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**JUS POST BELLUM IN IRAQ: THE DEVELOPMENT  
OF EMERGING NORMS FOR ECONOMIC  
REFORM IN POST CONFLICT COUNTRIES**

*Christina C. Benson*<sup>1</sup>

**ABSTRACT:**

Finally emerging from decades of conflict and isolation, Iraq has endured three devastating wars, the demise of the Saddam Hussein regime, the end of international economic sanctions, and the protracted process of approving a constitution and forming a new democratically elected government. The nation's emergence from war, and efforts to build the foundations of stable governance and economic growth, provides a fascinating case study for analyzing new international norms promoting the "rule of law" in post-conflict countries.

This paper addresses arguments that early legal and economic reforms implemented by the Coalition Provisional Authority (CPA) and the Iraqi Interim Government (IIG) in Iraq during 2003-2005 may have violated the principle of "conservation" in international humanitarian law. The paper further examines whether a new doctrine of "*jus post bellum*" is emerging, and the extent to which the United Nations and international economic organizations are permitted to support economic reforms as part of a larger effort to engage in peace building and to establish a "rule of law" in post-conflict countries.

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The clearest way to show what the rule of law means to us in everyday life is to recall what has happened when there is no rule of law.

—U.S. President Dwight D. Eisenhower<sup>2</sup>

We’ve persevered because of a belief we share with the Iraqi people - a belief that out of the ashes of war, a new beginning could be born in this cradle of civilization. Through this remarkable chapter in the history of the United States and Iraq, we have met our responsibility. Now, it’s time to turn the page.

—U.S. President Barack Obama<sup>3</sup>

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<sup>2</sup> President Dwight D. Eisenhower, President, Address to the Nation Establishing Law Day (May 5, 1958).

<sup>3</sup> Barack Obama, President, Address to the Nation on the End of Combat Operations in Iraq (Aug. 31, 2010) (transcript available at <https://my.barackobama.com/page/content/iraqremarks/>).

## INTRODUCTION

The Mesopotamian valley between the Tigris and Euphrates rivers once served as a cradle of civilization, and grew into a crossroads of commerce and culture at the intersection of strategic international trade routes.<sup>4</sup> Today, Iraq stands at a geographic, historic, and economic crossroads. Finally emerging from decades of conflict and isolation, the country has endured three devastating wars, the demise of the Saddam Hussein regime, the end of international economic sanctions, and the protracted process of approving a constitution and forming a new democratically elected government.<sup>5</sup> Iraq still faces massive challenges for rebuilding its legal and economic institutions and infrastructure internally, while re-engaging with regional and multilateral trading partners externally. The nation's emergence from war, and efforts to build the foundations of stable governance and economic growth, provides a fascinating case study for analyzing new international norms espoused by the United Nations and international economic organizations promoting the "rule of law" in post-conflict countries.

This paper specifically addresses economic reforms implemented in Iraq following the invasion by coalition troops in May 2003, the ousting of the Saddam Hussein regime, and the period of occupation by coalition forces.<sup>6</sup> More specifically, this paper responds to arguments that the scope of early legal and economic reforms implemented by the Coalition Provisional Authority (CPA) in Iraq may have violated the principle of "conservation" in international humanitarian law, and examines the changing role of the United Nations and international economic organizations in developing new norms for implementing economic reforms as part of a multilateral peace building process aimed at establishing the "rule of law" in post-conflict countries.<sup>7</sup>

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<sup>4</sup> See, e.g., *History of Mesopotamia*, ENCYCLOPEDIA BRITANNICA ONLINE ACADEMIC ED., <http://www.britannica.com/EBchecked/topic/376828/history-of-Mesopotamia> (last visited Sept. 14, 2012).

<sup>5</sup> See generally *Iraq*, ENCYCLOPEDIA BRITANNICA ONLINE ACADEMIC ED., <http://www.britannica.com/EBchecked/topic/293631/Iraq> (last visited Sept. 14, 2012) (describing the history of Iraq after the 1958 revolution).

<sup>6</sup> At the time of the invasion, the coalition forces were primarily made up of U.S. troops, with a significant contingent from the United Kingdom, and much smaller numbers from Australia and Poland. See, e.g., Michael B. Callaghan, *Numbers Don't Lie: World Against U.S.*, TORONTO STAR, Mar. 22, 2003, at H07.

<sup>7</sup> See Herbert Docena, *Free Market by Force: The Making and Un-Making of a Neo-Liberal Iraq*, 1 INT'L J. CONTEMP. IRAQI STUD. 123, 125 (2007); Gregory H. Fox, *The Occupation of Iraq*, 36 GEO. J. INT'L L. 195, 199 (2005); Wolfram Lacher, *Iraq: Exception to, or Epitome of, Contemporary Post-Conflict Reconstruction?*, 14 INT'L PEACEKEEPING 237, 237 n.2 (2007).

Part I of the paper briefly describes the early legal and economic reforms implemented by the CPA and the Iraqi Interim Government (IIG) during 2003-05, prior to the period when Iraq held a referendum approving a permanent Constitution and electing a new sovereign Government of Iraq. Part II outlines the principle of “conservation” and other relevant aspects of international humanitarian law that are traditionally applicable during periods of post-war occupation, and evaluates whether the CPA and IIG reforms may have violated these principles. Finally, Part III argues that new international norms for “jus post bellum” are emerging, as the United Nations and other international organizations have shifted their focus from “peacekeeping” to promoting the “rule of law” in post-conflict countries.

It is important to note at the outset that this paper does *not* seek to address issues relating to whether the original invasion of Iraq can be justified under principles of international law, or whether the war in Iraq was conducted in a manner consistent with international law. In other words, this paper does not address the justice of the war itself under international law (“*jus ad bellum*”), nor does it consider the justice of how the invasion and war were conducted prior to occupation by the Coalition Provisional Authority (“*jus in bellum*”),<sup>8</sup> as these issues are beyond the scope of this paper, and already have been extensively addressed in prior academic literature.<sup>9</sup> Rather, the focus of this paper is on the justice of developments during the post-war period of occupation (“*jus post bellum*”),<sup>10</sup> after the CPA took control of

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<sup>8</sup> *E.g.*, Brian Orend, *War*, STANFORD ENCYCLOPEDIA OF PHILOSOPHY, <http://www.plato.stanford.edu/entries/war> (last updated July 28, 2005).

<sup>9</sup> For example, there are a number of articles specifically debating whether this U.S. invasion of Iraq was justified under applicable standards of international law. See Barry Collins, *The Invasion of Iraq and the Mythology of International Law*, 2 INT’L J. CONTEMP. IRAQI STUD. 307 (2008); Sean D. Murphy, *Assessing the Legality of Invading Iraq*, 92 GEO. L.J. 173 (2004); John C. Yoo, *International Law and the War in Iraq*, 97 AM. J. INT’L L. 563 (2003) (arguing that the invasion was legally justified given applicable UN resolutions). There are also numerous recent books and articles addressing the so-called “Bush Doctrine” and evaluating U.S. foreign policy in Iraq more generally under principles of international law. See M. Cherif Bassiouni, *Legal Status of US Forces in Iraq from 2003-2008*, 11 CHI. J. INT’L L. 1 (2010); Peter G. Danchin, *International Law, Human Rights and the Transformative Occupation of Iraq*, in INTERNATIONAL LAW, HUMAN RIGHTS AND THE TRANSFORMATIVE OCCUPATION OF IRAQ 64 (Bret Bowden et al. eds., 2009); Wayne Sandholtz, *The Iraq War and International Law*, in ROUTLEDGE HANDBOOK OF INTERNATIONAL LAW 222 (David Armstrong ed., 2009); William H. Taft IV & Todd F. Buchwald, *Preemption, Iraq, and International Law*, 97 AM. J. INT’L LAW 557 (2009); Hakan Tunç, *Preemption in the Bush Doctrine: A Reappraisal*, 5 FOREIGN POL’Y ANALYSIS 1 (2009); MARC WELLER, IRAQ AND THE USE OF FORCE IN INTERNATIONAL LAW 10 (2010).

