, but it has moved beyond sentence reduction68 and now includes bargaining over the location of a defendant’s detention after conviction69 as well as the withdrawal of certain charges (so-called “charge bargaining”).70 Charge bargaining has even resulted in the withdrawal of genocide charges, which Rwanda has harshly condemned.71

Beyond the prosecutor’s ability to appeal an acquittal and the unique and evolving approach to plea bargaining, other features of the tribunals may also be unfamiliar to common law lawyers, as a result of the tribunal’s combining both common law and civil law characteristics.

III. Common Law and Civil Law Features in the Tribunals72

The ad hoc international criminal tribunals exhibit features that are characteristic of both common law and civil law systems.73 Part A of this section will explore differences between the two systems at a very general level. Part B will then explore how the two systems have influenced the ICTY.

61. Id. at 58.
63. Id. at 59.
64. Id.
66. Schuon, supra note 62, at 201.
67. Id. at 202.
68. Notably, however, trial chambers have sometimes sentenced defendants outside of the ranges recommended as part of the plea agreements, which has sometimes deterred others from concluding such agreements. See Combs, supra note 60, at 112-13.
69. Cf. Rules of Evidence, supra note 26, at 97 (noting that the pretrial detention facilities for ICTY defendants is “quite upscale, certainly in comparison to some American prisons”).
70. Combs, supra note 60, at 111.
71. Id. at 112.
72. Throughout this section, this article will interchangeably refer to common law and civil law “systems,” “states,” “jurisdictions,” etc.
73. See infra Part III.
A. General Differences

At the most general level, the major difference between common law and civil law systems is that common law systems are party-based adversarial systems that often rely on juries, and civil law systems are inquisitorial, judge-driven systems. This is a broad generalization, and many commentators have criticized the absolutist “either-or” characterization of systems as adversarial/non-adversarial and inquisitorial/non-inquisitorial. After all, the shape of a country’s legal system can be attributed to numerous political, cultural, and economic factors, and there are rich differences even among countries sharing the same legal framework. Although it is beyond the scope of this article to explore these in detail (the reader is encouraged to explore the sources cited in the footnotes), it cannot be overstated that taxonomies that merely distinguish between adversarial/inquisitorial, common law/civil law, hierarchical/coordinate, reactive/activist, etc., do not fully capture the procedural differences among states. Still, discussion of certain features that generally distinguish the two systems, while acknowledging that numerous


75. Civil law systems exist in states like those in continental Europe. See id.


78. See Bantekas & Nash, supra note 76, at 438, 450.

79. Id. at 437.

80. Cf. Françoise Tulkens, Criminal Procedure: Main Comparable Features of the National Systems, in The Criminal Process and Human Rights: Toward a European Consciousness 5, 8 (Mireille Delmas-Marty ed., 1995) (“Theoretically, accusatory [i.e. common law] proceedings are public, oral and adversarial . . . Inquisitorial [i.e. civil law] proceedings, on the other hand, are secret, unilateral, and written.”).

81. See, e.g., William T. Pizzi, The American “Adversary System”, 100 W. VA. L. REV. 847, 847 (1998) (“The world that seems black and white to others seems to be only gradations of gray to me: some dark, some light, but all shades of gray.”); Tulkens, supra note 80, at 8 (“[D]istinguishing [between the two systems] is almost a metaphysical question which is now sterile and obsolete . . . [T]oday those boundaries are blurred”) (internal quotation marks omitted).

82. See Orrantia, supra note 74, at 1161-63 (attributing differences in legal systems to “different historical backgrounds and national ideals . . . as well as the cultural, political and economic circumstances; “different levels of intellectual and scientific development, which in turn generate different attitudes toward the legal norms required by society to different types of needs and different types of conflicts,” and “the obvious lack[,] in some states[,] among the great part of the population of access to the material commodities that facilitate economic progress”).

83. See id. at 1162 (“Even if we compare France and Mexico, which are states with similar legal systems, we find that French law represents the antithesis of . . . Mexican law in such areas as family law, property law or contact [at] law.”).

substantial exceptions exist.\textsuperscript{85} is useful in exploring the tensions they pose in the ICTY’s judicial framework.\textsuperscript{86}

One way to envision the differences between the systems during the evidence-gathering-and-presentation stage is as a dispute versus an official investigation.\textsuperscript{87} Common law procedure functions as a dispute between two active parties who each present a case to an ostensibly passive decision maker,\textsuperscript{88} while civil law procedure involves an official investigation conducted by ostensibly impartial public officials to determine the truth.\textsuperscript{89} In common law countries, the prosecutor is a party to the lawsuit and is independently responsible for investigating and prosecuting crimes.\textsuperscript{90} Importantly, the police are generally seen as aligned with the prosecution.\textsuperscript{91} The prosecutor in civil law jurisdictions, however, is typically seen not as a party but as another public official, like the judge, whose role is to investigate the truth.\textsuperscript{92}

\textsuperscript{85} See id. at 1330 (“Recently, English law in particular has taken a major step away from the so-called ‘adversarial’ model. Aimed at reducing the length of judicial proceedings, a comprehensive reform of English civil procedure has severely curtailed the power of parties and strengthened the authority of courts to manage cases.”); \textsuperscript{86} FOSTER \& SULE, supra note 65, at 346 (“[W]hen investigations in criminal proceedings are taken up, the police are assistants to the state prosecution, receiving orders from them.”); \textsuperscript{87} THOMAS WEGENER \\THOMAS WEGENER, The German Legal System 191 (1999) (“The public prosecutor is assisted by the police in carrying out the investigative process.”); Stephen C. Thaman, Spain Returns to Trial by Jury, 21 HASTINGS INT’L \& COMP. L. REV. 241, 241-42 (1998) (noting that in 1995, Spain revived the trial by jury in criminal cases); Bandes, supra note 57, at 418 (noting that in France, investigative judges serve with laypersons on juries); Louis F. Del Duca, An Historic Convergence of Civil and Common Law Systems—Italy’s New “Adversarial” Criminal Procedure System, 10 DICK. J. INT’L L. 73, 81 n.40 (1991-92) (noting that one inquisitorial aspect of U.S. procedure is the \textit{ex parte} proceedings when the police or prosecutor request a judge to issue arrest, eavesdropping, or search warrants (citing A.S. Goldstein, Reflections on Two Models: Inquisitorial Themes in American Criminal Procedure, 26 STAN. L. REV. 1009 (1974))).

\textsuperscript{86} But see Zekoll, supra note 84, at 1334 (finding it “difficult to agree” that “grouping procedural systems into categories is either possible or useful,” although it does “prove the need to pay attention to historical detail and the contemporary political, economic, and cultural conditions that prevail in individual systems”).


\textsuperscript{88} One author has suggested that a judge’s discretion in sentencing is one example of how the term “adversarial” does not accurately capture judicial decision-making in common law systems. See Pizza, supra note 81, at 851 (“Like many American judges at sentencing, the neutral and detached referee at trial turns out to have very broad discretion in sentencing.”).

\textsuperscript{89} Langer, supra note 87, at 839. Cf. Hazard, supra note 77, at 1019 (“The judge [in a common law system] is not responsible for there being an adequate development of the evidence during trial and \textit{a fortiori} is not responsible for there being an adequate pretrial discovery of evidence. Nor is the judge responsible for getting at ‘the truth.’”). If this latter point is correct, it explains why plea bargaining fits so well in the dispute model: if procedure is a dispute between two parties, prosecutorial discretion in charging means that the prosecutor should also be able to determine when the dispute is over. See Langer, supra note 87, at 841 (“In the same way, if the defendant accepts the prosecution’s claim, the dispute also ends.”).


\textsuperscript{91} Cf. Pizza, supra note 81, at 849 (“[I]f this adversary alignment of the police and the prosecutor is what marks out systems that are truly adversary systems from those that are inquisitorial, I cannot understand why we would be so proud of an alignment of forces against the suspect that seems so unbalanced in terms of resources and so likely to produce police investigations that are biased, slanted, or even distorted to favor conviction.”).

\textsuperscript{92} Langer, supra note 87, at 840.
The implications of this are striking. First, the defense does not gather its own evidence. Rather, the prosecutor and judge have a duty to gather both inculpatory and exculpatory evidence. Second, the police in an archetypal civil law state act as investigators for both prosecution and defense. Consequently, everyone involved—prosecutor, defense attorney, and judge—will often work out of the same file (a dossier) and will thus have the same body of information with which to prepare for trial. Moreover, the lawyers can review the growing record during the course of the investigation and can recommend that the judge seek additional evidence, request experts (or different experts), question other witnesses, or further examine the witnesses already questioned.

The two systems also have different forms of adjudication. Common law jurisdictions often use juries in criminal trials while civil law jurisdictions use professional judges. The famous model useful in describing these relationships is one of coordination versus hierarchy. In common law jurisdictions, the jury is a lay organ that coordinates with a professional organ (the judge), resulting in a kind of bifurcated court; in the civil law hierarchical model, the court is unitary. This bifurcation characterization also highlights the reasons underlying the two-stage process, pretrial and trial, in common law systems: because a jury is composed of laypersons whose minds are said to be more susceptible to influence by prejudicial evidence, a pretrial is deemed necessary to control the evidence that is allowed to reach them. Due to juries’ perceived inability to weigh evidence fairly, common law systems have elaborate exclusionary rules that regulate the admissibility of certain kinds of evidence—for instance, hearsay evidence; opinion evi-

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93. Id. at 841; see also id. at 841 n.19 ("This is because the investigating prosecutor or judge is supposed to have an objectivity and impartiality that the defense lacks . . . .").
95. Pizzi, supra note 81, at 849.
96. Though the defense attorney does act as an advocate for his client, “in principle, the advocates’ function is to assist the judge in fulfillment of the judicial responsibility.” Hazard, supra note 77, at 1019-20.
97. Pizzi, supra note 81, at 849.
99. See Langer, supra note 87, at 844. It should be noted, however, that the bench in civil law states is sometimes composed of lay judges as well. Cf. Bantekas & Nash, supra note 76, at 450 ("Civil law countries often have judges on the bench who determine the case without lay members.").
100. See Zekoll, supra note 84, at 1331-32 (discussing Mirjan Damaska, The Faces of Justice and State Authority 1 (1986)).
101. See Langer, supra note 87, at 844.
102. Cf. Hazard, supra note 77, at 1020. But cf. Bantekas & Nash, supra note 76, at 437-38 (“Trial judges [in civil law systems] lead and control the trial and rely heavily on the ‘Dossier’ drafted by a police officer or other investigator, containing detailed information about the pre-trial stage. Hence, the core stage of criminal proceeding in a civil law system is the pre-trial stage, rather than the trial stage.”). To avoid confusion on this point, it is important to distinguish between “pretrial” in the sense of judicial proceedings in which attorneys argue motions (the common law sense) and “pretrial” in the strictly temporal sense of events that take place before trial (the civil law sense). Obviously, there was always be a time pretrial (before trial) when investigations and such are going on; but the above-referenced two-stage common law process is meant strictly to refer to the a specific phase of judicial proceedings—the pretrial phase—in which attempts are made to exclude evidence from reaching the jury during the trial phase.
103. Cf. Bantekas & Nash, supra note 76, at 450 ("Dubious evidence should be kept away from [juries], as such may influence the minds of the jury members.").
dence; character evidence; or evidence that is irrelevant, is protected by legal privilege, or has been improperly obtained. Since juries are lacking in the archetypal civil law state, a pretrial phase is not necessary; the individual evaluating the reliability of the evidence (the judge) also participates in the verdict, although in some systems laypersons will sit on panels with the judges. The judge calls and interrogates witnesses, subdividing cases issue-by-issue (instead of separating legal issues from factual issues) and ordering a deeper inquiry into evidence only when necessary. Thus, in civil law states, “legal instruments preventing the trier of fact from following his own cognitive path are fewer in number and are much less frequently invoked than in Anglo-American systems of adjudication.”

Admissibility rules are largely missing, and evidence is rarely excluded.

B. These Characteristics in the ICTY

The ICTY’s Rules of Evidence and Procedure—initially 125 of them, spanning seventy-two pages—were written in a quick two months in early 1994. The common law insistence on live testimony was combined with the civil law liberality in admitting evidence; character evidence; or evidence that is irrelevant, is protected by legal privilege, or has been improperly obtained. Since juries are lacking in the archetypal civil law state, a pretrial phase is not necessary; the individual evaluating the reliability of the evidence (the judge) also participates in the verdict, although in some systems laypersons will sit on panels with the judges. The judge calls and interrogates witnesses, subdividing cases issue-by-issue (instead of separating legal issues from factual issues) and ordering a deeper inquiry into evidence only when necessary. Thus, in civil law states, “legal instruments preventing the trier of fact from following his own cognitive path are fewer in number and are much less frequently invoked than in Anglo-American systems of adjudication.”

Admissibility rules are largely missing, and evidence is rarely excluded.

104. See id.


106. Mary C. Daly, Legal Ethics: Some Thoughts on the Differences in Criminal Trials in the Civil and Common Law Legal Systems, 2 J. INST. STUD. LEG. ETH. 65, 71 (1999) (describing panels as “most likely consisting of three professional judges and several lay persons”); Bandes, supra note 57, at 418 (noting this phenomenon in France).

107. See Hazard, supra note 77, at 1021 (“The necessity for such further inquiry will be signaled by the party against whom the evidence was received. Evidence received on a tentative basis is taken as truth if there is no negative signal from the opposing party . . . .”); see also Dixon, supra note 30, at 92–93 (“In the civil law system, the judge is responsible for determining the evidence that may be presented during the trial, guided primarily by its relevance and its revelation of the truth.”) (citing Prosecutor v. Tadiæ, Case No. IT-94-1, Decision on Hearsay, ¶ 13 (Aug. 5, 1996)).


109. This is not to say that admissibility rules are completely non-existent, however. See id. at 95 n.9 (“Rules rejecting evidence on grounds extraneous to truth-finding (e.g., excluding illegally obtained evidence) are found in many Continental countries. In most Continental systems, privileges of witnesses to refuse to testify are more generous than in common law jurisdictions.”).

110. See id. at 95 (“[T]he common lawyer will search in vain for those admissibility rules that are predicated on the idea that some information, albeit probative, can so easily be overvalued or is otherwise so volatile that it should not be presented to the factfinder (for example, gruesome evidence, hearsay, and so on). Also exceedingly rare or absent are rules and practices requiring the factfinder to use some evidence only for certain surgically limited purposes [as is sometimes the case in common law systems, “]; see also BANTEKAS & NASH, supra note 76, at 438 (“Since the finding of guilt is a task of the judges, with or without the assistance of lay members who are trained and experienced in assessing the weight of the evidence, evidence is more likely than not admitted at trial.”).


112. Moranchek, supra note 9, at 480 (“By way of comparison, a committee of American judges and law professors spent four years drafting the first U.S. Federal Rules of Criminal Procedure in the early 1940s.”).
It is not clear why the common and civil law features were combined in this way; there is no publicly available drafting history of the Rules of Procedure and Evidence. It should not be surprising that some believe the unique combination to be more a political compromise than a well-considered allocation of powers and privileges. Whatever the reason, it has not stopped the Rules’ slow shift through the years to the other side, such that the ICTY now exhibits more features characteristic of civil law systems. The Rules’ seemingly sui generis existence—and their numerous amendments—illustrate the competing tensions among the rules that have driven the amendment process and the jurisprudence of the ICTY.

As stated, the ICTY Rules began with a decidedly common law tilt. The initial rules provided for an independent prosecutor, the prosecutor had to prove guilt beyond a reasonable doubt, witnesses were subject to routine cross-examination, and there were few exceptions made to the requirement of live witness testimony. In this sense, these party-driven trials very much resembled common law trials. These features are largely still in place, except there is now a much greater emphasis on the submission of documentary evidence.

Even at this very early stage, however, there were departures from the standard common law model for criminal trials. For instance, a majority of the three-judge bench could find guilt; the defendant had a right to give an unsworn and un-cross-examined statement at the beginning of trial, as well as testify as an ordinary witness; the prosecutor could...
appeal an acquittal; and the judges could question and call their own witnesses. In addition, there was some amount of collaboration between the Trial Chamber and the prosecution in analyzing and authenticating particularly sensitive or problematic information, such as intelligence evidence. Finally, the admission of depositions was allowed in “exceptional cases,” corroborative affidavits were allowed regardless of the content of the declaration, and judicial notice of “adjudicated facts” was accepted.

The tilt towards preferring live testimony but allowing exceptions for exceptional circumstances did not last forever. As the number of arrests increased and the length of the defendants’ pre-trial detention extended, the slow pace and high cost of trials resulted in mounting pressure on the ICTY to expedite its proceedings. This eventually led to the development of the Completion Strategy, which set time targets for both the ICTY and ICTR to finish their business. With this pressure over their heads, judges needed ways to speed up trials. The practical experience of real trials had quickly brought gaps and deficiencies in the Rules to the surface, and the most logical way to fix problems was through interpretation or amendment. Thus, while the Rules initially explicitly favored live testimony, judges became more flexible in interpreting the Rules to permit the introduction of substitutes for live witnesses. One example of this more liberal conception

127. Incredible Events by Credible Evidence, supra note 23, at 537. One former ICTY judge has anecdotally noted problems that judges who are active questioners have caused counsel. See The ICTY Comes of Age, supra note 26, at 90 (“Civil law judges may question witnesses much more freely than in our [i.e. the U.S.] system. However, I have noticed that such questioning may throw off the rhythm of the prosecution’s or the defense’s case presented in an adversarial mode, casting the judge in the role of an uninvited guest at the party. The prosecution or the defense may have a carefully selected series of witnesses, called in sequence to build on each other’s testimony and with knowledge of just how far to take each witness in questioning. The other side, for its own strategic reasons, may have no desire to press that witness further, but then when the judge steps in and asks the ultimate blunt conclusionary questions the prosecution (or the defense) have been slowly and painstakingly working toward, the lawyer that presented the witness must scramble to get back control of the case. Additionally, judges don’t always repeat the witness’s testimony precisely when they ask a follow-up question (or, not infrequently, it may be garbled in translation), thereby risking an answer based on an erroneous premise.”).
128. See Moranchek, supra note 9, at 494 (“Given the international checks and balances on tribunals like the ICTY, however—where no one national party controls the intelligence gathering efforts, the prosecution team, and the judicial process collectively—a measure of trust and collaboration seems more appropriate than it might in a national law context . . . As long as the prosecutor’s office undertakes reasonable efforts to make its methodology transparent, such efforts do not pose a substantial problem for defendant’s rights.”).
129. Incredible Events by Credible Evidence, supra note 23, at 544 (noting that in the United States, deposition testimony is not allowed at all in federal criminal trials); see also Fed. R. Civ. P. 32 (stating that deposition testimony can only be used in federal civil trials to impeach the testimony of a live witness or in exceptional circumstances).
130. Incredible Events by Credible Evidence, supra note 23, at 545.
131. Cf. id.
133. See Rules of Evidence, supra note 14, at 762.
134. Id. at 545 (noting that this was done “where, in [the judges’] view, the substitution [did] not invade too intrusively into the core guarantees of cross-examination and provide[d] sufficient indicia of reliability”); see also Prosecutor v. Naletiliæ and Martinoviæ, Case No. IT-98-34-PT, Decision on Prosecutor’s Motion to Take Depositions for Use at Trial (Rule 71) (Nov. 10, 2000) (emphasizing “the great interest the Tribunal has in adopting measures that will expedite the proceedings before it”).
of the Rules has been the Trial Chamber’s allowance in several cases of the admission of transcripts of witnesses who testified in earlier ICTY cases, to the concern of some. After a series of amendments to the Rules, though, liberal interpretation tactics were no longer needed. In 1999, Rule 71—dealing with depositions—was amended by the deletion of the requirement that such evidence only be admitted in exceptional circumstances. Thus, in Prosecutor v. Naletilic and Martinovic the Trial Chamber—over defense objection that witnesses should appear live at The Hague so that the judges could ask questions and observe their demeanor—authorized the prosecution to take twenty-three depositions to use at trial, finding persuasive the fact that the witnesses were predominantly going to testify about conditions not directly related to the accused. In addition, in 2000 the old Rule 90(A)—espousing the principle of live testimony—was

135. See, e.g., Prosecutor v. Aleksovski, Case No. IT-95-14-AR73, Decision on Prosecutor’s Appeal on Admissibility of Evidence (Feb. 16, 1999) (“[T]he witness was extensively cross-examined in the Blaskic trial, and there is a common interest between the Defence in the two cases. Nonetheless, the fact remains that, if the evidence is admitted upon a hearsay basis, this accused will be denied the opportunity of cross-examining the witness. However, this is the case with the admission of any hearsay evidence . . . [I]n any event, any residual disadvantage to the accused is outweighed by the disadvantage which would be occasioned to the Prosecution by the exclusion of the evidence in the circumstances of this case.”); see also Prosecutor v. Naletilic and Martinovic, Case No. IT-98-34, Decision on Prosecution Motion for Admission of Transcripts and Exhibits Tendered During Testimony of Certain Blaskic and Kordic Witnesses (Nov. 27, 2000) (“While the Trial Chamber agrees that the guilt of an accused can never be pre-determined [sic] by reference to other proceedings before the Tribunal, there are nonetheless common issues in many of the cases. Pre-requisite elements of offences charged in the indictments . . . such as the existence of an international armed conflict . . . or the existence of a widespread or systematic attack . . . fall within this category. These pre-requisite elements determine the category of crimes within the jurisdiction of the Tribunal that the alleged actions of an accused person are to be placed, and not whether an individual accused has in fact committed the acts alleged. Therefore, admitting evidence of such pre-requisite elements from other proceedings also covering a similar location and time period, in no way infringes the rights of the accused.”).

136. See, e.g., The ICTY Comes of Age, supra note 26, at 112 (“I must admit that I find the use of prior witness statements as a substitute for live testimony troublesome. In my short time at the tribunal I have seen too many instances in which witnesses on the stand have changed, reneged, or even repudiated earlier statements which though closer in time to the events, had not been tested in any way and were unsworn. Often the statement the witness signs for a Prosecution investigator in the field is not even in his native language. It has been orally translated from English and read to him in Serbo-Bosnian-Croat.”).

137. See ICTY Rules of Procedure and Evidence, Rule 71, U.N. Doc. IT/32/Rev.7 (Jan. 18, 1996) (now allowing depositions “[w]here it is in the interests of justice to do so”); see also Incredible Events by Credible Witnesses, supra note 23, at 546 n.55 (“Perplexingly, the amendment to the deposition rule was adopted to allow for this device in matters not in serious dispute, as contrasted to the prior judicial requirement that it be used only for important evidence.”).

138. Prosecutor v. Naletilic and Martinovic, Case No. IT-98-34, Decision on Prosecution Motion for Admission of Transcripts and Exhibits Tendered During Testimony of Certain Blaskic and Kordic Witnesses (Nov. 27, 2000).

139. See Prosecutor v. Naletilic and Martinovic, Case No. IT-98-14-PT, Decision on Prosecutor’s Motion to Take Depositions for Use at Trial (Rule 71) (Nov. 10, 2000) (“[M]any of the witnesses were prisoners in camps mentioned in the indictment and their testimony covers matters such as general living conditions and the occurrence of forced labour in the camps . . . witnessing acts such as beatings, hearing gun shots and/or screams, and being the victim of, or witness to, property damage . . . [T]he Trial Chamber has been guided by the fact that the witnesses proposed for deposition will not present eyewitness evidence directly implicating the accused in the crimes charged, or alternatively, their evidence will be of a repetitive nature in the sense that many witnesses will give evidence of similar facts.”).

140. “Witnesses shall, in principle, be heard directly by the Chambers unless a Chamber has ordered that the witness be heard by means of a deposition as provided for in Rule 71.” ICTY Rules of Evidence and Procedure (Revision 6), Rule 90(A), U.N. Doc. IT/32/Rev. 6 (Oct. 6 1995). Of course, at the time this Rule
deleted entirely and replaced with Rule 89(F): “[a] Chamber may receive the evidence of a witness orally or, where the interests of justice allow, in written form.” Thus, the old preference for live testimony has been replaced with a provision that is essentially neutral as to whether testimony is oral or written. Finally, also in 2000, Rule 92 bis was added, providing for circumstances when written statements and transcripts can be admitted into evidence, so long as they do not go to the conduct or acts of the accused.

Other rules, in place at the very beginning, also speak to civil law influence in the Tribunal. As in most civil law systems, the perceived reliability of evidence will usually go to its weight, not its admissibility. Thus, hearsay and opinion evidence is generally freely admissible. Evidence of a consistent pattern of conduct is also admissible “in the interests of justice.” Rule 95 is the only exclusionary rule, keeping out any evidence “obtained by methods which cast substantial doubt on its reliability or if its admission is antithetical to, and would seriously damage, the integrity of the proceedings.” And there is generally no need for corroboration for witness testimony. The standard of proof is on the balance of probabilities, meaning the party seeking to tender a document has to show some relevance, some probative value, and some reliability.


Rules inserted between two other Rules are designated by Latin numeral adverbs to avoid renumbering all of the Rules. “Bis” means “twice” in Latin. Many Rules have been added since 1994; thus, after Rule 92 bis comes Rule 92 ter and Rule 92 quater.

See ICTY Rules of Procedure and Evidence, Rule 92 bis, U.N. Doc. IT/32/Rev.7 (Jan. 18, 1996) (noting that factors in favor of admitting evidence include circumstances in which the evidence (a) is of cumulative nature, (b) relates to the relevant historical background, (c) consists of statistical analysis of the ethnic composition of the population, (d) concerns the impact of crimes upon victims, (e) relates to the character of the accused, and (f) relates to sentencing issues); see id. at Rule 92 bis(A)(ii) (noting that factors against admitting such evidence include circumstances in which (a) there is an overriding public interest in the evidence being presented orally, (b) a party demonstrates that the evidence’s natures or source renders it unreliable or so prejudicial that its effect outweighs its probative value, and (c) other factors make cross-examination appropriate).


See Rules of Evidence, supra note 14, at 769 (noting language in cases indicating “reliability is not a judgment that must be made at the admissibility stage, but only goes to the weight of the evidence.”).

Id. at 768-69 (“There has never been a bar against hearsay in ICTY trials . . . Besides hearsay, lay witnesses pretty freely engage in opinion testimony.”) This does not mean that the evidence is always admitted. See id. (“There were, however, originally a few Appeals Chamber decisions saying that reliability is a component of probativeness, and that written statements not under oath taken by a field investigator, who speaks a different language, from the witness whose answers are then translated into an English document which the witness signs, is not probative when it concerns a critical part of the case and is uncorroborated.”).

ICTY Rules Dec. 8, 2010, supra note 15, at Rule 93; see also BANTUKAS & NASH, supra note 76, at 449 (“Whilst civil law systems generally the admission of evidence of previous misconduct of the alleged perpetrator, such is prohibited in common law jurisdictions.”).


See Byrne, supra note 23, at 615 (“The Rules of Procedure and Evidence of both ICTR and ICTY do not require corroboration.”).

BANTUKAS & NASH, supra note 76, at 458 (“The fact that the author is unknown, the signature illegible, and the seizure disputed are matters which will affect the weight to be given to the evidence so long as there is a minimum showing of indicia of reliability.”).
In summary, the ICTY’s more common law, adversarial approach has from the beginning been in tension with many of its civil law characteristics. Though a piece of evidence’s reliability was rarely used to exclude its admissibility, the kinds of evidence that are now admissible have broadened considerably. Now that documentary evidence has a much stronger foothold in ICTY’s jurisprudence, the evidentiary tilt has been reversed towards that of civil law systems.

IV. Theories of Evidence

Evidence law can be defined as a series of compromises created to accommodate a variety of competing tensions. Though the ascertainment of “truth” is generally seen to be the ultimate goal of evidence law, there are a number of other rationales in play. These might include such considerations as saving time and money, minimizing the danger of unfair prejudice, avoiding confusion of the trier of fact, affording fairness to witnesses or the defendant, and preserving the parties’ right to test the trustworthiness of evidence. Thus, efficiency and finality of decision may be deemed important in one context, while fairness to the defendant may win out in another. Additionally, evidence may be excluded for social policy reasons despite being deemed highly relevant and reliable. Given these other considerations, it is important to reflect on the value choices behind our current rules, how different values might be in play in different legal systems, and how we can design rules for a particular legal system that accommodate these different values in a way that is acceptable to the members of that system.

As a preliminary matter, it is useful to note some of the inherent difficulties in ascertaining truth. First, it is usually necessary to rely on incomplete sources of information. Unlike a moot court competition, the facts are never clear. This factual uncertainty is magnified enormously in international crises such as those in Rwanda and the former Yugoslavia. Second, our individual understanding of the world around us is inherently subjective and often unreliable. (This is a reality so obvious that it barely requires mention, but it nevertheless has a substantial effect on how testimony is given and heard.)

152. RONALD L. CARLSON ET AL., EVIDENCE: TEACHING MATERIALS FOR AN AGE OF SCI. & STATUTES 11 (2007); see also FEIO R. EVDO, 403 (“Although relevant, evidence may be excluded if its probative value is substantially outweighed by the dangers of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence.”).

153. Cf. ALEX STEIN, FOUNDED OF EVIDENCE LAW 218 (Oxford Univ. Press 2005) (“The conflicting presence of fairness and efficiency principles in evidence law constitutes a problem for cases featuring no specific rules that determine the apportionment of the risk of error.”).


156. Id.

157. Cf. id. at 231 n.35 (“Some witnesses lie, and some (though blessed few) perhaps observe, remember and recount with a high degree of fidelity to what ‘really happened,’ but by far the greater number do neither. Witnesses (like plumbers, lawyers, psychiatrists and even judges) filter what they perceive through a complex maze of ego-preserving defense mechanisms . . . which have the effect of deluding themselves most of all into believing that they are telling the truth, the whole truth and a great deal of it.” (quoting Richard C. Allen, The Dynamics of Interpersonal Communicat & the Law, 3 WASHBURN L.J. 135, 137 (1964))).
Third, subjectivity will also afflict the judge, who comes to the table with many of her own societally constructed assumptions.\textsuperscript{158} Again, the relevance of this factor is heightened in an environment as cross-cultural as that of the ad hoc international criminal tribunals. Finally, any factual findings will be based not on a description of the “real” world but upon a reality that has been constructed in court through presented evidence.\textsuperscript{159} Given these circumstances, the judge’s assumed role as an historian\textsuperscript{160} is a precarious one, and it is the role of evidence law to negotiate these problems in the search for truth.