<sup>10</sup> Orend, *supra* note 8.

the country and up until such time as a nominally representative sovereign government could be elected. Determining whether activities carried out during the post-war period of occupation are consistent with international law requires an analysis that is separate and distinct from the legal merits of the invasion of Iraq and the conduct of military operations.

## I. EARLY ECONOMIC AND LEGISLATIVE REFORMS IMPLEMENTED BY THE COALITION PROVISIONAL AUTHORITY

It would be an understatement to say that the Iraqi government was in a state of flux for many years following the initial invasion by U.S.-led coalition forces in the spring of 2003. Critics have been quick to point out that the substantial transformation of Iraq from a centrally planned to a market-based economy was one of the primary goals of U.S. administration and CPA policy from the outset of the invasion by Coalition forces.<sup>11</sup> The nation's political, legal, economic, and security systems were thrown into chaos following the demise of the Saddam Hussein regime, which made re-establishing security, restoring a sense of order, and repairing a shattered economy a CPA priority.<sup>12</sup> On the economic side, critics have naturally questioned whether the occupying powers sought to implement free market reforms in order to promote economic growth, opportunity, and self-sufficiency for a newly emerging sovereign country, or whether they merely intended to open the door for Western corporate interests to exploit Iraqi oil resources.<sup>13</sup> To place these post-war developments in context, and to evaluate their legitimacy under international law, it is helpful to begin with a timeline.

### A. *Timeline of the Invasion, Occupation, and Transfer Of Power In Iraq*

Before considering whether economic reforms implemented from 2003 to 2005 were consistent with international law, it is helpful to first provide a timeline of events to establish the relevant period during which Iraq could be deemed "occupied" by foreign forces. The attached **Appendix A** provides a detailed timeline of key events re-

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<sup>11</sup> See, e.g., Neil King Jr., *Bush Officials Draft a Broad Plan For Free-Market Economy in Iraq*, WALL ST. J., May 1, 2003, at A1.

<sup>12</sup> See generally Rebecca Santana & Robert H. Reid, *Iraq: A War of Muddled Goals, Painful Sacrifice*, ARMY TIMES (Dec. 10, 2011), <http://www.armytimes.com/news/2011/12/ap-iraq-a-war-of-muddled-goals-painful-sacrifice-121011/> (describing the issues facing coalition forces following the demise of Saddam Hussein's regime).

<sup>13</sup> See, e.g., King, *supra* note 11.

lated to the occupation and handover of authority to subsequent Iraqi sovereign governments through several successive stages during which a constitution was drafted and voted on by the people of Iraq, and a new government was ultimately elected pursuant to the new constitution. As shown in the detailed timeline in **Appendix A**, the key periods of post-war transition in the governance of Iraq included the following:

| <b>Dates</b>                   | <b>Governing Body in Power</b>        | <b>Description</b>  |
|--------------------------------|---------------------------------------|---|
| March 20, 2003 – June 28, 2004 | Coalition Provisional Authority (CPA) | Provided governance during period of occupation; led by US Administrator Paul Bremer. <sup>14</sup>   |
| June 2004 – May 2005           | Iraqi Interim Government              | 25 Iraqi representatives selected under supervision of the CPA as caretaker government pending constitution and elections; led by Prime Minister Iyad Allawi. <sup>15</sup>   |
| May 2005 – May 2006            | Iraqi Transitional Government         | Operated under the “Law of Administration for the State of Iraq for the Transitional Period”; main functions were to draft a permanent Constitution of Iraq and facilitate transition to permanent government; led by Prime Minister Ibrahim al Jaafari of the United Iraqi Alliance, and Kurdish President Jalal Talabani. <sup>16</sup> |

<sup>14</sup> JAMES DOBBINS ET. AL., OCCUPYING IRAQ: A HISTORY OF THE COALITION PROVISIONAL AUTHORITY iii (RAND Corp. 2009), available at [http://www.rand.org/pubs/monographs/2009/RAND\\_MG847.pdf](http://www.rand.org/pubs/monographs/2009/RAND_MG847.pdf).

<sup>15</sup> KENNETH KATZMAN, CONG. RESEARCH SERV., RS21968, IRAQ: POLITICS, ELECTIONS, AND BENCHMARKS 1 (2011).

<sup>16</sup> *Id.* at 1–2.

|                          |  |  |
|--------------------------|--|--|
| October 15, 2005         | New Iraqi Constitution Ratified                | Referendum Conducted and constitution ratified by popular vote. Many Sunnis decided not to participate. <sup>17</sup>  |
| December 2005 – May 2006 | Parliamentary elections under new Constitution | Votes counted; No single alliance can form a controlling government. <sup>18</sup>   |
| May 2006 – March 2010    | First permanent post-war Iraqi Government      | Continued challenges in forming ruling party alliances and filling key Ministry positions; Nouri al-Maliki eventually selected as Prime Minister. <sup>19</sup>  |
| March 2010 – Present     | Second permanent post-war Iraqi Government     | Second parliamentary elections conducted; Iyad Allawi's Iraqiya coalition wins 91 seats and Nuri al-Maliki's State of Law bloc is second with 89 seats; 8 months pass without forming a majority coalition government and filling key posts. <sup>20</sup> |

This paper focuses primarily on the first two stages of post-war governance in Iraq, during the era from March 2003 through May 2005 when Iraq was governed by the CPA and then the IIG.<sup>21</sup> As outlined below, the CPA was plainly an “occupying power” for purposes of applying international humanitarian law. In July 2003, the CPA formed an “Iraqi Governing Counsel” made up of 25 Iraqis who were selected by coalition leaders, but who remained under the supervision of the CPA.<sup>22</sup>

The IIG was formed to take control from the CPA pursuant to UN Security Council Resolution 1546, and was recognized by the United Nations and the Arab League as a legitimate sovereign govern-

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<sup>17</sup> *Id.* at 2.

<sup>18</sup> *Id.* at 3.

<sup>19</sup> *Id.* at 3–6.

<sup>20</sup> KATZMAN, *supra* note 15, at Summary, 14.

<sup>21</sup> See *Building Iraqi Security Forces: Testimony Before the H. Subcomm. on H. Government Reform*, 112th Cong. (2005) (statement of Joseph A. Christoff, Dir., Gov't Accountability Office).