Exactly what role evidence law should play in this search for truth is much debated. Sir Rupert Cross, a great evidence scholar, famously stated, “I am working for the day when my subject is abolished.”\textsuperscript{161} This abolitionist view is one shared by many, perhaps most notably by the great utilitarian Jeremy Bentham (1748-1832).\textsuperscript{162} Bentham’s influential works\textsuperscript{163} specifically advocated abolishing all binding technical rules of evidence.\textsuperscript{164} He abhorred judge-made law,\textsuperscript{165} trusting judges as fact-finders but not as competent creators of substantive legal rules that accommodate value preferences.\textsuperscript{166} As a result, he advocated the codification of rules, grounded in the sole value of utilitarianism, to constrain judicial discretion.\textsuperscript{167} This constraint was needed to prevent judges from injecting their own value preferences into decision-making; abolitionists like Bentham believed that the only enforceable value preferences should be those formed by social-consensus mechanisms (i.e. law),\textsuperscript{168} and that allowing anything else would be tantamount to licensing judicial dictatorship.\textsuperscript{169} In sum, he believed the appropriate evidentiary methodology should be a system of unregulated fact-finding.\textsuperscript{170}

There are at least a couple of reasons that explain this abolitionist wave, which has extended beyond the rules of evidence to include calls for abolition of the adversarial system altogether. One reason is the general skepticism that moral truths exist, much less

\begin{itemize}
\item \textsuperscript{158} See Weinstein, supra note 155, at 232 (“The effort to reconstruct the past accurately is . . . inhibited by the effect which societal expectations and assumptions have on the trier.”).
\item \textsuperscript{159} See id. at 229 (“[F]actual findings are based . . . upon a modified or constructive world of the law.”).
\item \textsuperscript{160} Cf. id. (“The court is required to assume the role of historian—without the historian’s opportunity to reserve decision. It is saved embarrassment by its acknowledgement that it is finding only ‘operative facts,’ for the purpose of the litigation.”) (internal citation omitted); see also Incredible Events by Credible Evidence, supra note 23, at 536-37 (“A trial at the ICTY is usually more akin to documenting an episode or even an era of national or ethnic conflict rather than proving a single discrete incident.”).
\item \textsuperscript{161} STEIN, supra note 153, at 111.
\item \textsuperscript{162} See id. at 108 (“This abolitionist claim has permeated legal discourse for approximately two centuries.”); see also David Crump, The Case For Selective Abolition of the Rules of Evidence, 35 Hofstra L. Rev. 585, 585 (2006).
\item \textsuperscript{163} See, e.g., Jeremy Bentham & John Stuart Mill, Rationale of Judicial Evidence (London Hunt & Clark 1827).
\item \textsuperscript{164} WILLIAM TWINNING, RETHINKING EVIDENCE: EXPLORATORY ESSAYS 200 (Cambridge Univ. Press 2006).
\item \textsuperscript{165} WILLIAM TWINNING, THEORIES OF EVIDENCE: BENTHAM & WIGMORE 115 (Weidenfeld & Nicolson 1985).
\item \textsuperscript{166} STEIN, supra note 153, at 116.
\item \textsuperscript{167} Id.; see also Twinning, supra note 165, at 115 (“Bentham was an ardent codifier . . . . ”).
\item \textsuperscript{168} See STEIN, supra note 153, at 112 (describing factors explaining abolitionist wave in evidence law).
\item \textsuperscript{169} Id.
\item \textsuperscript{170} Id. at 116.
\end{itemize}
a judge who can determine them.171 Likely, the greater reason for explaining the desire by some to abolish rules of evidence is the development of the empirical scientific method and the subsequent great advances in science and technology, which have in turn engendered confidence in human cognitive abilities.172 These developments have brought not only criticism of the rules of evidence themselves but also their mode of presentation at trial; some commentators have called either for the reform or abolition of the current adversarial system, seeing it as relic from a past of very different circumstances.173

There are of course more moderate approaches to evidence; indeed, they predominate. The codification of the U.S. Federal Rules of Evidence generally reflects the perception in the United States that there is value in having binding rules that embody “both the accumulated wisdom of centuries of practical experience and some fundamental notions of procedural fairness.”174 John Henry Wigmore (1863-1943),175 the “pragmatic conservative,” exemplified this approach.176 He was more concerned with “rules of extrinsic policy,” the “side constraints” on the pursuit of truth that often took focus away from Bentham’s concern with the “rectitude of decision.”177 To be fair to Bentham, however, even he admitted that pursuit of truth was but a means to an end—the enforcement of legal rights and duties—and that this end could be weighed against other, collateral ends, like “the avoidance of the pains of vexation, expense or delay” in adjudication.178 Of course, to Bentham, whether those collateral ends prevail over the pursuit of truth would be judged by the principle of utility.179

Despite the differences between these two scholars’ viewpoints, their ultimate goal is essentially the same. Almost all specialized writings on the common law of evidence since Gilbert180 have been founded on similar traditions. This “remarkably homogenous intellectual tradition” can be called the “Rationalist Tradition of Evidence Scholarship,” the central purpose of which is adjudication leading to the pursuit of truth, subject to various

171. See id. at 112 (“Some moral truths have . . . been accused . . . of contributing to totalitarianism, racism, and poverty. These heinous experiences have further fortified the mood of suspicion in the domain of morality.”).

172. Id. at 111; see also id. at 111-12 (“This empiricist turn characterizes not only natural scientists, but also many social scientists, law reformers, politicians, and people at large . . . . The empiricist turn has also had exclusionary implications. Distrustful of any deductive reasoning from postulated foundations, this turn shattered numerous efforts . . . at replacing fragmented and diversified morality by moral truths.”).

173. See, e.g., Alexander Greenfeld, Abolish the Adversary System, 1 CAL. L. REV. at 12 (Dec. 1981) (“The adversary system was born before the development of the scientific method and before the concept of objective truth. It is time that lawyers take themselves out of the Middle Ages of primitive intellectual and economic resources, out of the darkness that pitted hungry man against hungry man and away from the primal fear that taught that battle, cunning and evasion were the only ways to survive.”); Marvin E. Frankel, The Search for Truth: An Umpireal View, 123 U. PA. L. REV. 1031, 1031 (1975) (advocating reform of adversarial system).

174. Twining, supra note 165, at 200.

175. Id. at 189.

176. Id. at 117.

177. See id. at 89 (“[T]here is no doubt about the high value Bentham placed on rectitude of decision.”). In this sense, our common law procedural and evidentiary arrangements differ from a pure adversarial model. See id. at 200.

178. Twining, supra note 165, at 89.

179. Id.

180. Lord Chief Baron Gilbert’s Law of Evidence, written in the 1720s, was the first specialized work on evidence. Id. at 1.
side constraints (Wigmore’s “rules of extrinsic policy” and Bentham’s preoccupation with “vexation, expense, and delay”).\textsuperscript{181} The difference may simply be that Bentham was less willing to compromise on the search for truth.\textsuperscript{182} In reality, however, our current institutions have not completely accepted Bentham’s categorical approach to evidence; our current rules and practices balance utilitarianism with notions like due process (a practical approach that Bentham might castigate as “interest-begotten prejudice”).\textsuperscript{183} While Bentham believed no binding evidentiary rule could be devised that maximized “rectitude of decision,”\textsuperscript{184} our systems today recognize certain core concerns—such as the need for procedural fairness—that operate as more than simple “side constraints” to the pursuit-of-truth value.\textsuperscript{185} Whether these concerns need to be codified is still open to debate. Certainly, formal rules offer stability and predictability; but they are also inflexible, unable to accommodate unforeseen but relevant factors or scientific advances.\textsuperscript{186} Conversely, informal rules permit a more holistic, balancing approach, but they are unpredictable, subject to judicial biases, and more time-consuming to adjudicate.\textsuperscript{187} It will be up to a particular legal system—in our case, the international criminal tribunals—to determine the best approach.

V. Evidentiary Issues in the ICTY

A. Generally

Trials in the ICTY are long. The average trial is over 100 days, though some last well over 200; the number of witnesses is also often in the triple digits,\textsuperscript{188} and each witness takes an average of one full day to question.\textsuperscript{189} Though reducing the number of witnesses would greatly speed things up (as live witnesses take up the most trial time), the prosecutor will often insist that she needs certain evidence to prove her case.\textsuperscript{190} This is understandable given the unique problems posed by the prosecution of international crimes, which often require the presentation of events leading up to the outbreak of hostilities and the proof of certain predicate conditions, such as “the existence of an international armed conflict” or a nexus between the conflict and the alleged illegal acts.\textsuperscript{191} The need for speed, spurred on by the Completion Strategy, is thus in great tension with the prosecutor’s perceived need to adduce a certain amount of proof. This tension has to some extent been addressed—though not resolved—in the shift towards the use of documentary evi-
dence (which does not even have to be presented by a witness) over live evidence in the ad hoc tribunals.192

The emerging dominance of written testimony has been but one of many methods used to speed trials along, though it is perhaps the most significant.193 The use of documentary evidence has given rise to a number of due process concerns. It is true that the pressure of the Completion Strategy has necessitated a quickened pace, and the rules do, after all, grant the right to a speedy trial.194 But to the extent the tribunals are concerning themselves with the speed of the proceedings alone, instead of the rights of the accused, they walk a fine line that threatens the legitimacy of the project. This tension between speed and fairness is not easy to resolve. Given the complex military, political, and legal environment in which these conflicts arise,195 the trials will likely never be truly expeditious or perfectly “fair” for the defendant. For instance, when a prosecutor raids a Serbian army headquarters, snatching every paper in sight with the intent of sorting it all out later, it will be essentially impossible to authenticate documents or signatures; thus, the barriers to admissibility are lowered and the onus is on the defendant to then discredit the documents.196 Presenting evidence in this manner would be unacceptable in the United States and other domestic legal systems, but many would say the realities of international crimes require such flexibility.197 If true, however, any decision to make such a tradeoff should be made “conscientiously and consciously.”198

The problem, of course, is that such tradeoffs are not always conscientious or conscious. The nature of the common law tradition is such that rules develop over time (theoretically for the better), but changes in the rules of the ad hoc tribunals have tended to reflect quick fixes rather than a long-range vision of what the rules should accomplish in a wider variety of cases.199 This myopia mirrors the larger problem in the tribunals’ shift from reliance on oral evidence to documentary evidence. Though the use of documentary evidence saves travel costs, saves time spent in hearings, curtails oral testimony, and can be more carefully studied than oral testimony, it suffers—from a common law perspective, at least—from some serious shortcomings: the veracity of the declarant’s statements cannot be assessed because the declarant’s demeanor cannot be observed and the declarant...

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192. Bantekas & Nash, supra note 76, at 460 n.81 (citing Prosecutor v. Blaškic, Case No. IT-95-14, Judgment, ¶ 35 (Mar. 3, 2000)).
193. Other methods include more active case management by judges and the addition of a large number of ad litem judges.
194. ICTY Statute, supra note 40, at art. 21 (noting accused shall “be tried without undue delay”). The rules are, however, silent as to ensuring compliance with this requirement. Falvey, supra note 41, at 503. Perhaps, then, it is unsurprising that many suspects have spent many years in pre-trial detention.
195. See Dixon, supra note 30, at 88.
197. See id. at 772 (“[I]t is a slippery slope, and I have the impression that human rights activists and even some academics who would flinch at any such standardless trials at home, tend to swallow when they occur in war crimes prosecutions.”).
198. Id.
199. Id. at 762.
200. This article lists this as a potential shortcoming only because common law lawyers generally believe the ability to observe a witness is quite important. Given the significant cultural differences among the individuals involved in these trials, however, one might reasonably question the ability of judges to attain useful information from a witness’s demeanor.

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cannot be cross-examined. That the ICTY has deviated from these principles for apparently little other reason that expediency may be cause for alarm. This is the case not necessarily because the right to cross-examination is something we should be concerned about (though we should), but because these changes are not based on conscientious decisions of how best to construct trial proceedings that both sufficiently enable the prosecution and are fair to the defendant.

When viewed this way it becomes clearer why the solution is not necessarily to ditch documentary evidence and go back to all-oral evidence. The problem is not that the ICTY moved from a focus from (ostensibly) reliable evidence—oral testimony—to (ostensibly) unreliable evidence—documentary testimony—but rather that the ICTY may have moved from one approach to another without a compelling reason for doing so (apart from meeting a deadline), and without addressing the reasons why the first approach did not work (other than increasing the speed of adjudication). Because these rules of evidence lead to a substantial deprivation of liberty for many of these defendants, and because these trials may be critical to national reconciliation for some groups, the legitimacy of these and future tribunals would be better served by a more deliberate, long-term view to evidence-rule amendments.

B. SPECIFICALLY

As indicated, however, the answer cannot simply be to revert back to the exclusive use of oral testimony. Even without considering the glacial pace and astronomical costs burdening the earlier trials that insisted on live testimony, it is not obvious that the former approaches were any more successful at producing reliable evidence or protecting the rights of the accused than the new ones. For example, the reliability of testimony from witnesses suffering from PTSD or other stress-related disorders may be limited; indeed, these disorders are presupposed, as evidenced by the general avoidance of expert testimony on PTSD. Due to these inevitable distortions, inconsistencies in prior statements are frequent, yet the ICTY has taken a restrained approach in attributing significant probative weight to this fact. Recognizing that circumstances such as lapses in

203. See Prosecutor v. Stakiæ, Case No. IT-97-24, Trial Chamber Judgment, ¶ 15 (July 31, 2003) (“Apart from the fact that much time has passed since 1992, the Trial Chamber is aware of the limited value of witness testimony in general. Special caution is warranted in cases like this one that have both a highly political, ethnic and religious element and a complex historical background. The Judges are convinced that for the most part, most witnesses sought to tell the Chamber what they believed to be the truth. However, the personal involvement in tragedies like the one in the former Yugoslavia often consciously or unconsciously shapes a testimony.”).  
204. Byrne, supra note 23, at 636.
205. Id. at 616.
206. Id. at 632; see also Prosecutor v. Akayesu, Case No. ICTR 96-4-T, Judgment, ¶ 140 (Sept. 2, 1998) (“Since testimony is based mainly on memory and sight, two human characteristics which often deceive the individual, this criticism is to be expected. Hence, testimony is rarely exact at to the events experienced. To deduce from any resultant contradictions and inaccuracies that there was false testimony, would be akin to criminalising frailties in human perceptions. Moreover, inaccuracies and contradictions between the said statements and the testimony given before the Court are also the result of the time lapse between the two. Memory over time naturally degenerates, hence it would be wrong and unjust for the Chamber to treat
time between statements, translation issues, and the victims’ traumas may all contribute to
distorted testimony, at least one Trial Chamber has adopted the counterintuitive solution
of simply using courtroom testimony, the testimony farthest removed from the incident in
question, as the point of departure. And no corroboration is needed.

Translation is another difficult issue for the tribunals. For instance, numerous words in
Kinyarwanda (Rwanda’s primary language) can be translated in English as “rape.” In
addition, one particular verb can be translated as either seeing or hearing, which, when
combined with the purported Rwandan cultural tendency not to answer questions on sen-
sitive matters directly, means that it is often difficult to determine whether someone
was an eyewitness or had just heard about something. Beyond these practical difficulties,
several studies have shown that these technical and cultural factors not only result in
flawed credibility assessments but that they can also substantially affect the accuracy of
the record.