<sup>22</sup> See, e.g., *Iraqi Governing Council*, GLOBALSECURITY.ORG, <http://www.global-security.org/military/world/iraq/igc.htm> (last visited Sept. 14, 2012).

ment.<sup>23</sup> There is some question, however, regarding whether the period of “occupation” may arguably have continued under the IIG given the substantial continued influence of coalition forces and their military presence in the country.<sup>24</sup>

In Resolution 1546, the UN Security Council states that the continued presence of a multinational coalition military force is justified based on a “request of the Interim Government,” and reaffirms that a special unit within the multinational military force shall be given the task of protecting UN activities in Iraq.<sup>25</sup> Thus, as addressed below, there remains some question as to whether the period of effective “occupation” may have continued during the IIG era for purposes of applying the laws of occupation under the Hague Regulations and the Fourth Geneva Convention. The following section provides an overview of economic reforms implemented during the CPA and IIG eras, and then analyzes whether such reforms violated international humanitarian law of occupation applicable at that time.

### *B. Early Economic and Legislative Reform Efforts in Iraq*

From his first speech to the international community, delivered on June 23, 2003 to a special meeting of the World Economic Forum held in Amman, Jordan, CPA Administrator L. Paul Bremer emphasized the extent and importance of legal and economic reforms.<sup>26</sup> Bremer emphasized that the CPA intended to pursue the following specific economic reforms to begin the process of transitioning Iraq to a market-based economy.<sup>27</sup>

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<sup>23</sup> S.C. Res. 1546, U.N. Doc. S/RES/1546 (June 8, 2004), available at <http://www.uncc.ch/resolutio/res1546.pdf>; Magdi Abdelhadi, *Arab World Split on Volatile Iraq*, BBC News (Sept. 9, 2003), [http://news.bbc.co.uk/2/hi/middle\\_east/3093836.stm](http://news.bbc.co.uk/2/hi/middle_east/3093836.stm).

<sup>24</sup> See Rudiger Wulfrum, *Iraq – from Belligerent Occupation to Iraqi Exercise of Sovereignty: Foreign Power versus International Community Interference*, 9 MAX PLANCK Y.B. UNITED NATIONS 34–45 (2005) (discussing an alternate view of the status of the coalition forces during the IIG period under international humanitarian law of occupation).

<sup>25</sup> S.C. Res. 1546, *supra* note 23, ¶ 9.

<sup>26</sup> Ambassador L. Paul Bremer III, Chief Adm’r in Iraq, Address at the World Economic Forum (June 23, 2003), available at <http://www.c-spanvideo.org/program/177131-4>. The CPA also emphasized the importance of creating a market economy in Iraq, stating: “The ultimate goal for Iraq is a durable peace for a unified and stable, democratic Iraq that is underpinned by new and protected freedoms and a growing market economy.” COALITION PROVISIONAL GOVERNMENT, AN HISTORIC REVIEW OF CPA ACCOMPLISHMENTS 2003–2004, at 4, available at [http://pdf.usaid.gov/pdf\\_docs/PCAAB654.pdf](http://pdf.usaid.gov/pdf_docs/PCAAB654.pdf) (last visited Sept. 21, 2012).

<sup>27</sup> *Id.*

- a) Begin substantial reforms of Iraq's financial sector to provide liquidity and credit for the Iraqi economy;<sup>28</sup>
- b) Simplify Iraq's regulatory regime to lower barriers to entry for new domestic and foreign firms;<sup>29</sup>
- c) Review Iraq's body of commercial law to determine what changes are needed to encourage private investment;<sup>30</sup>
- d) Lift unreasonable restrictions on property rights;<sup>31</sup>
- e) Develop antitrust and competition laws;<sup>32</sup>
- f) Develop an open market trade policy, providing for a level playing field with regional trade partners;<sup>33</sup> and
- g) Encourage the adoption of laws and regulations to assure that Iraq has high standards of corporate governance.<sup>34</sup>

The CPA's goals were reinforced a year later, from the highest levels of the U.S. administration, when President George W. Bush delivered a major speech outlining U.S. goals and policies on Iraq in May 2004.<sup>35</sup> Bush emphasized CPA progress in transforming Iraq's economy, specifically mentioning the relevance of the World Trade Organization and major legal reforms in that process:

The third step in the plan for Iraqi democracy is to continue rebuilding that nation's infrastructure so that a free Iraq can quickly gain **economic independence** and a better quality of life. . . . And **now a growing private economy is taking shape. A new currency has been introduced. Iraq's governing council approved a new law that opens the country to foreign investment for the first time in decades. Iraq has liberalized its trade policy. And today an Iraqi observer attends meetings of the World Trade Organization.** Iraqi oil production has reached more than two million barrels per day, bringing revenues of nearly \$6 billion so far this year, which is being used to help the people of Iraq. And . . . many of Iraq's largest creditors

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<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> Bremer, *supra* note 26; CPA Press Release, *supra* note 26.

<sup>32</sup> Bremer, *supra* note 26.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> Remarks at the United States Army War College in Carlisle, Pennsylvania, 1 PUB. PAPERS 919, 919 (May 24, 2004), available at <http://www.gpo.gov/fdsys/pkg/PPP-2004-book1/pdf/PPP-2004-book1-doc-pg919.pdf>.

have pledged to forgive or substantially reduce Iraqi debt incurred by the former regime.<sup>36</sup>

The above statement by President Bush, commenting on the economic reforms already implemented by the CPA as an occupying power, was made a month before the formal transfer of power from the CPA to the IIG.<sup>37</sup>

During its 14 months in control of Iraq before transferring power to the IIG, the CPA implemented a large number of legislative orders aimed at restructuring the Iraqi economy, including institutional and legal reforms relating to issuing a new currency, curbing inflation, instituting banking reforms, debt relief, taxation, foreign trade, foreign investment, customs laws, private economic transactions, securities regulation, improving regulatory systems, and reducing government subsidies.<sup>38</sup> These reforms of existing Iraqi laws and regulations were proposed and implemented in consultation with the Iraq Governing Council; however, members of the IGC were largely selected in consultation with the CPA rather than through open elections.<sup>39</sup> One hundred separate, official CPA orders, some of which were later revised or rescinded, made significant legislative changes from May 2003 through June 2004, and had legal effect and were described by the CPA as “binding instructions or directives to the Iraqi people that create penal consequences or have a direct bearing on the way Iraqis are regulated, including changes to Iraqi law.”<sup>40</sup>

In short, there is no doubt that the United States and the CPA actively promoted economic and legislative reforms in Iraq as a central part of reconstruction initiatives. To be balanced, however, it is also important to note that many of the goals pursued in CPA reforms were also referenced in UN Security Council resolutions, and were largely implemented with the direct support and involvement of the UN, international financial institutions, and other international organizations.

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<sup>36</sup> *Id.* at 923 (emphasis added).

<sup>37</sup> *Id.*

<sup>38</sup> For detailed discussions of these CPA-era reforms, see generally Gregory H. Fox, *The Occupation of Iraq*, 36 GEO. J. INT’L L. 195, 240 (2005), Christopher Foote, William Black, Keith Crane, & Simon Gray, *Economic Policy and Prospects in Iraq*, J. ECON. PERSP., no. 3, Summer 2004, at 58-66, and JAMES DOBBINS ET AL. OCCUPYING IRAQ: A HISTORY OF THE COALITION PROVISIONAL AUTHORITY, 197-42 (2009).

<sup>39</sup> See DOBBINS, *supra* note 38, at 243-48.

<sup>40</sup> CPA Official Documents, IRAQCOALITION.ORG, <http://www.iraqcoalition.org/regulations/> (last visited Sept. 14, 2012) (listing and providing the full text of all binding orders issued by the CPA).

## II. DID ECONOMIC AND LEGISLATIVE REFORMS IN IRAQ VIOLATE THE PRINCIPLE OF CONSERVATION UNDER INTERNATIONAL HUMANITARIAN LAW?

Although there are valid policy-based criticisms of the manner in which the CPA initially pressed for early market-based and legislative reforms in Iraq, it is not entirely clear whether such reforms violated international humanitarian laws applicable during periods of post-war occupation, particularly given the context of the peacekeeping and nation-building goals outlined in applicable UN Security Council resolutions during this period. The sections below outline criticisms of the economic reforms implemented in Iraq, then seek to place the reforms initiated by the CPA in the larger context of conditions on the ground in Iraq, the status of the Iraqi economy following crippling pre-war economic sanctions, and the scope of the mandates for Iraq that were supported by UN Security Council resolutions.

### A. *Criticisms of Economic Reforms Implemented by the Coalition Provisional Authority in Iraq*

The aggressive push by the CPA to begin restructuring the Iraqi economy within the first year after invasion by coalition forces has been criticized both by academic authors and the mainstream media. A few authors, such as Naomi Klein in her book *The Shock Doctrine*, have employed rather exaggerated language to argue that the CPA's economic reforms in post-war Iraq were part of a vast and long-standing neo-conservative conspiracy to deliberately apply economic "shock treatments" to fragile countries.<sup>41</sup>

Torturers believe that when electrical shocks are applied to various parts of the body simultaneously subjects are rendered so confused about where the pain is coming from that they become incapable of resistance. . . . A similar theory applies to economic shock therapy, or "shock treatment," the ugly term used to describe the rapid implementation of free-market reforms. . . . The theory is that if painful economic "adjustments" are brought in rapidly and in the aftermath of a seismic social disruption like a war, a coup, or a government collapse, the population will be so stunned, and so preoccupied with the daily pressures of survival, that it too will go into suspended animation, unable to resist. . . . In only a few

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<sup>41</sup> See, e.g., NAOMI KLEIN, *THE SHOCK DOCTRINE: THE RISE OF DISASTER CAPITALISM* 7–8 (2008).

months, the postwar plan to turn Iraq into [such] a laboratory for the neocons had been realized.<sup>42</sup>

One difficulty with Klein's "shock doctrine" theory as applied to Iraq is that the economy already had been immersed in a longstanding state of shock long before implementation of any CPA economic reforms.<sup>43</sup> Although Iraq had achieved middle-income status in the late 1970s, the economy imploded during the Iraq-Iran War in the 1980s, and was only made worse by 12 years of UN sanctions that followed the Persian Gulf War from 1990-1991.<sup>44</sup> The multilateral UN international sanctions program under the Saddam regime had not only isolated Iraq's government, but also crippled the entire economy, given that oil has traditionally provided about 95 percent of foreign exchange earnings for Iraq.<sup>45</sup> In response to international sanctions, Saddam Hussein's government engaged in black market sales of oil and financed operations by printing more money, which only served to debase the currency, fuel inflation, and promote a culture of widespread corruption.<sup>46</sup> For decades, the government had propped up a whole host of money-losing subsidies and state owned enterprises, and nepotism and corruption were rampant at every level.<sup>47</sup> Foreign investment from any non-Arab sources was prohibited in pre-war Iraq and more than sixty percent of the population depended on government food rations.<sup>48</sup>

In contrast to Klein's impassioned rhetoric, a number of academic authors have employed more objective legal analyses to criticize early reforms in Iraq as potentially violating international humanitarian law. These authors argue that the United States and the United Kingdom were "occupying powers" under international law by virtue of military occupation by their troops and administrative control of the CPA, and thus they were bound by the rules of occupation under Article 43 of the Hague Convention of 1907 and Article 64 of the Fourth Geneva Convention of 1949.<sup>49</sup> These rules set forth the principle

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<sup>42</sup> Naomi Klein, *Baghdad Year Zero: Pillaging Iraq in Pursuit of a Neocon Utopia*, HARPER'S MAGAZINE, Sept. 2004, at 43, 45-46, available at <http://www.harpers.org/archive/2004/09/0080197>.

<sup>43</sup> See Christopher Foote et al., *Economic Policy and Prospects in Iraq*, 18 J. ECON. PERSPECTIVES, no. 3, Summer 2004, at 47, available at <http://pubs.aeaweb.org/doi/pdfplus/10.1257/0895330042162395>.

<sup>44</sup> *Id.*

<sup>45</sup> See *id.* at 68.

<sup>46</sup> See *id.* at 47, 54.

<sup>47</sup> See *id.*

<sup>48</sup> See Foote, *supra* note 43, at 47-48.

<sup>49</sup> For detailed discussions of the applicability of the Hague Regulations of 1907 and the Geneva Conventions of 1949 to the sweeping legal and economic reforms made in Iraq under the Coalition Provisional Authority, see generally Fox, *supra*

known as “conservation” in international humanitarian law, which generally requires that an occupying power keep in force the prior laws of the sovereign and respect existing institutions of justice and governance, unless “absolutely prevented” from doing so, or unless derogation is essential to “ensure security” or “maintain orderly government” and “civil life.”<sup>50</sup> These obligations and limitations apply to periods of armed conflict, as well as to post-conflict reconstruction efforts during an occupation, including constitutional reforms, and economic and social policy reforms.<sup>51</sup>

A key legal question is whether the CPA violated these principles by promoting dramatic reforms of the economy, laws, and public institutions in Iraq while it was still an occupied state, before handing control over to a formally recognized indigenous government selected by Iraqi people.<sup>52</sup> Based on the context in which these economic reforms occurred, and subsequent acceptance of such reforms by the duly elected governments of Iraq, this paper argues that such economic reforms did not violate principles of international humanitarian law, as outline below.

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note 7; Kristen E. Boon, *Open for Business: International Financial Institutions, Post-Conflict Economic Reform, and the Rule of Law*, 39 N.Y.U. J. INT'L L. & POL. 513 (2007). See also Geneva Convention Relative to the Protection of Civilian Persons in Time of War (IV) art. 64, Aug. 12, 1949, 6 U.S.T. 3516, 75 U.N.T.S. 287 [hereinafter “Fourth Geneva Convention”]; Convention Respecting the Laws and Customs of War on Land art. 43, Oct. 18, 1907, 36 Stat. 2277, T.S. No. 539 [hereinafter “Hague Convention”]. See generally 2(a) FINAL RECORD OF DIPLOMATIC CONFERENCE OF GENEVA 285–287 (1949), available at [http://www.loc.gov/rr/frd/Military\\_Law/pdf/Dipl-Conf-1949-Final\\_Vol-2-A.pdf](http://www.loc.gov/rr/frd/Military_Law/pdf/Dipl-Conf-1949-Final_Vol-2-A.pdf) (detailing the negotiating history of article 64).

<sup>50</sup> For example, article 64 of the Fourth Geneva Convention provides that occupying powers can only change prior civil laws that “are essential to enable the Occupying Power to fulfill its obligations under the present Convention, to maintain the orderly government of the territory, and to ensure the security of the Occupying Power.” Fourth Geneva Convention, *supra* note 49, at art. 64. Article 43 of the Hague Convention further complements this provision of article 64 of Geneva IV. Hague Convention, *supra* note 49, at art. 43. For a detailed discussion of the scope and applicability of Art. 43 of the Hague Convention in peacekeeping operations, see also M. Sassòli, Article 43 of the Hague Regulations and Peace Operations in the Twenty First Century at 6–8 (June 25–27, 2004) (unpublished manuscript, on file with the Program on Humanitarian Policy and Conflict Research at Harvard University), available at <http://www.hpcrresearch.org/sites/default/files/publications/sassoli.pdf>.