The tribunals’ open admissibility of hearsay and opinion, both written and oral, also
bears significantly on the accuracy of the record. As with most evidence in the ICTY
(contrary to the U.S. system), the reliability of a piece of evidence goes to its weight rather
than its admissibility. Inconsistencies and other blemishes are judged by apparent non-
standards (to common law ears) such as “accordingly” or “in that light.” Given the
“everything comes in” approach, how are judges to weigh the evidence? While civil law
judges may feel confident in their abilities to give appropriate weight to whatever evidence
comes in, this otherwise-justifiable perception might be attributed to features of their own
systems that have not carried over into the international criminal tribunals. For instance,
a dossier created by an investigative judge who has supervised and often cross-examined
witnesses’ statements does not exist in the ad hoc tribunals. Without a dossier, docu-


207. Byrne, supra note 23, at 632-33.
208. Id. at 615.
209. Id. at 634.
210. Id.
211. See Rules of Evidence, supra note 14, at 769 (“I have seen many witnesses on the stand change many facets
of their testimony from prior statements made out of court. I certainly could not have identified what was
true, and what was not, from the written word alone; it is, frankly, hard enough in the courtroom judging
demeanor when the witness speaks a different language and the translator has literally the last word on what
the witness says.”).
212. Byrne, supra note 23, at 623 (citing studies in Deborah B. Anker, Determining Asylum Claims in the
United States, 19 N.Y.U. REV. L. & SOC. CHANGE 433 (1992), and Cécile Rousseau et al., The Complexity of
Determining Refugeebod, 15 J. REFUGEE STUD. 43 (2002)). Important for this area has been the use of expert
testimony on cultural and linguistic issues. See id. at 614.
213. See Rules of Evidence, supra note 14, at 768.
214. See, e.g., Prosecutor v. Akayesa, Case No. ICTR 96-4-T, Judgment, ¶ 143 (Sept. 2, 1998) (“Inconsis-
tencies or imprecisions in the testimonies, accordingly, have been assessed in the light of [the assumption that
some or all witnesses may suffer from extreme stress disorders] . . . . ”).
215. See Rules of Evidence, supra note 14, at 770 (“Now I am certainly not enamored of our hearsay Rules with
their intricate exceptions. But I am also concerned that current international law tribunals not devolve into
[something like Yamashita] . . . . I often felt the need for more precise guidance than the assurance I could give
testimony whatever weight I wanted, be it first, second, or third-hand hearsay. The confidence that civil
judges have in their own capabilities in this regard may be traceable to parts of their indigenous process that
have not been carried over into the Tribunal’s hybrid system.”).
ments submitted by the parties are simply pieces of paper; and given the lack of rules to
guide reliability assessments, determining the evidentiary value of these papers is com-
pletely up to the judges.216 These judges will thus have to rely on basic instincts of what is
and is not allowed, which in turn can lead to wildly divergent results, given the variation in
origin and training of the judges.217

This article proposes solutions to some of these problems that are simple but that have
received remarkably little discussion. The first suggestion is that these and future tribu-
nals employ powerful and independent investigative judges.218 The second proposed solu-
tion is to engage in a more substantial codification of rules of evidence and procedure in the
tribunals. This article will discuss each in turn.

1. Investigative Judges

The use of investigative judges should not necessarily stymie efforts by the parties to
develop their own cases, but the judges’ singular focus on amassing reliable information
could create a separate tier of evidence that could bypass the embarrassing and damaging
problems posed by both oral and documentary evidence used in the tribunals to date.
This more reliable evidence would not only lead to a more just result for the accused; it
would enhance the legitimacy of the courts within the post-conflict states and the interna-
tional community in general. It would also provide the foundation on which judges could
counter begin to fairly weigh competing pieces of evidence, which due to vague and open-
ended rules has not been obviously successful.219

The inclusion of such a role does not come without costs, however. In particular, con-
cerns regarding the impartiality of an investigative judge and the reliability of the dossier
produced need to be addressed. Given that such judges already exist in certain civil law
systems, it is useful to begin by examining whether these issues are problematic in real-
world contexts. This article will discuss the use of investigative judges in France; while the
situation there is not completely rosy, it is a useful illustration of some of the hurdles to be
overcome. This article concludes that there is no reason to believe that the problems
evident in the French system would be replicated in an international tribunal.

In France, there are two types of investigation: a police investigation and a judicial
investigation, the latter having greater coercive powers.220 Either the prosecutor or the
victim, who many join the case as a civil party,221 can open a judicial investigation, part of
a process called instruction.222 It builds on the work of a police investigation and is de-
signed to determine whether the case should be referred to trial.223 In cases where a

216. Id.
217. See id. at 763.
218. For discussions that hint at this, see generally McClelland, supra note 94; see also Schuon, supra note 62,
at 266 (proposing the use of a dossier in the ICTY).
219. See infra Part V.B.2.
221. Daly, supra note 106, at 72 (“This enables the individual to have access to the magistrate’s files and to
the investigation itself as it develops and ultimately to win an award of damages if the defendant is found
guilty.”).
223. ELLIOTT ET AL., supra note 220, at 206; see also JOHN BELL ET AL., PRINCIPLES OF FRENCH LAW 134
(2d ed. 2008).
judicial investigation is conducted (usually only particularly grave and complex cases), the investigation is formally conducted by the prosecutor or in serious cases an investigative judge (juge d’instruction), who is appointed to a three-year renewable term but in practice may remain there for many years. The investigative judge is independent of the office of the public prosecutor (ministère public) and cannot be the trial judge in the same case. The investigative judges are tasked with discovering the truth rather than the guilt of the suspect. In so doing, they may visit the scene of the crime, hear witnesses, search and seize property, interrogate the parties, and arrest a person charged. At any stage of the proceedings, the prosecutor’s office can demand to see the dossier or request that the investigate judge carry out acts it believes would be useful to discover the truth and maintain security. Similarly, the suspect and a civil party (i.e. a victim) may ask the investigative judge to carry out an act to discover truth. The judge may refuse these requests, but she must give reasons, and the refusal is subject to appeal. The investigative judge in France is not a passive umpire. Although there is input from both the prosecution and defense, the judge will question the accused and witnesses and may order further investigation, including for example the production of an expert report. Materials used to establish guilt are put into the dossier, which is used at both the trial and appellate stages. Parties can appeal a decision of the investigative judge, though the prosecutor’s power to do so is greater than that of the accused or a participating civil party. A prosecutor can petition the president of the court to have an investigative judge replaced “in the interests of the good administration of justice,” for example if the proceedings have ground to a halt or if it appears that the judge is not impartial.

So far, so good. One critical problem, however, is that it is difficult for an investigative judge to carry out an investigation herself. In complex cases, additional investigative judges may be added, but because there are so few investigative judges, judges in practice ultimately delegate their authority to the police, with a judge’s role being primarily to watch over the investigation carried out in her name to prevent the abuse of the broad coercive powers. Thus, theoretical judicial control is modified in practice by a delega-
tion of authority, such that the police conduct most investigations.242 This poses two interrelated problems. First, the fact that the police are answerable to the Ministry of the Interior or the Ministry of Justice may feed the suspicion that the judiciary is dependent on politicians and that the police communicate information about their investigation to improper entities.243 In addition, because the police are the predominant investigators, it is their work—and not that of the investigative judge—that is put into the dossier and used as the basis for judicial decisions.244

The role of the prosecutor in France also has a substantial effect on investigative judges. A French prosecutor exercises a supervisory function over the police and plays a more neutral and wide-ranging role than that of the partisan prosecutor in systems such as that in the United States.245 Like many European countries, France has a career judiciary but unlike Germany, the judiciary also includes the prosecutor.246 This commonality is demonstrated physically by the prosecutor standing on a raised platform beside the judge, while the defense attorney stands on the floor with the accused.247 The shared status and the resulting ties of collegiality and ideology that bind them as magistrats militates against a clear separation of the prosecutorial and investigative roles.248 From one perspective, having prosecutors in the same professional grouping as judges might be seen as strengthening the independence and credibility of the investigative function.249 Instead, the blended role has generally been criticized; the investigative judge’s close relationship with the police and prosecutor is said to undermine the judge’s neutrality, which is of particular concern because trial judges tend to defer to the findings of the investigative judges who are assumed to have effectively supervised the investigation250 and are themselves reliant on the version of the events given by the police and prosecutor.251 Further, because the system assumes that judges protect the rights of the accused, the defense attorney has little power to intercede when judges fail to perform their functions.252 Professor Jacqueline Hodgson produced an impressive study in which she conducted eighteen months of direct observation over a period of six years in the offices of prosecutors, investigative judges, gendarmes, and the national police.253 Although all of her findings are well beyond the scope of this article, her monograph highlights the less-than-arm’s-length relationship

242. Bell et al., supra note 223, at 130.
243. Elliott et al., supra note 220, at 209.
244. Bell et al., supra note 223, at 130.
245. Hodgson, supra note 225, at 75.
246. Id. at 69; cf. Bell et al., supra note 223, at 127. In Germany, there are separate career structures for judges and prosecutors. Hodgson, supra note 225, at 69 n.17.
247. Id. at 70 n.23.
248. Id. As one investigative judge stated, referencing prosecutors: “We are the same, we come out of the same school, we know each other. That is the real problem . . . I am often shocked by the way in which people talk about certain cases before and after the court hearing. That is already an encroachment on the independence of each . . . I once heard a judge say, “but of course we must defend the police.” . . . That is the real debate. It is all the product of the ideology of society, the profile of the state. Our problem is based on having multiple functions coming out of the same school . . . Even I question myself: Do I work as a judge, investigator or partner of the police or Gendarmerie? I do not know.” Id. at 70.
249. Id. at 71.
250. See Bandes, supra note 57, at 425; see also Hodgson, supra note 225, at 71.
251. See Bandes, supra note 57, at 420–21.
252. Id. at 425; see also id. at 420–21.
253. Ross, supra note 225, at 370.
between the investigative judge and prosecutor and between the prosecutor and police, as well as the practical diminishment of defendants’ rights despite the formal strengthening of defense safeguards.254

The issues surrounding the use of investigative judges in France are good illustrations of the concerns when importing such a role into the ad hoc tribunals. The predominant concerns are neutrality and independence, but if the role were crafted with care, the use of an investigative judge in these tribunals could overcome these concerns. An investigative judge at an international tribunal would neither rely on local police to conduct investigations nor rely on potentially partisan prosecutors to supervise them. Rather, a special corps of judicial investigators working directly for and answering only to the investigative judge would be marshaled to carry out the task.255 Further, placing the appointment of the investigative judge in the hands of the trial judges would ensure the independence of the investigative judges from political forces. This removal from executive interference, when combined with the fact that the tribunals are time-limited, would also help ensure the investigative judges’ neutrality. Because the position of investigative judge in the tribunals would not be a career position, and because in any event the entities having the most immediate influence over the careers of those acting as investigative judges would be neutral parties (the trial judges), an investigative judge would have no more incentive to be non-impartial than any other judge. While lawyers from common law systems might be uneasy about the investigative judges having a substantially more active judicial role,256 this unease may stem from an inappropriate equating of a judge’s passivity with impartiality.257 As noted above, active judging is present in numerous civil law systems—including the European Court of Justice, where a special judicial officer (judge-rapporteur) is responsible for building the record258—and concerns surrounding the impartiality of judges can be addressed through carefully crafted structural mechanisms, as with the selection of judges in any system, to prevent the role from being politicized.

These are merely the outlines of the role an investigative judge would play in an international tribunal. While an examination of the role of such judges in France shows that there are certain legitimacy concerns that would need to be addressed were such a role instituted in an international criminal court, a careful crafting of the position should address most if not all of those issues. Further, an international tribunal has a distinct advantage in overcoming these obstacles because “it is not tightly bound to socio-cultural premises and notions, or century-old legal traditions, as domestic legal systems.”259 As a result, an international court can make an experience-based assessment of its particular needs and customize its procedures to serve those purposes, unfettered by a particular legal tradition.260 By having a clear vision of how an investigative judge would operate to

254. See id. at 373–75.
255. This has been done in Italy for the investigation of Mafia-related offenses, Elliott et al., supra note 220, at 210, although Italy has eliminated the role of investigative judge and moved to a more adversarial system of criminal procedure. See Del Duca, supra note 85, at 74, 82.
256. See Bandes, supra note 57, at 428 (“At the risk of oversimplifying, inquisitorial systems are based on a willingness to trust judges, and our system [i.e. the U.S. system] is premised on a mistrust of judges.”).
257. Schuong, supra note 62, at 194, 262.
258. Koch, supra note 98, at 152.
259. Schuong, supra note 62, at 251.
260. Id.
fulfill the specific needs of the tribunal, any concerns of how such judges have operated in other systems are relatively easily addressed.261

2. Greater Codification of Rules of Evidence

The second solution this article proposes is to engage in a more substantial codification of rules of evidence and procedure in the tribunals. The rules have engendered great uncertainty; vagueness invites open-ended interpretation using basic instincts that will vary considerably from judge to judge. Moreover, the lack of corroboration requirements or admissibility standards means that even the most unreliable evidence may stand on the same evidentiary plane as standard, authenticated evidence. Indeed, under the current approach there is often no way of knowing whether an assertion is reliable. How, then, can a judge be expected to “weigh” anything “accordingly?” On this point, a quote from Patricia Wald—who served on the D.C. Circuit Court of Appeals and was the U.S. judge at the ICTY for a number of years—is instructive:

I do have practical problems with this “let a thousand flowers bloom” approach toward evidence. It may be that a “holistic” approach, in theory, means at the end of the trial a judge assesses the weight of each piece by looking at its place in the overall picture. But the ICTY trials take months, or even years, and in my experience at the end it is often difficult to recall (even with notes and transcript) individual pieces of evidence. Candidly, when it comes time to write up the facts in the case (and a typical case has 500 or more factfindings), a legal assistant is usually assigned the first draft without detailed instructions from the judges as to their assessment of the reliability of each piece of evidence and how it relates to the others. Often, sad to say, the legal assistant may not have been at the trial at all, or at least not all of it, and drafts from cold copy. I also think letting everything in and postponing valuations until the end of trial prolongs the trial itself; since the opposing party must assume that the evidence will be given some weight, they will take all precautions to challenge it, if there is even a remote possibility it will be critical . . . I fear the situation is a bit too wide open and unpredictable for my taste . . . .

Because of this reality, without pre-screening it is difficult to imagine how judges, when the time comes to draft a judgment, could do anything but accept each piece of evidence as reliable. This inevitability cuts strongly against the criticism of many individuals who have suggested that restrictive evidentiary rules divert the parties’ attention away from truth-seeking because everyone is caught up in “technical procedural issues.”263 After all, if everything is generally accepted as true, how is the truth-seeking value being fulfilled at all? While judges might be able to filter out what would be excessively prejudicial information to a layperson, they cannot do the same for evidence that is unreliable because they would have no way of knowing its reliability absent some inquiry. Further, fights

over the admissibility of evidence are not absent in civil law systems (nor are they in the tribunals themselves)—for example, in France the parties may challenge the contents of the dossier, which is a complex area of law that involves judicial decision-making with respect to specific items in the file—and there is no reason to believe that a managerial judge armed with clear guidelines could not prevent such rules from unnecessarily protracting trials.