<sup>51</sup> Sassòli, *supra* note 50, at 1, 24.

<sup>52</sup> See, e.g., Fox, *supra* note 7, at 196–97; Docena, *supra* note 7, at 123–24.

*B. Economic and Legislative Reforms Implemented by the CPA  
Likely Did Not Violate Key Principles of International Law*

The principle of conservation in international occupation law likely does not invalidate legal and economic reforms implemented in Iraq to date, for several key reasons:

- 1) There are recognized exceptions within the above Hague Regulation and Fourth Geneva Convention provisions that appear to apply in Iraq's case, and such exceptions should be interpreted in light of modern peacekeeping goals and norms under international law.<sup>53</sup>
- 2) The economic reforms implemented by the CPA arguably were authorized by UN Security Council Resolutions, which specifically referenced goals relating to legal and economic reform in Iraq, and the reforms were implemented with assistance from international organizations in direct coordination with UN bodies.<sup>54</sup>
- 3) Duly elected sovereign governments in Iraq subsequently reaffirmed many of the economic reforms and CPA orders following the end of CPA occupation, suggesting the Iraqi electorate did not have strong objections to the reforms.<sup>55</sup>

Below I address each of these arguments in turn.

*1. Economic Reforms During Occupation of Iraq Arguably Were Permissible Under the Hague Regulations and Fourth Geneva Convention*

The rules of occupation under Article 43 of the Hague Regulations of 1907 and Article 64 of the Fourth Geneva Convention of 1949 relied upon by the critics of reforms in Iraq include certain limitations and exceptions to the general rule of conservation. For example, Article 43 of the Hague Regulations specifies:

The authority of the legitimate power having in fact passed into the hands of the occupant, the latter shall take all the measures in his power to restore, and ensure, as far as possible, **public order and safety, while respecting, unless absolutely prevented, the laws in force in the country.**<sup>56</sup>

Similarly, the third clause of Article 64 of the Fourth Geneva Convention, clarifying Article 43 of the Hague Regulations, states:

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<sup>53</sup> See *infra* notes 56–58 and accompanying text.

<sup>54</sup> See *infra* notes 70–74 and accompanying text.

<sup>55</sup> See *infra* notes 107–09 and accompanying text.

<sup>56</sup> See Hague Convention, *supra* note 49, at art. 43 (emphasis added).

The Occupying Power may, however, subject the population of the occupied territory to provisions which are essential to enable the Occupying Power to fulfill its obligations under the present Convention, to **maintain the orderly government** of the territory. . .<sup>57</sup>

Taken together, these provisions permit an occupying power to implement reforms that can be deemed necessary to support public order and maintain orderly functioning of government ministries and services, and even to protect private property.<sup>58</sup> Varying interpretations have been suggested for the meaning of the exception “unless absolutely prevented,” but it is well established that this phrase was intended to be a reformulation of the term “necessity” as it originally appeared in Article 3 of the Brussels Declaration before that article was incorporated into Article 43 of the Hague Regulations.<sup>59</sup> Based on the preparatory notes for Article 3 of the Brussels Declaration, it is clear that the term “necessity” as originally used did not require any “military necessity,” and thus can be interpreted to simply require a general justification relating to maintaining orderly government and administering civil life for an occupying power to justify deviating from local legislation.<sup>60</sup>

The original French language version of this exception further supports a broad interpretation of Article 43. Although the English version of the provision uses the words “public order and safety,” the authentic and original French phrasing used the words “l’ordre et la vie publique,” which is viewed as much broader in scope. The legislative history indicates that “la vie publique” (or “public life”) encompasses “des fonctions sociales, des transactions ordinaires, qui constituent la vie de tous les jours” (*i.e.*, “social functions, ordinary transactions, which constitute daily life”).<sup>61</sup> Thus, legal scholars have

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<sup>57</sup> See Fourth Geneva Convention, *supra* note 49, at art. 64. The official ICRC commentary to this provision reiterates: “(b) It [the occupying power] will have the right to enact provisions necessary to maintain the ‘orderly government of the territory’ in its capacity as the Power responsible for public law and order.” INT’L COMM. OF THE RED CROSS, COMMENTARY TO CONVENTION (IV) RELATIVE TO THE PROTECTION OF CIVILIAN PERSONS IN TIME OF WAR 335, available at <http://www.icrc.org/ihl.nsf/COM/380-600071?OpenDocument>.

<sup>58</sup> For instance, a number of provisions of the Fourth Geneva Convention of 1949 relate specifically to the duty of the occupying power to preserve state property and also to protect private property. See, e.g., Fourth Geneva Convention, *supra* note 49, at art. 53; INT’L COMM. OF THE RED CROSS, *supra* note 57, at 300.

<sup>59</sup> See Sassòli, *supra* note 50, at 1.

<sup>60</sup> See Edmund Schwenk, *Legislative Power of the Military Occupant Under Article 43, Hague Regulations*, 54 YALE L.J. 393, 401 (1945).

<sup>61</sup> See Sassòli, *supra* note 50, at 3–4; Schwenk, *supra* note 60, at 393 n.1 (citing MINISTÈRE DES AFFAIRES ÉTRANGÈRES DE BELGIQUE, ACTES DE LA CONFÉRENCE DE

noted that Article 43 does not offer any fixed criterion to determine which specific legislative changes by an occupying power would be deemed necessary and lawful, and after two world wars and countless conflicts, international courts and tribunals have indeed accepted a great variety of legislation by occupying powers as legitimate.<sup>62</sup>

These rules of international humanitarian law are logically focused on those occupation issues that were viewed in 1907 and 1949 as relating directly to human rights and humanitarian relief, and thus remain notoriously silent on most matters relating to the economy, international trade, and commerce. The rules under the Fourth Geneva Convention and Hague Regulations make some specific references to taxes and customs,<sup>63</sup> prohibiting pillage,<sup>64</sup> and providing some protections for private and state property,<sup>65</sup> as well as natural resources.<sup>66</sup> However, there is virtually no guidance or even mention of economic

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BRUXELLES DE 1874 23 (Paris, 1874)). *See generally* 2 FINAL RECORD OF DIPLOMATIC CONFERENCE OF GENEVA (1949) (describing the negotiation history of article 64 of the Fourth Geneva Convention).

<sup>62</sup> *See* M. Sassòli, *supra* note 50, at 1; Sylvain Vité, *The Interrelation of the Law of Occupation & Economic, Social and Cultural Rights: The Examples of Food, Health and Property*, 90 INT'L REV. OF THE RED CROSS 629, 634–35 (2008). *See generally* KRETZMER, *THE OCCUPATION OF JUSTICE – THE SUPREME COURT OF ISRAEL AND THE OCCUPIED TERRITORIES* (2002) (detailing instances in which the Israeli Supreme Court has affirmed legislation implemented by occupying powers).

<sup>63</sup> *See* Hague Convention, *supra* note 49, at art. 48 (“[If] the occupant collects the taxes, dues, and tolls imposed for the benefit of the State, he shall do so, as far as is possible, in accordance with the rules of assessment and . . . be bound to defray the expenses of the administration of the occupied territory to the same extent as the legitimate Government was so bound.”). *See also* Fourth Geneva Convention, *supra* note 49, at art. 61 (requiring the free passage of certain consignments related to religious worship, clothing, and medical supplies).