This is not to say that the rules should parrot the Federal Rules of Evidence used in the United States. Intricate hearsay exceptions may not be appropriate in post-conflict international adjudication, but giving judges general guidelines—for example, avoiding reliance on second- or third-hand hearsay—may be appropriate. Whatever guidelines are established, citing the truth-seeking value as the reason for avoiding restrictive evidentiary rules is somewhat inconsistent with other practices that have been adopted during the evolution of the ad hoc tribunals to exclude evidence—for instance, the increasingly managerial judging (including a judge's ability to direct the prosecutor regarding the counts of the indictment on which to proceed) and the use of a pretrial conference to reduce the amount of evidence presented and the complexity of the case. For this reason, concerns that more restrictive rules would unduly shackle judges and prolong the proceedings may be overstated.

VI. Conclusion

The international criminal tribunals have sometimes been plagued by their “hybrid” status. Adversarial systems do not mix well with liberal admissibility rules, and as a result the trials at the ICTY have been incredibly slow. Judges hailing from a variety of legal backgrounds and who are often unschooled in cross-examination must pull together a huge amount of evidence—often of unknown reliability—adduced by lawyers who also hail from a variety of legal backgrounds and who are also often not schooled in cross-examination.

Though headway has been made in making the proceedings more efficient—such as training inexperienced counsel, allowing for the use of video link instead of live testimony (which should be greatly expanded), and adding a number of ad litem judges—it is not apparent that any of these changes have been made with any eye towards the accused. Judges hold great power over the accused, yet because they have only vague rules, and

264. See BANTEKAS & NASH, supra note 76, at 468-69 (noting a dispute in two ICTY cases over the prosecutor’s attempt to submit into evidence a dossier relating a particular attack; the court looked at the materials independently, rather than as a whole, and determined that not all categories of the proposed evidence should be admitted).

265. BELL ET AL., supra note 223, at 128.

266. Beyond truth-seeking, establishing a historical record of the conflicts is also a goal of the tribunals, but many have suggested that the adversarial trial process and factual-findings by judges may not produce the best approximations of history, and “the ‘adjudication’ by the ICTY of who started, prolonged, or ended the war and why in the context of criminal proceedings without the states themselves having input is basically unfair, or at least does not contribute to future reconciliation.” The ICTY Comes of Age, supra note 26, at 11617.


268. See The ICTY Comes of Age, supra note 26, at 105 (“I came away from the two lengthy trials in which I have participated thinking that the potential of cross-examination by defense counsel in the search for truth has not been realized.”).
because there are few reliability requirements of practical effect, the evidence with which judges are armed to convict these accused is often of questionable reliability. The institutional confidence in judges' ability to weigh these competing pieces of often-unreliable evidence threatens the legitimacy of these courts and future courts who would use these rules as models for their own. While it may be appropriate to lower the standards on oral and documentary evidence by some degree to accommodate the realities of international conflicts, this should result from a conscious decision that takes into consideration more than mere speed, especially given the capacity of other countries to give these defendants a fair trial in their own national courts.

Even scholars as diverse as Bentham and Wigmore would agree that the pursuit of truth is the major goal of evidence. It is not obvious, however, that the ad hoc tribunals have managed to achieve "truth," and to blame it solely on the complex nature of the proceedings would be to miss the larger problems with the rules of evidence themselves. In attempting to address these problems, the rights of the accused should be more than "side-constraints" (to use Wigmore's terminology) in these proceedings. This article has proposed two relatively simple but widely ignored solutions that would address these and other concerns. By combining a powerful and independent investigative judge with a more substantial fleshing-out of the rules of evidence and procedure, these and future tribunals could both speed up the trial process and better protect the rights of the accused, thereby occupying a more legitimate place in the field of international criminal justice.

269. See Zappalà, supra note 261, at 856 (noting that the draft provisions of the rules of evidence and procedure for the Iraqi Special Tribunal for Crimes against Humanity were strongly influenced by rules of the ad hoc tribunals and the Special Court for Sierra Leone); cf. Incredible Events by Credible Evidence, supra note 23, at 114 ("[S]ince some of our modus operandi are being adopted or adapted—for better or worse—in the procedures of the permanent ICC, the Tribunal's due diligence is required to evaluate how our practices work in practice.").
Transfer-Pricing with Software Allows for Effective Circumvention of Subpart F Income: Google’s “Sandwich” Costs Taxpayers Millions

JOHN SOKATCH

I. Introduction

A. PREFACE

“And remember . . . don’t be evil, and if you see something that you think isn’t right—speak up!”—Unofficial Slogan from Code of Conduct for Google, Inc. 1

Every day millions of web users peer into the vast beyond of their proximate familiarities through the use of various internet search engines. These gatekeepers of information allow a remote user in Dallas, Texas to view news from the Middle East, sports scores from the United Kingdom, and stock market information from China. One such gatekeeper and world-renowned search engine servicer, Google, continues to make international headlines 2 by providing, often to the detriment of governments, access to free-flowing information at the click of a button. 3 Although Google is a U.S.-based company

1. See Google.com, Code of Conduct, http://investor.google.com/corporate/code-of-conduct.html#VII (last visited Feb. 28, 2011) (“The Google Code of Conduct is one of the ways we put “Don’t be evil” into practice. It’s built around the recognition that everything we do in connection with our work at Google will be, and should be, measured against the highest possible standards of ethical business conduct. We set the bar that high for practical as well as aspirational reasons: Our commitment to the highest standards helps us hire great people, who then build great products, which in turn attract loyal users.”).


whose worldwide operations are subject to local and federal U.S. taxation laws, its cross-border transactions have significantly minimized its tax bill to Uncle Sam.

Consider the following: Consumer A (a non-U.S. citizen) and Corporation Y (incorporated outside the jurisdiction of the United States) contract to do business, whereby A purchases widgets from Y for a certain value. Under general U.S. tax principles, Y’s recognized income would be subject to tax in the jurisdiction in which the transaction occurred or the place of Y’s incorporation. As such, this transaction would generally not qualify as a taxable event subject to U.S. taxation rates. Nonetheless, U.S. lawmakers have enacted a long-arm statute that broadly characterizes this situation as a taxable event in the case where Corporation Y is a wholly owned subsidiary of a domestic U.S. company with shareholders residing within the United States. To avoid this result, multi-national corporations take advantage of legal tax havens in the form of off-shore entities that enable them to defer taxes on their income earned from foreign-based entities. Congressional attempts to curb such behavior have largely proven to be fruitless, as the number of corporations implementing similar tax maneuvers appears to be increasing every year.

B. The Issue

The Internal Revenue Code dictates that U.S. corporations pay the standard corporate tax of 35% on profits earned domestically and abroad, one of the highest corporate tax rates in the world. In October 2010, however, Bloomberg.com reported that Google reduced its overseas tax rate to 2.4%, resulting in a $60 billion loss to the U.S. government and harsh criticism from politicians for Google’s injurious, although technically legal, use of international tax loopholes. Google accomplished this feat by utilizing an

7. See I.R.C. § 954(d)(1)(A) (2011); Treas. Reg. § 1.954-3(a)(2) (as amended in 2002) (“Foreign base company sales income does not include income derived in connection with the purchase and sale of personal property (or purchase or sale of personal property on behalf of a related person) in a transaction described in subparagraph (1) of this paragraph if the property is manufactured, produced, constructed, grown, or extracted in the country under the laws of which the controlled foreign corporation which purchases and sells the property (or acts on behalf of a related person) is created or organized.”).
10. Most U.S. multinationals avoid current U.S. taxation of their foreign business income by accumulating such income in controlled foreign subsidiaries: in essence, their offshore piggybanks. The ability to suspend the taxation of foreign business income in this manner is commonly referred to as ‘deferral,’ and it has become an important strategic objective for managers of U.S.-based multinationals.
12. See I.R.C. § 11(b)(1)(D) (“The amount of the tax imposed by subsection (a) shall be the sum of . . . 35 percent of so much of the taxable income as exceeds $10,000,000.”); see also id. §§ 951, 952, 954.
13. Drucker, supra note 5.
income-shifting method known to tax lawyers as the “Double Irish” and the “Dutch Sandwich,” which, as some commentators noted, “[t]he sandwich leaves no tax behind to taste.”14 Despite the criticisms, several other U.S. technology-based companies, such as Microsoft, Inc. and the social networking giant Facebook, have begun to utilize similar methods to avoid tax payments to the U.S. government.15

Access to these strategies is widely available. For example, KPMG, one of the top four U.S. accounting firms, conducted a survey in 2010 on corporate and indirect rates of countries from various places around the world, which brought to light the incentives behind why companies elect to establish related businesses on international soil, rather than maintain full operations within U.S. borders.16 This survey is one of many informal sources available to corporate directors, who will review information provided by KPMG and other similar resources to make business decisions in the best interest of the shareholders.17 As a result, if lawmakers continue to ignore this issue, we will see more companies creating offshore subsidiaries to reallocate profits and escape paying domestic taxes.

Part I of this paper compares international corporate taxation rates to U.S. rates to provide a comprehensive understanding of why companies like Google would elect to utilize transfer pricing and shift profits from U.S. soil. Part II explains the “Double Irish” and “Dutch Sandwich” tax maneuvers and how Google implements these strategies to legally lower their effective corporate tax rates to minimal levels. Part III examines various legal measures that the U.S. government has enacted to counter-balance such practices and bring profits back within U.S. borders. It also examines the possible solutions to the problem with commentary on why amendments to the current taxation regime are necessary.

While the extent to which the global economy is affected by avoidance maneuvers implemented by Google and other similarly situated companies remains unclear, such maneuvers may eventually become commonplace practices for average-size businesses. Moreover, while some commentators claim that Google is ignoring its corporate slogan, “Don’t be evil,” by the creation of such a scheme,18 these tax maneuvers may signify a more disturbing and potentially detrimental future for international bodies choosing to ignore such on-goings while the rest of the world embraces the ever-changing landscape and globalization of international business transactions.

14. Id.
15. Id. (“Google’s practices are very similar to those at countless other global companies operating across a wide range of industries.”).
17. See id.
18. See, e.g., Drucker, supra note 5 (“Google is ‘flying a banner of doing no evil, and then they’re perpetrating evil under our noses.’”).
II. Background

A. History and Historical Data on Corporate Tax Rates in the United States

Corporate law in the United States pre-dates the imposition of the federal income tax. Chief Justice John Marshall famously pronounced a corporation’s essence in American jurisprudence in *Trustees of Dartmouth College v. Woodward*:

A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence. These are such as are supposed best calculated to effect the object for which it was created. Among the most important are immortality, and, if the expression may be allowed, individuality; properties, by which a perpetual succession of many persons are considered as the same, and may act as a single individual. They enable a corporation to manage its own affairs, and to hold property, without the perplexing intricacies, the hazardous and endless necessity, of perpetual conveyances for the purpose of transmitting it from hand to hand. It is chiefly for the purpose of clothing bodies of men, in succession, with these qualities and capacities, that corporations were invented, and are in use.19

The idea that a corporation is separate from the individual has since continued thematically with the enactment of subsequent laws regarding liability of corporations.20 Following the advent of the federal income tax in 1861, only individuals were taxed on a percentage of their incomes.21 It was not until the Revenue Act of 1894 that the U.S. government established the principle of treating corporations as taxable entities separate from their owners.22 The Act was later overturned in *Pollock v. Farmers’ Loan & Trust Co.*, where the Supreme Court held 5-4 that the income taxes on interest, dividends, and rents imposed by the Act were unconstitutional because they violated the constitutional provision that direct taxes be apportioned.24 In 1913, the Sixteenth Amendment reversed the decision in *Pollock* by granting Congress the express power to lay and collect taxes on incomes for individuals and corporations.25

21. U.S. Dep’t of Treasury, Chronology of Events 1800-1899, http://www.treasury.gov/about/history/Pages/1800-1899.aspx (last visited Feb. 22, 2011) (“August 5, 1861-The U.S. government levied the first income tax to help pay for the Civil War. All incomes over $800 were taxed three percent until the year 1872, when the tax was repealed.”).
24. *Id.* at 86.
25. U.S. CONST. amend. XVI (“The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.”).
The first federal corporate income tax brackets were set at rate of 1% for all income exceeding $5,000.26 From 1913-1915, Congress eliminated the tax brackets and instead imposed the 1% rate on all taxable income.27 Corporate tax rates steadily increased for the next few years until the advent of World War II, when economic conditions forced Congress to dramatically increase the rates on the upper corporate income earners to pay for war debts.28 In 1919, corporations making over $25,000 per taxable year were subjected to a tax rate of 19%.29 This rate increased to 24% in 1940 and rose as high as 40% during war times.30 Corporate tax rates thereafter rose as high as 52.8% in 1969 before finally settling on the present day rate of 35% for the highest corporate earners.31

With U.S. corporate tax revenues totaling $191.4 billion, or 9% of total tax revenues for 2010,32 it is no surprise that corporations are hiring tax attorneys to find ways to circumvent payments to the U.S. government and satisfy their shareholders. Some congressmen are currently attempting to curb this behavior as they work to close these loopholes amid the looming threat of ever-increasing debts.33 The eventual outcome of these tensions remains unclear; but what remains certain is that corporations will continue to use all means necessary, including outsourcing business overseas, to lower their effective tax despite legislative attempts to the contrary.

B. SURVEY OF WORLD CORPORATE TAX RATES

With the second-highest gross domestic product (GDP) in the world in 2009, behind the European Union,34 the United States imposes one of the highest marginal tax rates (35%) in the world on its top corporate income earners.35 When this rate is coupled with the power of states and local governments to impose additional corporate taxes ranging from 1% to 12% (7.5% on average), U.S. corporations pay well above the world average of 24.99% of their annual income to the federal government.36 As a result, companies like

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27. Id.
28. See id.
29. Id.
30. Id. at 287-88.
31. Id. at 288; see also I.R.C. § 11(b) (2011).
33. See, e.g., id. (“Many business leaders and tax experts say the corporate tax code discourages foreign investment in the United States and hinders the ability of U.S. companies to compete internationally.”); see also Drucker, supra note 5 (“U.S. policy makers, meanwhile, have taken halting steps to address concerns about transfer pricing. In 2009, the Treasury Department proposed levying taxes on certain payments between U.S. companies’ foreign subsidiaries.”).
35. I.R.C. § 11 (2011); see also Sahadi, supra note 32 (“The 35% top corporate tax rate . . . is among the highest in the world.”).
36. See Drucker, supra note 5 (“Two thousand U.S. companies paid a median effective cash rate of 28.3 percent in federal, state and foreign income taxes in a 2005 study by academics at the University of Michigan and the University of North Carolina.”).
Google have chosen to establish subsidiaries in other countries with significantly more favorable corporate tax rates to increase profits and offset any of the costs in the process.\textsuperscript{37} Japan, which in 2010 imposed the world's highest corporate tax rate of 40.69\%, has recently experienced the effects of that decision.\textsuperscript{38} Because of recent economic woes and corporations moving business outside of Japan's borders, Japanese lawmakers chose to cut the corporate tax rate by around 5\% to bring the rate more in line with that of the United States.\textsuperscript{39} With a national debt nearly twice the size of its S5 trillion economy, Prime Minister Naoto Kan explained that "[b]y daring to go with a 5\% reduction, [Japan] will spur companies to invest domestically, expand employment and raise wages . . . [t]hat will stimulate the domestic economy, support growth and shake off deflation."\textsuperscript{40} In the three months following the announcement, the Japanese economy grew by a reported 1.1\%.\textsuperscript{41} Although this is just a preliminary indication of signs that the Japanese economy is improving, several commentators from some of Japan's largest corporations have noted that having such a high corporate tax rate "has been one big barrier" to investment in Japanese corporations, and therefore a reduction in the corporate tax rate was "imperative to attract people, products and funds to Japan."\textsuperscript{42}

The United Arab Emirates (UAE), a political unit comprised of the seven countries Abu Dhabi, Dubai, Sharjah, Ajman, Umm Al Quwain, Fujairah, and Ras Al Khaimah, boasts the highest tax rate on a specific corporate sector within their boundaries, namely oil companies, which must pay 55\% of their operating profits to the local government.\textsuperscript{43} But citizens in the UAE are not subject to an individual income tax, nor do any other corporate sectors pay a corporate income tax, which likely offsets any detrimental effects to their economy.\textsuperscript{44}

Other notable countries with relatively high corporate tax rates include France at 33.33\%, India at 33.99\%, Libya at 40\%, Pakistan at 35\%, South Africa at 34.55\%, and Venezuela at 34\%.\textsuperscript{45} While it may come as no surprise that these are also some of the largest economies in the world, companies from these countries have already or soon will likely implement tax avoidance maneuvers similar to that of Google or simply leave the country for one with a lower corporate tax rate. This could result in dire consequences for the long-term growth of these nations.

At the other end of the corporate tax spectrum, several countries, particularly those with smaller, or less developed, economies refrain from imposing taxes on corporations within their national borders. Several of these countries, such as the Bahamas, Bermuda, and the Cayman Islands are located just off the coast of the United States and provide tax incen-

\begin{itemize}
  \item \textsuperscript{37} See, e.g., id.
  \item \textsuperscript{38} See KPMG, supra note 16, at 13.
  \item \textsuperscript{39} Hiroko Tabuchi, Japan Will Cut Corporate Income Tax Rate, N.Y. TIMES, Dec. 14, 2010, http://www.nytimes.com/2010/12/14/business/global/14yen.html ("Lowering the corporate tax burden by 5 percentage points could increase Japan's gross domestic product by 2.6 percentage points, or 14.4 trillion yen ($172 billion), over the next three years, according to estimates by Japan’s Trade Ministry.").
  \item \textsuperscript{40} Id.
  \item \textsuperscript{41} Id.
  \item \textsuperscript{42} Id.
  \item \textsuperscript{44} See id.
  \item \textsuperscript{45} KPMG, supra note 16, at 12-14.
\end{itemize}
tives for U.S. companies that place subsidiaries at these locales. 46 Bermuda in particular has become a favorite offshore tax haven because it imposes no income tax, no capital gains tax, no withholding tax on dividends or interest, and currently has no double taxation treaties with other countries. 47 Other countries, like Bahrain, Guernsey, the Isle of Man, Jersey, and Montenegro, also have either negligible or non-existent corporate tax rates that attract investment from other countries around the world. 48 The reasons a country elects to have a certain corporate tax rate may differ from country to country because there are so many economic variables that go into a country’s decisions to levy a corporate tax. But with the increased globalization of the world’s economy and the pressures on corporate directors to maintain high profit margins, there is now a tremendous incentive for companies to send resources to foreign countries with lower tax rates at the expense and to the detriment of their respective home countries, especially when the logistical barriers that may once have prevented them from investing abroad are gone. 49

C. Direct Foreign Investment as an Indicator and the Case for Ireland

One indicator that corporations are taking advantage of global tax rate differences is direct foreign investment (DFI) into a country. 50 DFI is the “value of all investments . . . in the home country made directly by residents—primarily companies—of other countries” during a given time period. 51 While DFI does not capture all of the economic benefits effectuated by a low corporate tax rate, it does help to explain why certain countries attract more foreign investment than others despite the lack of domestic resources to support such an investment. 52

The Netherlands and Ireland, both of which are utilized by Google to make their tax avoidance scheme possible, are good examples. 53 They rank seventh and nineteenth, respectively, in the world for DFI 54 but have relatively low world rankings in population (Netherlands—60th; Ireland—119th), 55 members of the labor force (Netherlands—58th; Ireland—119th), 56 and GDP growth rate (Netherlands—157th; Ireland—199th). 57 These

46. See id. at 12.
49. See Drucker, supra note 5.
51. Id.
52. See id.
53. See Drucker, supra note 5.
rankings suggest that something other than an invaluable work force, such as more favorable tax situations, contributes to the high influx of foreign investment.

Two attorneys who agree with this hypothesis, Joseph B. Darby III and Kelsey Lemaster, found that Ireland has created an ideal situation for foreign investment, particularly for foreign technology companies like Google.\(^{58}\) According to Darby and Lemaster, Ireland’s ability to attract foreign investment stems from pressure from the European Union to remove discriminatory tax incentives and Ireland’s subsequent decision to enact a uniform corporate tax in 1999.\(^ {59}\) As a result, Ireland imposes a meager 12.5% rate on taxable income of corporations, which is one of the lowest corporate tax rates in the world, especially among developed countries.\(^ {60}\) Ireland has also entered into several favorable tax treaties with other countries that have the effect of significantly limiting corporate income taxes on business transactions made between those countries.\(^ {61}\) When coupled with Ireland’s well-educated, English-speaking workforce “it is easy to see why Ireland has become a preferred foreign base of operations for U.S. software companies and other U.S. technology-driven enterprises.”\(^ {62}\)

Ireland simultaneously refuses to enforce aggressively “anti-abuse” mechanisms related to transfer-pricing regulations.\(^ {63}\) Normally, countries with a high volume of economic activity will heavily regulate transfer-pricing transactions to prevent maneuvers, like the one employed by Google, where companies will shift taxable income to low-tax jurisdictions.\(^ {64}\) For example, the United States has adopted Section 482 of the Internal Revenue Code:

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.\(^ {65}\)

This provision grants broad authority to the Treasury Secretary to “adjust” items that are reported by corporations seeking to game, or even abuse, the transfer-pricing regulations.\(^ {66}\) Without the ever-present threat that a corporation’s income could be adjusted to reflect properly any abuses of income tax laws and regulations, Ireland attracts more inter-


\(^{59}\) See id.

\(^{60}\) See id.

\(^{61}\) See id.

\(^{62}\) See id.

\(^{63}\) See id.

\(^{64}\) See id.

\(^{65}\) I.R.C. § 482 (2011).

\(^{66}\) See id.
national business at the expense of decreased tax revenues. While the long-term effects of this decision still remain largely unclear, Ireland’s recent seeking of bailout funds may, in part, be attributable to such shortsighted fiscal policies.

D. Basic International Taxation Concepts of Corporations

The United States subscribes to a “residence-based” tax system whereby a corporation is subject to income tax if it is “created or organized in the United States or under the law of the United States or of any State,” or “effectively connected with the conduct of a trade or business within the United States.” As such, U.S. corporations must pay federal income taxes on all sources of income whether earned domestically or worldwide. This is true whether or not the taxes were paid in the foreign country based on the same receipt of income. Accordingly, U.S.-based corporations must recognize taxable income attributed to their foreign subsidiaries’ business operations worldwide. Company directors, therefore, often seek ways to alleviate the pressures of the “double taxation” by implementing strategic tax avoidance measures to satisfy corporate shareholders’ interests.

One way that corporations avoid this double taxation, which has enjoyed long-term support since early Tax Court decisions, is “by transferring assets and/or business activities to a foreign corporation, such that neither the corporation nor the U.S. shareholder would be currently taxable in the U.S. on the corporation’s income.” Corporations can set up and transfer assets to foreign subsidiaries, which are recognized as separate taxable entities.

67. See Darby & Lemaster, supra note 58, at 12.
68. See Joe Brennan & Stephanie Bodoni, Ireland Seeks Bailout as ‘Outsized’ Problem Overwhelms Nation, BLOOMBERG, Nov. 21, 2010, http://www.bloomberg.com/news/2010-11-21/lenihan-says-he-will-recomm-end-ireland-should-formally-ask-for-eu-bailout.html (“Ireland was one of the poorest countries in Europe when it joined the EU in 1973 along with Britain. Even with European subsidies, unemployment in the mid-1980s averaged 16 percent. In the 1990s, lured by a 12.5 percent corporate tax, companies such as Pfizer Inc. and Microsoft Corp. helped Ireland export its way into becoming the “Celtic Tiger.” The jobless rate sank to 3.9 percent by 2001. In the decade through 2006, Ireland grew at an average annual rate of about 7 percent, the fastest among euro-area countries. That expansion, together with easy credit, fanned a real-estate bubble. Home prices almost quadrupled in the decade through 2007. It went disastrously wrong for Ireland following the 2008 demise of Lehman Brothers Holdings Inc., which turned the slowdown in the property market into an implosion that engulfed the economy. The ISEQ stock index has plunged 70 percent from its record in 2007.”).
70. Treas. Reg. § 1.1-1(b) (1974) (“[A]ll citizens . . . are liable to the income taxes imposed by the Code whether the income is received from sources within or without the United States.”).
71. The Tax Code recognizes the existence of two types of corporations—domestic (one organized or created under the laws of the United States, or any of its states) and foreign (one which is not domestic). I.R.C. § 7701(a)(4)-(5) (2011). “The term ‘domestic’ when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or of any State unless, in the case of a partnership, the Secretary provides otherwise by regulations.” Id. § 7701(a)(4). “The term ‘foreign’ when applied to a corporation or partnership means a corporation or partnership which is not domestic.” Id. § 7701(a)(5).
72. See id. § 11(a) (“A tax is hereby imposed for each taxable year on the taxable income of every corporation.”), id. § 882(a)(1) (defining as “taxable income” that income which is “effectively connected with the conduct of a trade or business within the United States.”)
73. See Darby & Lemaster, supra note 58, at 2.
and whose income does not automatically flow through the parent corporation.\textsuperscript{74} In the event that the foreign subsidiary earns income from sources outside the United States and conjunctively does not conduct a U.S. trade or business, the foreign subsidiary is not subjected to taxation by the United States.\textsuperscript{75} But any distributions by a subsidiary in the form of dividend payments\textsuperscript{76} or payments for goods or services that are repatriated back into U.S. soil are taxable upon receipt by the corporation’s shareholders.\textsuperscript{77}

Due to the stringent nature of Tax Court decisions, corporate tax advisors must strategically plan around these provisions and study world corporate tax rates to incorporate federal tax avoidance measures like the “Double Irish” and “Dutch Sandwich.” As shown, anyone who studies the Tax Code and applicable case law quickly realizes the ever-present struggle between both individuals and corporations and the IRS for payment and non-payment of taxes, which serves as a viable starting point for this paper’s analysis of Google’s tax avoidance mechanisms.

E. FOREIGN TAX HAVENS

Since the rise of the corporate fiduciary duty by directors to protect shareholder interests, corporations have sought ways to increase earnings and decrease operational costs—one such operational cost being taxes. Unfortunately for those companies incorporated within U.S. borders, complete avoidance of taxation is tricky because income tax calculations are based on U.S. citizenship.\textsuperscript{78} Consequently, the U.S. corporation cannot completely avoid federal taxation without simultaneously relinquishing its U.S. citizenship.\textsuperscript{79} Companies not willing to take such extreme action will instead take advantage of the Nineteenth Century principle that corporations, under the U.S. Constitution, enjoy separate legal status from their employees.\textsuperscript{80} When applied, the separate “legal person” principle entitles a foreign-based corporation “to the same privileges, as any citizen of that country.”\textsuperscript{81} Such privileges entitle the corporation to benefit from the tax laws governing that particular country, aside from any multi-national tax treaties senior to those laws.\textsuperscript{82} Similar behaviors are observed in companies located solely within U.S. borders—for example, many companies elect to incorporate in the state of Delaware due to more

\textsuperscript{74}. See PHILLIP F. POSTLEWAITE, INTERNATIONAL CORPORATE TAXATION 5 (1980).
\textsuperscript{75}. See id. at 5-6.
\textsuperscript{76}. I.R.C. § 316(a) (2011) (the term “dividend” is defined as “any distribution made by a corporation to its shareholders—1) out of its earnings and profits accumulated after February 28, 1913, or 2) out of its earnings and profits of the taxable year . . . without regard to the amount of the earnings and profits at the time the distribution was made.”).
\textsuperscript{77}. See POSTLEWAITE, supra note 74, at 6.
\textsuperscript{78}. Id. at 11.
\textsuperscript{79}. See id. (“For most American businessmen, relinquishing U.S. citizenship is neither necessary nor desirable. The most commonly used method of establishing the tax haven company, therefore, is to incorporate in the tax haven country (or countries, if a tiered structure is desirable), thereby taking advantage of the principle that is observed world-wide—a corporation has the legal status of a separate legal person.”).
\textsuperscript{80}. Santa Clara v. S. Pac. R. Co., 118 U.S. 394 (1886) (“One of the points made and discussed at length in the brief of counsel for defendants in error was that ‘Corporations are persons within the meaning of the Fourteenth Amendment to the Constitution of the United States.’”) (comments of court reporter in preamble to opinion).
\textsuperscript{81}. See POSTLEWAITE, supra note 74, at 11.
\textsuperscript{82}. See id. at 11-12.
favorable liability protections. While incorporating in another state does not give the corporation more favorable federal income tax treatment, the basic principle remains the same: businesses will constantly seek avenues to lower costs and avoid risk exposure in the form of liabilities, taxes, or any other cost-inducing mechanism.

The foreign tax haven can be recognized in basically any form of business genre found in the United States. Companies in one of the most popular industries—shipping (or aircraft) services—regularly establish tax haven companies by incorporating in low-tax jurisdictions. Due to the transient nature of their business and near-universal demand, shipping corporations, like DHL (originally founded in San Francisco, CA in 1969 and reincorporated in Germany in 2001), have either been bought out or established their headquarters overseas because of lower corporate tax rates.

Google, a producer of mainly intangible computer and internet software, utilizes entities formally known as "patent holding companies" to create tax havens. Although primarily based out of California, Google creates licensing agreements with its international subsidiaries by allowing them to realize profits from the use of Google’s software outside U.S. borders. Because the local laws in which the subsidiary is located (in this case, the Netherlands) allows the subsidiary to deduct royalty payments from gross income calculations on distributions made to Google in accordance with the licensing agreement, the Dutch subsidiary avoids Dutch withholding taxes on dividends. Therefore, Google and its Dutch subsidiary set the royalty rate at an optimum level to minimize Dutch tax exposure and maintain operations abroad. Although Google’s system is significantly more complicated, as the next section explains the underlying theme remains the same: Google (a publicly traded company since August 2004) ultimately answers to its shareholders, whose stock appreciates in value when Google is able to report high profit margins.

F. Applicable Provisions to Make These Schemes Possible

As corporate tax strategists continue to discover more complex ways to circumvent recognition of taxable income, Congress has attempted to counteract the transfer of assets by enacting “anti-deferral rules” and transfer-pricing rules to prevent or penalize the use of a foreign corporation to avoid taxes on sources of income. Anti-deferral rules seek to curb a domestic corporation’s ability to defer recognition of income attributed to a foreign subsidiary. One such anti-deferral rule is codified in Section 951 of the Tax Code, which

83. See id.
84. See id. at 12.
87. See POSTLEWAITE, supra note 74, at 26-27.
88. See id.
89. Paul R. La Monica, Google Sets $2.7 Billion IPO, CNNMoney, Apr. 30, 2004, http://money.cnn.com/2004/04/29/technology/google/ (“In the filing, Google said that it generated revenues of $961.9 million in 2003 and reported a net profit of $106.5 million. Sales rose 177 percent from a year ago although earnings increased by just 6 percent. Google also revealed that [it] has been profitable since 2001.”).
90. See Darby & Lemaster, supra note 58, at 10.
91. See id. at 11.
requires U.S. shareholders to currently recognize parts of their income from “controlled foreign corporations” (CFC’s).  