<sup>64</sup> *See* Fourth Geneva Convention, *supra* note 49, at art. 33. *See also* INT'L COMM. OF THE RED CROSS, *supra* note 57, at 226–27 (“The prohibition of pillage is applicable to the territory of a Party to the conflict as well as to occupied territories. It guarantees all types of property, whether they belong to private persons or to communities or the State. On the other hand, it leaves intact the right of requisition or seizure.”).

<sup>65</sup> *See* Hague Convention, *supra* note 49, at art. 46 (protecting private property); *see also* Fourth Geneva Convention, *supra* note 49, at art. 53 (“Any destruction by the Occupying Power of real or personal property belonging individually or collectively to private persons, or to the State, or to other public authorities, or to social or cooperative organizations, is prohibited, except where such destruction is rendered absolutely necessary by military operations.”). *See generally* INT'L COMM. OF THE RED CROSS, *supra* note 57, at 301 (elaborating on the scope of the property protections offered by the Fourth Geneva Convention).

<sup>66</sup> *See* Hague Convention, *supra* note 49, at art. 55 (providing that an occupant must safeguard public resources).

administration, international trade, banking systems, currency reforms, or regulation of private sector industry during periods of occupation.

In the first regulation outlining its powers, the CPA made clear from the outset that it would exercise powers only temporarily during a transition period, and would be focused on restoring order and administering activities of daily life, including facilitating economic recovery.<sup>67</sup>

The CPA shall exercise powers of government temporarily in order to provide for the effective administration of Iraq during the period of transitional administration, to restore conditions of security and stability, to create conditions in which the Iraqi people can freely determine their own political future, including by advancing efforts to restore and establish national and local institutions for representative governance and **facilitating economic recovery** and sustainable reconstruction and development.”<sup>68</sup>

The CPA also emphasized in this initial regulation that such powers would be “exercised under relevant U.N. Security Council resolutions, including Resolution 1483 (2003),” reflecting that the CPA viewed such economic, construction, and development reforms as within the scope of activity authorized by relevant Security Council resolutions, as discussed below.<sup>69</sup>

## *2. Economic Reforms in Iraq Were Arguably Backed by UN Security Council Resolutions With Direct Assistance from Other UN and International Organizations*

UN Security Council resolutions, both during and after the CPA occupation, included specific language supporting goals of economic reconstruction and building Iraq’s capacity for international trade.<sup>70</sup> From the outset, Security Council Resolution 1483, dated May 22, 2003, included numerous statements endorsing economic reconstruction in Iraq and authorizing direct involvement of international economic agencies such as the International Monetary Fund and the

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<sup>67</sup> Coalition Provisional Authority Regulation Number 1 in the Transitional Period [Coalition Provisional Authority] of 2003, § 1, ¶ 1 [hereinafter CPA Reg. 1], available at [http://www.iraqcoalition.org/regulations/20030516\\_CPAREG\\_1\\_The\\_Coalition\\_Provisional\\_Authority\\_.pd](http://www.iraqcoalition.org/regulations/20030516_CPAREG_1_The_Coalition_Provisional_Authority_.pd).

<sup>68</sup> *Id.* (emphasis added).

<sup>69</sup> *Id.*, § 1, ¶ 2.

<sup>70</sup> See, e.g., S.C. Res. 1483, ¶ 4, U.N. Doc. S/RES/1483 (May 22, 2003); S.C. Res. 1511, ¶1, U.N. Doc. S/RES/1511 (Oct. 16, 2003); S.C. Res. 1546, ¶ 2, U.N. Doc. S/RES/1546 (June 8, 2004).

World Bank in implementing such reforms.<sup>71</sup> For example, Security Council Resolution 1483 states:

(Preambulatory clause) *Noting* the statement of 12 April 2003 by the Ministers of Finance and Central Bank Governors of the Group of Seven Industrialized Nations in which the members **recognized the need for a multi-lateral effort to help rebuild and develop Iraq and for the need for assistance from the International Monetary Fund and the World Bank** in these efforts. . . .<sup>72</sup>

15. ***Calls upon the international financial institutions to assist the people of Iraq in the reconstruction and development of their economy*** and to facilitate assistance by the broader donor community, and welcomes the readiness of creditors, including those of the Paris Club, to seek a solution to Iraq's sovereign debt problems;<sup>73</sup>

Resolution 1483 also took the important step of appointing a UN Special Representative for Iraq, who was specifically authorized to coordinate with the CPA and international institutions activities in Iraq related to economic, legal, and judicial reform:<sup>74</sup>

8. *Requests* the Secretary-General to appoint a Special Representative for Iraq whose independent responsibilities shall involve reporting regularly to the Council on his activities under this resolution, coordinating among United Nations and international agencies engaged in humanitarian assistance and reconstruction activities in Iraq, and, in coordination with the Authority, assisting the people of Iraq through:

(a) coordinating humanitarian and reconstruction assistance by United Nations agencies and between United Nations agencies and non-governmental organizations; . . . .

(d) facilitating the reconstruction of key infrastructure, in cooperation with other international organizations;

(e) promoting economic reconstruction and the conditions for sustainable development, including

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<sup>71</sup> See S.C. Res. 1483, *supra* note 70, preambular clause 8.

<sup>72</sup> *Id.* (emphasis added).

<sup>73</sup> See *id.*, ¶ 15 (emphasis added).

<sup>74</sup> *Id.* ¶ 8.

through coordination with national and regional organizations, as appropriate, civil society, donors, and the international financial institutions;

(f) encouraging international efforts to contribute to basic civilian administration functions; . . . and

(i) encouraging international efforts to promote legal and judicial reform;<sup>75</sup>

A reasonable interpretation of these provisions of Resolution 1483 is that the Security Council not only acknowledged the importance of “economic reconstruction” and “legal and judicial reform” in Iraq, but the Security Council also viewed these processes as urgent and important enough to authorize immediate appointment of a special UN representative to actively coordinate such efforts among the CPA and other international agencies and institutions.<sup>76</sup>

The International Court of Justice has interpreted Article 103 of the UN Charter to establish that binding UN Security Council resolutions prevail over other international obligations.<sup>77</sup> Thus, Security Council resolutions authorizing legislative changes in an occupied territory would, by law, prevail over contrary restrictions in Article 43 of the Hague Regulations and Article 64 of the Fourth Geneva Convention.<sup>78</sup> On this basis, Resolution 1483 also could be interpreted to create a specified “carve out” from the Hague Regulations and Fourth

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<sup>75</sup> *Id.*

<sup>76</sup> This interpretation is consistent with observations made in American Society for International Law commentary at the time, stating that paragraph 8 of resolution 1483 created a binding mandate, the scope of which would have to be determined based on responding to actual conditions in Iraq: “Paragraph 8 of the resolution also calls on [the Special Representative], in coordination with the occupying powers, not only to work toward such goals as restoring and establishing institutions for representative governance, but also to promote conditions for sustainable development and for the protection of human rights. Exactly how far these mandates extend will have to be established by practice when the Special Representative is in place in Iraq.” Frederic L. Kirgis, *Security Council Resolution 1483 on the Rebuilding of Iraq*, ASIL INSIGHTS May 2003, available at <http://www.asil.org/insigh107.cfm>.