The Internal Revenue Code provides for the taxation of CFC’s, which are controlled by U.S.-based parent companies. A CFC is defined as:

Any foreign corporation if more than fifty percent of (1) the total combined voting power of all classes of stock of such corporation entitled to vote, or (2) the total value of the stock of such corporation, is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation.

Consequently, a U.S. shareholder must have ownership of the CFC’s company stock to satisfy the “control” requirement for purposes of taxation. The U.S. sharehber is then taxed at the applicable tax rate based on the receipt of income from the CFC.

Because U.S. parent corporations generally qualify as “U.S. shareholders,” if the parent corporation’s ownership of the subsidiary’s stock rises to the level of 50% or more, then their parent/subsidiary relationship meets the definition of a CFC and all income will be currently recognizable during the taxable year. While this rule as codified can be used to give corporations generous tax breaks, Tax Court decisions have limited the availability of these breaks by strictly enforcing the requirements of section 957(a). For example, the Tax Court in Framatome Connectors USA, Inc. v. C.I.R. held that a U.S. corporation failed the “control” requirement of section 957(a) where it did not own 50% or more of the “voting power” in stocks of the foreign subsidiary. The Tax Court found it dispositive that the six veto powers and an 80% supermajority permitted the Japanese-based subsidiary to block important company decisions, and, as a result, the U.S. parent company did not exercise “control” over the requisite voting power for section 957(a) recognition.

Shareholders of CFC’s are taxed according to the rules for “Subpart F” income. Subpart F income includes: 1) income from the insurance of U.S. risks; 2) foreign base

92. I.R.C. § 951(a)(1) (2011) (“[T]he term “United States shareholder” means, with respect to any foreign corporation, a United States person . . . who owns . . . 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation.”).
93. See generally id. §§ 951-964.
94. Id. § 957(a).
95. See id.
96. See id. § 951(a).
97. See id. § 951(b) (“[T]he term “United States shareholder” means, with respect to any foreign corporation, a United States person . . . who owns . . . 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation.”).
98. See id. § 957(a).
100. Id. at 60-61.
101. See id. at 49.
company income; and 3) amounts attributable to international boycott participation or to illegal bribes or kickbacks. Most relevant to this article, “foreign base company income” includes: 1) foreign personal holding company income; 2) foreign base company sales income; 3) foreign base company services income; and 4) foreign base company oil related income. To prevent corporations from abusing the recognition provisions of section 957(a), Congress, under section 952(a)(2), requires CFC’s to report “foreign based income,” defined by section 954(a) to mean, in part, “the foreign base company sales income for the taxable year.” Accordingly, if a CFC receives income earned abroad, it must report it to the parent company located in the United States, who subsequently must recognize the earnings as taxable income under the Tax Code. For many software-based companies who sell and license software products to foreign-based CFCs, this catch-all income recognition provision generally prevents tax avoidance on the sale of software products to CFCs, because even though they are outside U.S. borders, when the CFCs turn around to sell the products, the U.S. corporation will have to recognize the income from these transactions. These rules fall short of capturing Google’s strategy, which utilizes a transfer-pricing model that avoids section 954 recognition through an exception to the Tax Code on transfers of intangible property. As a service-based internet company that provides advertising and search engine products, Google takes advantage of the exemptions provided by the Tax Code for “foreign base company sales income” from its advertising programs. Generally, when a U.S. corporation transfers a product to one of its foreign-based subsidiaries, section 367(d)(2)(A)(i) necessarily deems the property to be sold “in exchange for payments which are contingent upon the productivity, use, or disposition of such property.” Sections 954(a)(2) and 954(b)(5) generally mandate distributions to domestic shareholders made by CFCs to be taxable events if the following four requirements are met:

1) the purchase or sale must be to or from a related party;
2) the transaction must involve personal property;
3) the purchase or sale must be for use or destination outside the base company jurisdiction; and
4) the personal property must not have been manufactured, produced or constructed by the foreign base company.

The term “related parties” is defined to include all entities and individuals that own more than 50% of the CFC’s stock.

103. See id.
104. 105. 106. 107. 108. 109. 110. 111.
Conversely, and as is the case with Google, the foreign base provision is inapplicable if the personal property is “manufactured, produced, or constructed by the CFC.” The Treasury Regulations provide that this exemption is only applicable if the CFC manufactures the property in its totality or conducts a “substantial transformation of the property.” The Tax Court historically takes a relaxed approach when addressing the issue of “substantial transformation,” making the determination on a case-by-case analysis by looking at the totality of the surrounding facts and circumstances. On the other hand, if the property purchased by the CFC is not “substantially transformed,” but instead is utilized as a component part in the end-product (i.e. computer hard drives purchased for the manufacture of assembled computers), then the income generated from the sale becomes taxable income under the Code. The court in Dave Fischbein sided with a U.S. corporate taxpayer in its holding because the operations of its subsidiary established in Belgium were “substantial [enough] in nature . . . to constitute the manufacture of [the] product.” Even though the U.S.-based corporate stock holder was fully capable of developing the end product, the court found it dispositive that the lower labor and overhead costs, tariff and quantity restrictions, and the subsidiary’s purchase of some of the machine’s components from unrelated local entities were sufficient to warrant the exclusion of the income generated from the reach of U.S. taxation.

Ordinarily, software companies that develop their product solely within U.S. borders subsequently must recognize the income attributed to these transfers as taxable income because of their “sale” recognition. But section 367(d) recognition does not apply to cross-border transfers of intangible property if the intangible property is developed by the CFC outside of the United States. Moreover, if the software is a product of joint development through a “cost-sharing” arrangement, whereby the rights to utilize the intangible property in the United States are retained by the U.S. company (i.e. Google), and the rights to utilize the property outside the United States are vested in the CFC, then the non-U.S. rights are treated as being created in the jurisdictional location of the CFC. It is under these circumstances that software companies, like Google, can avoid section

112. POSTLEWAITE, supra note 74, at 250.
113. Id.; see also Treas. Reg. § 1.954-3(a)(4)(ii) (2009) and examples thereunder.
114. See Dave Fischbein Mfg. Co. v. Comm'r., 59 T.C. 338, 352, 360 (1972) (income from individual parts of portable bag-closing machines was not includable as Subpart F income because the parts "were not perfect, that many of them had to be individually tailored and tested in order to have a completed, functioning sewing machine, that the mechanics were trained and experienced and used skill and judgment in performing their tasks, and that they were not performing purely ministerial functions.").
115. See Treas. Reg. § 1.954-3(a)(4)(ii) (“If personal property purchased by a foreign corporation is substantially transformed by such foreign corporation prior to sale, the property sold by the selling corporation is manufactured, produced, or constructed by such selling corporation.").
116. Dave Fischbein, 59 T.C. at 357.
117. See id.
118. I.R.C. § 367(d)(2)(A) (2011) (“[T]he United States person transferring such property shall be treated as— (I) having sold such property in exchange for payments which are contingent upon the productivity, use, or disposition of such property, and (ii) receiving amounts which reasonably reflect the amounts which would have been received— (I) annually in the form of such payments over the useful life of such property, or (II) in the case of a disposition following such transfer (whether direct or indirect), at the time of the disposition. The amounts taken into account under clause (ii) shall be commensurate with the income attributable to the intangible.”).
120. See Darby & Lemaster, supra note 58, at 11; see generally Treas. Reg. § 1.482-7A (2009).
III. Discussion

A. The Issue of Transfer Pricing

Due to the rise in communications and increased economic globalization, the world has witnessed a relatively new phenomenon—the “Multinational Enterprise” (MNE). Because MNEs do not have to adhere to one single, internationally recognized tax code, the use of MNEs creates increasingly complex taxation issues for tax administrations around the world. Consequently, various tax administrations use transfer-pricing guidelines as a means to govern MNE activity as they, like most consumers, search for ways to re-capture those profits otherwise lost to taxation.

Transfer-pricing is the practice of making payments from one business entity to another affiliated business entity for the receipt of goods or services. MNEs may elect to utilize transfer-pricing for marketing or policy reasons, or to avoid the higher taxation rates imposed upon market-based transactions, as in Google’s case. Because commercial transactions between two related business entities are not subject to the same market forces as those pertaining to non-related entities, members of the Organization for Economic Co-Operation and Development (OECD) have agreed to abide by a principle known as the “Arms-Length Principle” to ensure that the tax base of MNEs is divided fairly. Article Nine of the OECD Model Tax Convention explains:

[When] conditions are made or imposed between . . . two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

Abiding by this principle treats transactions between related companies as though they were non-related, “arms-length” dealings, thereby theoretically subjecting them to equivalent tax treatment. The OECD member countries believe that adoption of this creates broad parity of tax treatment between MNEs and independent enterprises. Ac-
Accordingly, the principle seeks to eliminate any tax advantages or disadvantages that would create distortions of relative competitive advantages associated with related or non-related status.\textsuperscript{129}

As mentioned above, national tax laws like section 482 of the U.S. Tax Code allow tax administrations to enforce the “Arm’s Length Principle” by “apportion[ing] or allocat[ing] gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if [they] determine[ ] that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.”\textsuperscript{130} Nevertheless, because the tax laws and regulations have failed to adapt to the changing times, Google has found several tax loopholes between various OECD member countries to allow it to reduce their effective tax rate to a meager 2.4\%\textsuperscript{131}

\textbf{B. Explanation of the “Double Irish” and “Dutch Sandwich”}

Utilizing a complex scheme of transfer-pricing agreements, conflicting tax codes, and bi-lateral tax agreements, Google has amazed many on-lookers that its system remains legally viable. The company accomplishes this feat through the creation of two subsidiaries in Ireland, one subsidiary in the Netherlands, and one subsidiary in Bermuda.\textsuperscript{132} In 2003, Google, a United States corporation, initiated the process when it negotiated and received approval from the IRS for its confidential transfer pricing arrangement with a newly established subsidiary, Google Ireland Holdings (Ire. sub. 1) (GIH).\textsuperscript{133} In accordance with the principles of transfer-pricing mentioned above, Google, as a software developer, could set up the joint development transfer-pricing arrangement with its GIH subsidiary so that Google retained the domestic rights for use of the software and GIH obtained the international rights for use of their software through an amortized buy-in agreement.\textsuperscript{134} As such, GIH controlled access to Google’s famously popular search engine software, advertising banners, and the Android platform.\textsuperscript{135}

By allocating all of their international revenues to Ireland, Google could continue to research and develop products in the United States while simultaneously earning profits abroad and avoiding high U.S. corporate taxation rates.\textsuperscript{136} GIH next established its operational “anchor” off the U.S. coast in the British overseas territory of Bermuda.\textsuperscript{137} This Bermudian subsidiary claims to be the “effective centre of management” for GIH, thereby exempting GIH from Irish taxation.\textsuperscript{138} Furthermore, by filing a “check-the-box election,”

\begin{itemize}
  \item \textsuperscript{129} See id.
  \item \textsuperscript{130} I.R.C. § 482 (2010).
  \item \textsuperscript{131} See Drucker, supra note 5.
  \item \textsuperscript{132} See id.
  \item \textsuperscript{133} See id.
  \item \textsuperscript{134} See Treas. Reg. § 1.482-7A(a) (2009) (“A cost sharing arrangement is an agreement under which the parties agree to share the costs of development of one or more intangibles in proportion to their shares of reasonably anticipated benefits from their individual exploitation of the interests in the intangibles assigned to them under the arrangement.”).
  \item \textsuperscript{135} Sherman, supra note 86.
  \item \textsuperscript{136} See Drucker, supra note 5.
  \item \textsuperscript{137} See id.
  \item \textsuperscript{138} See id.
\end{itemize}
the Bermudian subsidiary, as a “foreign eligible entity,” can elect to be classified as an entity that is disregarded as separate from its parent-company, Google, for U.S. tax purposes. As a result, any exchange of “royalty” payments between GIH and its Bermudian tax haven transfers tax-free from any tax administration because the U.S. or Irish taxation laws do not recognize the Bermuda subsidiary as a taxable entity for purposes of their tax codes.

Returning to the Irish mainland, GIH, as a licensee of Google’s software, allows one of its wholly-owned subsidiaries, Google Ireland Limited (GIL) to utilize Google’s software to perform its global marketing operations and receive all international advertising profits. This tax maneuver earns the nickname “Double Irish” for its employment of two Irish-based subsidiaries for its international operations. In turn, GIL receives all foreign-based income that, subsequently, is subjected to the favorable 12.5% corporate tax rate in Ireland as a beneficiary of the cost-sharing agreement. In 2009, GIL was credited by Google with 88% of its $12.5 billion in non-U.S. sales.

Conversely, Irish tax law allows GIL to write off its royalty payments for use of GIH’s software rights as trade expenses that, in 2008, permitted GIL to deduct $5.4 billion in royalties, and left GIL paying at a nominal 1% effective tax rate. If GIL immediately tried to return these profits back to GIH, the transfer would create taxable income under Irish law. Instead, GIL and GIH set these royalty payments at an optimal level so that GIL can reduce its taxable income to a nominal amount to be taxed at the Irish 12.5% corporate rate. Therefore, to evade Irish withholding taxes, payments from GIL must take a brief detour in the Netherlands—a maneuver characterized as the “Dutch Sandwich”—before finding their way back to GIH.

By exploiting a low rate of corporate taxation and generous European Union (EU) agreements, GIL is able to make “royalty” payments to another EU member, the Netherlands. Per the “Taxation of Cross-Border Interest and Royalty Payments” agreement by the EU member states in June 2003, corporations in one member state are allowed to make interest and royalty payments to subsidiaries located in other member states, pro-

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139. Treas. Reg. § 301.7701-3(b)(2) (2006) (A “foreign eligible entity” is any foreign entity that (i) engages in a threshold quantum of business activity such that is not properly classified as a trust, and (ii) is not explicitly listed in the regulations as a “per se” corporation.); see also Treas. Reg. § 301.7701-3(a), 2(a), 2(b)(8) (2006) (for listing of “per se” corporations).
140. See Darby & Lemaster, supra note 58, at 12.
141. See Sherman, supra note 86.
142. See Drucker, supra note 5.
143. See id.
144. See I.R.C. § 954(a)(2) (2011) (“The term ‘foreign base company income’ means . . . (2) the foreign base company sales income for the taxable year.”).
145. See Treas. Reg. § 1.482-7A (2011) (“A cost sharing arrangement is an agreement under which the parties agree to share the costs of development of one or more intangibles in proportion to their shares of reasonably anticipated benefits from their individual exploitation of the interests in the intangibles assigned to them under the arrangement.”); see also Darby & Lemaster, supra note 58, at 12.
146. Drucker, supra note 5.
147. Sherman, supra note 86.
148. See id.
149. Darby & Lemaster, supra note 58, at 14.
150. Drucker, supra note 5.
151. Id.
vided that the beneficial owner of the payment is a company or permanent establishment in another member state.152 GIL, therefore, pays royalties to an employee-less shell corporation in the Netherlands, Google Netherlands Holdings BV (Dut. sub.) (GNH), with the sole purpose of receiving these payments from GIL, and immediately redirecting them to the Bermuda holding company.153 All of the income received by the Bermudian subsidiary, in turn, enjoys the luxury of sandy beaches and Bermuda’s non-existent corporate taxation rates.154 The reported income remains on the island until Google decides to repatriate the income through dividend payments, whereby the payment will be subjected to the applicable U.S. dividend rate of taxation.155 Assuming Google has no plans to repatriate these revenues back into the country any time soon, Google shareholders continue to benefit from skewed annual reportings, while the U.S. government, to date, reports losses upwards of $60 billion.156

While policymakers search for ways to close these gaps that cost the U.S. Treasury millions of dollars each year, Google has benefited greatly from employing this scheme. In 2001, Google reported revenues of nearly $86.5 million, of which only 18% were attributable to international revenues.157 By 2004, the year of Google’s Initial Public Offering, revenues had nearly quadrupled from 2001 reportings to $3.2 billion, and international revenues accounted for 34% of Google’s revenues.158 Six years later, Google’s financial statements have been off the charts as the effects of increased market globalization and internet usage have made Google one of the highest revenue-grossing corporations in the world. To date, Google reports 2010 unaudited gross revenues totaling more than $29.3 billion, of which 52% are attributable to international revenues.159 Even though much of these revenues do not translate into taxable income to the U.S. government, profits lost to foreign taxable entities cost taxpayers millions in lost revenue. While the U.S. government tries to close a national debt in excess of $1.4 trillion, Google and other U.S.-based companies implementing the “Double Irish” and “Dutch Sandwich” tax avoidance arrangements have their proverbial cake and eat it too by reaping the benefits of the U.S. economy and more favorable tax laws abroad.160

152. European Commission Taxation and Customs Union, Taxation of Cross-Border Interest and Royalty Payments in the European Union, http://ec.europa.eu/taxation_customs/taxation/company_tax/interests_royalties/index_en.htm (last visited June 26, 2011) (“These interest and royalty payments shall be exempt from any taxes in that State provided that the beneficial owner of the payment is a company or permanent establishment in another Member State.”).
153. See Sherman, supra note 86.
154. See KPMG, supra note 16, at 12.
155. See Darby & Lemaster, supra note 58, at 13.
156. See Drucker, supra note 5.
160. See generally Drucker, supra note 5.
IV. Possible Solutions to the Problem

A. Application of I.R.C. Section 965

In 2005, the IRS reported nearly $804 billion in earnings and profits earned abroad by controlled foreign companies of U.S. corporations. Conversely, only $362 billion of those earnings were subsequently repatriated back into the U.S. economy and taxed at the U.S. corporate income tax rate. That same year, Congress, as part of the American Jobs Creation Act of 2004, enacted section 965 of the Tax Code in an attempt to offer companies a one-time opportunity to repatriate profits earned abroad at greatly reduced tax consequences to the company. The reasoning behind section 965’s enactment was the belief that the repatriation of profits would stimulate the economy and create jobs for American workers in the process. Instead, commentators observed the following:

Economists concluded that the repatriation holiday produced a windfall gain for companies with large amounts of accumulated earnings in low-tax countries. They found that companies used the funds principally for share repurchases. And they found that companies that benefited from the holiday were no more likely to spend on growing their businesses than companies that did not benefit.

While the U.S. economy never fully realized the potential benefits of section 965 as a means to recapture those foreign profits avoiding high U.S. corporate tax rates, section 965 serves as a reminder that the process may not be an easy one, considering corporations willingness to dole out large sums of cash to protect their bottom line.

In its current form, section 965 allows MNEs from the United States to benefit from an 85% tax break from income earned by foreign subsidiaries given that the payments were repatriated through cash dividends to their U.S. parent company within a one year time frame. Section 965(b)(4) requires the dividend payments to adhere to the Domestic Reinvestment Plan (“DRIP”) requirements, in that they: a) be approved by the taxpayer’s president, or chief executive officer (or equivalent) along with subsequent approval by the taxpayer’s board of directors (or its equivalent), and b) be provided for reinvestment in the U.S. economy as a source of “worker hiring and training, infrastructure, research and development, capital investments, or the financial stabilization of the corporation for the purposes of job retention or creation.”

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162. Id.
164. I.R.C. § 965 (2004); H.R. Rep. No. 108-548(l) (2004) (“The Committee observes that the residual U.S. tax imposed on the repatriation of foreign earnings can serve as a disincentive to repatriate these earnings. The Committee believes that a temporary reduction in the U.S. tax on repatriated dividends will stimulate the U.S. domestic economy by triggering the repatriation of foreign earnings that otherwise would have remained abroad. The Committee emphasizes that this is a temporary economic stimulus measure.”).
165. See Shephard & Sullivan, supra note 161, at 276-77.
166. Mauntel, supra note 69, at 128.
167. Id.
Not surprisingly, many corporations who took advantage of the tax holiday seemingly ignored the federally-mandated requirements, as the U.S. Treasury reported only $16.5 billion in revenues from its enactment. Some companies even cut jobs domestically after repatriating billions in cash dividends. Section 965 had a second side effect because it incentivized companies to ship intangible assets abroad in hopes that Congress would either extend the applicable period or reintroduce the bill at a subsequent date. Despite lobbying efforts by companies like Oracle Corp., Eli Lilly & Co., and Hewlett-Packard Co. to have Congress grant such relief, Congress has repeatedly declined to reenact section 965, likely due to the previous abuses and marginal returns of its existence.

One method to accomplish essentially the same goals as those provided by section 965 would be to completely eliminate the DRIP requirements before reenacting a Tax Holiday program like the one provided by section 965. However, taking into account the potential for abuse of another tax holiday and the fact that billions of dollars in corporate profits remain stationed abroad until a time when it becomes profitable to repatriate them back into the United States, it is still a question how the U.S. government, likely with the help of other foreign governments, can close this gaping hole in the Tax Code while avoiding the dire consequence of forcing U.S. corporations to move their headquarters abroad. Moreover, how much does the U.S. government care that these sorts of tax havens continue to exist in the face of historically high federal deficits? Recent political history would suggest not much.

B. Implementing a New System of Foreign Taxation

A simpler solution, considering its ranking among other developed nations, would be to follow in the footsteps of Japanese lawmakers and lower the tax rate for all U.S. corporations to a level on par with, or lower than, other developed nations. Currently, the U.S. marginal corporate tax rate ranks at the top of industrialized nations. Yet the current state of affairs of its tax system advocates continual defectors and circumventors who aimlessly sink profits into tax avoidance schemes to gain a larger piece of the consumer-driven economy of the United States. Alternatively, providing incentives in the form of tax breaks or lower rates for U.S. corporations who, in fact, derive profits from CFCs could recapture lost tax revenues while mitigating the unwarranted externality of shipping corporate business abroad. U.S. resistance to such a system has seemingly backfired on the Treasury and IRS, as they both waste millions of taxpayer dollars per year in oversight and monitoring of the tax schemes, only to arrive at the all-too-obvious conclusion that U.S. corporations are setting up these schemes and the government has no real way of stopping it.

170. See Mauntel, supra note 69, at 113.
171. See id. at 120-21.
172. See id. at 126.
174. See KPMG, supra note 16, at 12.
175. See Drucker, supra note 5.
Notably, Matthew J. Mauntel offered similar advice in his article *Stimulating the Stimulus: U.S. Controlled Subsidiaries and I.R.C. 965*, where he suggested that the United States look to the recent overhauls in the Canadian approach to CFCs. Currently, Canadian tax regulations provide tax exemptions for foreign-based income derived from certain countries privy to tax-information-sharing agreements with the Canadian government. This system exempts almost 90% of foreign-based corporate income produced by Canadian subsidiaries. Due to the similarities between the U.S. and Canadian tax systems and the free trade agreement between the countries, it would significantly benefit the United States to follow in Canada’s footsteps before it loses business in a similar fashion to its neighbors to the north.

To date, the United States has tax treaties established with sixty-seven countries around the world. This list includes countries relevant to the “Double Irish” and “Dutch Sandwich” maneuvers, like Ireland and the Netherlands. Similarly (and unlikely by coincidence, given Google’s contemporaneous undertakings), in 2003, the United States and the Bahamas entered into an information-sharing agreement that took effect on January 1, 2004. These types of treaties and agreements are intended to increase the transparency of international tax mechanisms and, in some cases, tax individuals and entities at reduced rates on certain items of income they receive.

Yet by allowing for an exemption for most, if not all, of foreign-earned corporate income, whether from countries sharing treaties or information agreements or on the whole, internationally-based corporations would likely find it economically advantageous to repatriate profits stationed abroad or move businesses into the United States. Moreover, the United States may find the economic stimulus package it has so desperately sought over the past decade, notwithstanding the repeated failures of raising and lowering of the prime rate and ineffective domestic tax credits. As Mauntel is quick to point out, “the United States and Canada are two of the last industrialized countries to attempt world-wide taxation and Canada is prudently in the process of abandoning it after finding it uncompetitive and unwieldy.”

For example, section 954(b)(3)(A) currently provides an exclusion of foreign-based income if the sum of the foreign base company income constitutes less than 5% of the gross income of the entire corporation. The Code further requires that the U.S. parent com-

176. See Mauntel, supra note 69, at 127.
178. See Mauntel, supra note 69, at 127.
181. See id.
184. See Mauntel, supra note 69, at 127.
185. I.R.C. § 954(b)(3)(A) (2011) (“If the sum of foreign base company income (determined without regard to paragraph (5)) and the gross insurance income for the taxable year is less than the lesser of—(i) 5 percent of gross income, or (ii) $1,000,000, no part of the gross income for the taxable year shall be treated as foreign base company income or insurance income.”).
pany report all income from the CFC if the sum of the foreign base company income exceeds 70% of the U.S. corporation’s gross income for the taxable year. Corporations often attempt to undermine these threshold requirements with careful tax planning so that they can exclude these foreign profits. As previously mentioned, Google’s reported revenues totaled $29.3 billion in 2010, of which 52% are attributable to international revenues. Under current application, the “de minimus” provision encourages cross-border corporations to elude section 954(b)’s reach by establishing a scheme whereby foreign profits are apportioned among thousands of smaller shell corporations so that each individual entity never surfaces above the 5% threshold. Instead of utilizing significant taxpayer dollars to police this possibility, why not raise the “de minimus” provision to a “majority” threshold? In other words, a corporation could exclude amounts less than 50% of the parent-corporation’s gross income, and remove the application of section 954(b)(3)(B), which forces the taxpayer to recognize all foreign profits above the 70% threshold. While, admittedly, any definitive threshold amount would still present opportunities to avoid U.S. taxation, a 50% threshold would serve a two-fold purpose: 1) it would properly reflect that percentage of a corporation subject to foreign taxation laws in their proportionate share of total gross income, and 2) it would increase the tax base of cross-border corporations by allowing for a larger exclusion and encouraging more corporations to incorporate within the United States.

Under the current tax regime, the Code allows for the shareholder to exclude those portions of his earnings and profits from his or her taxable income whenever a CFC makes a distribution to the parent company. This system is designed to prevent any ill-effects of “double taxation” that may occur as a result of the distribution. However, the situation where a U.S. shareholder who owns stock in a foreign-operated corporation that earns income from non-U.S. sources and concurrently must comply with non-U.S. standards is subjected to U.S. taxation seems to completely contravene a system that constantly preaches “substance over form.” Furthermore, this system simultaneously relieves a corporate shareholder of the adverse effects of “triple-taxation”, in which the foreign-based earnings of the corporation are subjected to taxation by the foreign jurisdiction and to “double-taxation” at the U.S. corporate and shareholder levels.

186. I.R.C. § 954(b)(3)(B) (“If the sum of the foreign base company income . . . and the gross insurance income for the taxable year exceeds 70 percent of gross income, the entire gross income for the taxable year shall . . . be treated as foreign base company income or insurance income (whichever is appropriate).”).
188. I.R.C. § 954(b)(3)(B) (“If the sum of the foreign base company income . . . and the gross insurance income for the taxable year exceeds 70 percent of gross income, the entire gross income for the taxable year shall . . . be treated as foreign base company income or insurance income (whichever is appropriate).”).
189. See I.R.C. § 959(b) (“For purposes of section 951(a), the earnings and profits of a controlled foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder under section 951(a), shall not, when distributed through a chain of ownership described under section 958(a), be also included in the gross income of another controlled foreign corporation in such chain for purposes of the application of section 951(a) to such other controlled foreign corporation with respect to such United States shareholder (or to any other United States shareholder who acquires from any person any portion of the interest of such United States shareholder in the controlled foreign corporation).”).
190. See id.
192. See I.R.C. § 954(a).
Although there are no current plans by either the House of Representatives or the Senate to amend the legislation surrounding foreign-based income to ameliorate the effects of Subpart F income recognition, there have been several attempts by various Members of Congress to do so. While it remains to be seen what the future holds for foreign-based income, one can certainly expect that corporations like Google will continue to find various methods to circumvent the harsh inequities derived from U.S. taxation on income clearly attributable to transactions where neither party resides within U.S. borders.

V. Conclusion

The United States and other international taxation bodies will certainly face unfavorable outcomes if they continue to expand the reach of their taxation laws to transactions in which none of the parties directly avail themselves of their domestic protections. While those jurisdictions claim they have a right to apply their taxation laws to such events, they simultaneously risk deterring any future direct foreign investment and alienation of their own domestically-created businesses. As previously mentioned, such ill-effects are already being felt by the United States as corporations like Google continue to establish and operate subsidiaries outside U.S. soil to avoid U.S. taxation. One can reasonably assume that these practices will continue to be implemented. Furthermore, as the United States tries to close the historically high national deficit, it appears to be economic suicide to continue to dissuade businesses from operating on a global level for fear that their earnings and profits will be further decreased by Uncle Sam’s greed.

Instead the United States and similar taxation bodies should shift their economic focus to encouraging investors to expand business operations. As one commentator put it, “[i]t is better for the United States to abandon taxation on foreign subsidiaries than to continue the farce of stated taxation that does not actually occur.” By allowing these companies to repatriate the foreign-earned profits back into the United States without fear of high taxation rates, the economy would reap the benefits, as shareholders would reintroduce these monies back into the U.S. economy and the Treasury would be able to tax accordingly. As Congress aimlessly continues its search for a more effective substitute for the previously enacted section 965, more domestically-owned corporations will be drawn to implement measures to increase profit-margins for the benefit of their shareholders. Ironically, the greedy taxing powers of the United States should heed the words of Google’s corporate slogan—”Don’t be evil.”

193. See H.R. 5328, 111th Cong. (2010) (“Repeal of Look-Thru Rule for Royalties Received From Controlled Foreign Corporations. Paragraph (6) of section 954(c) of the Internal Revenue Code of 1986 is amended—(1) by striking ‘rents, and royalties’ in subparagraph (A) and inserting ‘and rents’, and (2) by striking ‘, rent, or royalty’ both places it appears in subparagraph (B) and inserting ‘or rent.”); see also S. 45, 112th Cong. (2011).
194. See Mauntel, supra note 69, at 127.
195. See id. (“Section 965 was helpful as a herald for change in the taxation of international controlled corporations, but that call was ignored in 2004. Now with the economic crisis in full force, the United States Congress has a duty to reevaluate the international corporate taxation system, beginning with a reintroduction of section 965. The financial gains from repatriations will then fuel a more complete overhaul of the system, closing loopholes which allow transfer of assets abroad and eliminating taxes that other developed nations have abandoned. These steps will ensure a more effective taxation system and more robust competition by U.S.-based multinationals.”).