<sup>77</sup> See Questions of Interpretation and Application of the 1971 Montreal Convention Arising from the Aerial Incident at Lockerbie (Libyan Arab Jamahiriya v. U.S.), 1992 I.C.J. 126 (Apr. 14).

<sup>78</sup> See U.N. Charter art. 103 (“In the event of a conflict between the obligations of the Members of the United Nations under the present Charter and their obligations under any other international agreement, their obligations under the present Charter shall prevail.”); see also *id.* at art. 24–25 (establishing that the Security Council has “primary responsibility for the maintenance of international peace and security,” and “[t]he Members of the United Nations agree to accept and

Geneva Convention, leaving other provisions of those treaties in force, but suspending, with respect to the CPA, those provisions that otherwise would curb its license to change the laws, institutions, and personnel of the occupied state consistent with directives in the resolution.<sup>79</sup> In other words, in instances where there is a direct contradiction between the actions of an occupying power authorized under a Security Council resolution and the requirements of the Fourth Geneva Convention or Hague Regulations, the Security Council resolution should be deemed controlling under international law.<sup>80</sup>

Additionally, because Resolution 1483 mandated direct involvement of a UN Special Representative, it may have been intended to not only help to better coordinate the reform process, but also to provide oversight of coalition activities on the ground to help mitigate any risk that reforms might be conducted in a manner that would exploit the Iraqi people or jeopardize humanitarian rights of Iraqi citizens in a manner contrary to international humanitarian law.

Along these same lines, paragraph 24 of Resolution 1483 also set up a reporting system under which the Secretary General would regularly report to the Security Council on progress toward the Resolution's goals in Iraq.<sup>81</sup> In his first such report, dated July 17, 2003, the Secretary General noted his appointment of Sergio Vieira de Mello as the Special Representative for Iraq, and explained that the Special Representative and his team had identified economic reconstruction as a key priority based on their wide ranging and extensive interviews with

[P]eople representing a large and diverse spectrum of Iraqi society. . . . [including] political groups; religious leaders; tribal leaders; senior civil servants in the ministries; and members of civil society, including nascent Iraqi human rights and non-governmental organiza-

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carry out the decisions of the Security Council in accordance with the present Charter.”).

<sup>79</sup> This interpretation also reconciles any perceived conflict with paragraph 5 of Res. 1483, which calls upon all concerned to comply with their obligations under international law. See S.C. Res. 1483, *supra* note 70, ¶ 5; see also Thomas D. Grant, *Iraq: How to reconcile conflicting obligations of occupation and reforms*, *ASIL Insights*, AM. SOC'Y OF INT'L LAW (June 2003), <http://www.asil.org/insigh107a1.cfm> (citing as precedent the Security Council resolutions that established a legal basis for similar programs to be carried out relating to the independence of East Timor and administration of Kosovo).

<sup>80</sup> S.C. Res. 1483, *supra* note 70, ¶ 5.

<sup>81</sup> See U.N. Secretary-General, *Report of the Secretary-General Pursuant to Paragraph 24 of Security Council Resolution 1483*, ¶ 1, U.N. Doc. S/2003/715 (July 17, 2003), available at <http://daccess-dds-ny.un.org/doc/UNDOC/GEN/N03/430/63/PDF/N0343063.pdf?OpenElement>.

tions, women's associations, journalists and independent professionals and business leaders, both in Baghdad and in the regions. . . . [a]ll considered United Nations involvement essential to the legitimacy of the political process. Others frequently cited **key priority areas for ensuring future stability and prosperity, including economic reconstruction and sustainable development**, the need for an accounting for past crimes, respect for human rights and **the rule of law**, national reconciliation, the development of a dynamic civil society — including free and independent media, and **capacity-building**.<sup>82</sup>

This statement in Resolution 1483 suggests that the United Nations believed the Iraqi people strongly supported such efforts to promote economic reconstruction and to establish a “rule of law” through judicial and legislative reforms. Similarly, the Secretary General's report also specifically emphasized the urgency of efforts by existing internal institutions in Iraq to promote legal and judicial reform, consistent with paragraph 8 (i) of Resolution 1483, stating:

[t]he Iraqi legal community has been eager to establish the rule of law and functioning institutions after decades of living without an independent judicial system. . . . The lack of functioning courts has, so far, stifled the role of the legal community. . .<sup>83</sup>

The Secretary General's report under Resolution 1483 further stressed that unique circumstances in post-war Iraq made it urgent and necessary to begin the process of transitioning Iraq “from a centrally planned economy to a market economy” under the CPA:

84. As a result of successive wars, strict international sanctions and debilitating economic controls and distortions, Iraq's economic infrastructure and civic institutions have deteriorated significantly. . . .The UNDP Arab Human Development Report 2002 places Iraq at 110 among 111 countries reviewed and over 80 per cent of the population are now estimated to be living in poverty. The lack of progress towards the Millennium Development Goals, regarded as a potential longer-term benchmark for recovery, also indicates the degree to which Iraq has deteriorated. **It is against the backdrop of this situation, further exacerbated by the recent**

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<sup>82</sup> *Id.* ¶¶ 6, 13 (emphasis added).

<sup>83</sup> *Id.* ¶ 53; *see also* S.C. Res 1483, *supra* note 70, ¶ 8(i) (“encouraging international efforts to promote legal and judicial reform”).

**war and the attendant breakdown of social services, that the development of Iraq and the transition from a centrally planned economy to a market economy needs to be undertaken.**<sup>84</sup>

The report then emphasized the necessity and high priority of comprehensive market reforms, with immediate technical assistance to be provided by the IMF and World Bank:

**A comprehensive policy enacting institutional and legal reforms will be necessary to establish a market-oriented environment that promotes integration with the global marketplace.** Sustainable economic growth in Iraq will be feasible only through the establishment of a **dynamic private sector, a real challenge for an economy dominated by the public sector and State-owned enterprise . . . . Priority technical assistance missions in the next three months will focus on the areas of** (a) currency reform, central bank, and payments system; (b) the commercial banking sector; (c) public expenditure management; (d) tax policy and the fiscal regime for the oil sector; (e) price liberalization, enterprise reform, and social protection; (f) an initial assessment of policies and actions to energize the private sector; and (g) economic statistics. The two institutions [IMF and World Bank] have established a continuing presence in Baghdad, in close cooperation with my [UN] Special Representative.<sup>85</sup>

Finally, the July 2003 Secretary General's report on Iraq issued pursuant to Resolution 1483 also stressed that the ability to make progress on economic reforms was hampered by the increased violence and growing security risks in Iraq, necessitating a continued military presence in order to improve security:

Above all, my Special Representative's contacts expressed deep concern about the precarious, some believed deteriorating, security situation, particularly in Baghdad. They feared that if the situation were not addressed quickly insecurity would hamper efforts to address many of their immediate other concerns, notably the inadequate provision of basic public services and the pressing need to create jobs for the high numbers of unemployed in Iraq.<sup>86</sup>

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<sup>84</sup> U.N. Secretary-General, *supra* note 81, ¶ 84 (emphasis added).

<sup>85</sup> *Id.* ¶¶ 90, 93 (emphasis added).

<sup>86</sup> *Id.* ¶ 12.

This proved to be a prophetic statement. At 4:30 pm on August 19, 2003, a truck bomb was detonated outside the United Nations headquarters in Baghdad, killing 22 persons, including 15 UN staff members, and seriously wounding more than 150 others.<sup>87</sup> Among those killed was Sergio Vieira de Mello himself, the new Special Representative for Iraq appointed pursuant to Resolution 1483, who also served as the UN High Commissioner for Human Rights.<sup>88</sup> Abu Musab Zarqawi, leader of the Al-Qaida in Iraq terrorist organization, claimed responsibility for the blast, and further investigation supported this claim.<sup>89</sup> A December 2003 report on Iraq by the Secretary General details a string of additional violent attacks in Iraq between July and December of that year (even including a direct attack on the International Committee of the Red Cross), in which dozens of diplomats, government employees, relief workers, business persons, contractors, and coalition troops were killed.<sup>90</sup> These events resulted in the withdrawal of the 600 UN staff members from Iraq and had a profound impact on the UN's peacekeeping security policies and practices globally.<sup>91</sup>

The above UN resolutions and reports, and conditions on the ground in Iraq during 2003-04, have a direct bearing on whether legislative and market reforms undertaken during CPA occupation were justified and legitimate in light of the conservation principle in international humanitarian law. As discussed above, the key issue under Article 43 of the Hague Regulations and Article 64 of the Fourth Geneva Convention is whether it is "necessary" and justified for an occupying power to depart from existing law or implement new legal reforms in order to support orderly government and the institutions of public life.

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<sup>87</sup> See U.N. Secretary-General, *Report of the Secretary-General Pursuant to Paragraph 24 of Resolution 1483 (2003) and Paragraph 12 of Resolution 1511 (2003)*, ¶ 17, S/2003/1149 (Dec. 5, 2003), available at <http://daccess-dds-ny.un.org/doc/UNDOC/GEN/N03/642/85/PDF/N0364285.pdf?OpenElement>.

<sup>88</sup> *Id.*

<sup>89</sup> See *id.* ¶ 20; see also, Pam Benson, *CIA: Zarqawi tape 'probably authentic,' CNN.COM* (Apr. 7, 2004), available at <http://edition.cnn.com/2004/WORLD/meast/04/07/zarqawi.tape/>.

<sup>90</sup> See *id.* ¶ 22-32. Security Council Resolution 1511 also listed a number of the attacks directly impacting diplomatic personnel, specifically: "the terrorist bombing of the Embassy of Jordan on 7 August 2003, and of the Imam Ali Mosque in Najaf on 29 August 2003, and of the Embassy of Turkey on 14 October 2003, the murder of a Spanish diplomat on 9 October 2003, and the assassination of Dr. Akila al-Hashimi, who died on 25 September 2003." S.C. Res. 1511, *supra* note 70, ¶ 18.

<sup>91</sup> *Id.*; see also *Press Briefing by Manoel de Almeida de Silva, Spokesman for the Special Representative of the Secretary-General on Afghanistan*, U.N. NEWS SERV. (Aug. 21, 2003), available at <http://www.un.org/apps/news/infocusnews.asp?NewsID=597&sID=1>.

The above descriptions from the UN Secretary General's report suggest that the existing judicial system and economic laws and institutions in Iraq were either completely non-functional or utterly insufficient to support basic administration of public institutions and orderly government as necessary for reconstruction. Under the circumstances, based on the text of Resolution 1483 and reports issued thereunder, the UN determined that legislative and economic reforms to support a transition to a market-based economy were reasonably necessary under the circumstances to support Iraq's post-war transition.<sup>92</sup>

In light of these Security Council directives and the economic, judicial, and security conditions on the ground in Iraq, it would not appear that the CPA's economic reforms were merely a unilateral and deliberate effort to impose radical economic "shock therapy" on a country already reeling from violence as suggested by Naomi Klein.<sup>93</sup> Moreover, this analysis supports the view that such reforms arguably were implemented pursuant to directives under a UN Security Council Resolution that provided a specific carve-out from the "conservation principle" normally applied during periods of occupation.

3. *If the Iraqi Interim Government Functioned as a Sovereign Government Once the CPA Was Disbanded, the Period of "Occupation" Under International Law May Have Ended in June 2004*

The CPA was disbanded and formally transferred sovereign authority to the Iraqi Interim Government (IIG) as of June 28, 2004. Security Council Resolution 1546 of June 2003 "endorse[d] the formation of a sovereign Interim Government of Iraq" and stated that "by 30 June 2004, the occupation will end and the Coalition Provisional Authority will cease to exist, and Iraq will reassert its full sovereignty."<sup>94</sup> Once the United Nations and the Arab League formally recognized the IIG as a transitional sovereign government, the period of "occupation" arguably ended for purposes of applying the laws of occupation under the Hague Regulations and Fourth Geneva Convention.<sup>95</sup>

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<sup>92</sup> U.N. Secretary-General, *supra* note 81, ¶ 90.

<sup>93</sup> See NAOMI KLEIN, *THE SHOCK DOCTRINE: THE RISE OF DISASTER CAPITALISM* 20 (2008) ("I am not arguing that all forms of market systems are inherently violent. It is eminently possible to have a market-based economy that demands no such brutality and no such ideological purity. A free market in consumer products can coexist with free public health care, with public schools, with a large segment of the economy – like a national oil company – held in state hands. . . . Markets need not be fundamentalist.").

<sup>94</sup> See S.C. Res. 1546, *supra* note 23, ¶¶ 1–2.

<sup>95</sup> See *id.* ¶ 2. Note that some authors have argued that there nevertheless remained an "effective occupation" by the multinational force (MNF) because there is a reference in a preambular clause of Resolution 1546 "noting the commitment

Author Rüdiger Wolfrum argues that Resolution 1546 may not prove that the IIG was a sovereign and independent government; rather, the period of “occupation” may have continued under the IIG, given that the IIG was constrained in its ability to operate as a fully functioning government, and coalition military forces were still present and occupying the territory of Iraq.<sup>96</sup> Resolution 1546 and an exchange of official letters between the United States and the new IIG annexed thereto, however, endorse the continued presence of multilateral military forces in Iraq based upon the “request of the incoming Interim Government.”<sup>97</sup> Indeed, in Resolution 1546, the Security Council uses mandatory language and explicitly “[d]ecides that the multinational force shall have the authority to take all necessary measures to contribute to the maintenance of security and stability in Iraq in accordance with the letters annexed to this resolution expressing, inter alia, the Iraqi request for the continued presence of the multinational force.”<sup>98</sup>

Paragraph 11 of Resolution 1546 further describes the annexed letters between the US and Iraq that “establish a security partnership between the sovereign Government of Iraq and the multinational force and . . . ensure coordination between the two,” which suggests that the continued presence of military troops was coordinated under a security agreement with the formal consent of the IIG.<sup>99</sup>

Iraq was governed by an interim constitution known as the “Law of Administration for the State of Iraq for the Transitional Period” or the “Transitional Administration Law” (“TAL”) while the IIG drafted a new Iraqi constitution that was to be voted on in a national

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of all forces . . . to act in accordance with international law, including obligations under international humanitarian law.” *Id.* at intro. However, given that this statement is made in an introductory clause, it may be non-binding, and intended merely to provide general background information. See, e.g., Michael C. Wood, *The Interpretation of Security Council Resolutions*, 2 MAX PLANCK Y.B. UNITED NATIONS L. 73, 86–87 (1998), available at [http://www.mpil.de/shared/data/pdf/pdfmpunyb/wood\\_2.pdf](http://www.mpil.de/shared/data/pdf/pdfmpunyb/wood_2.pdf).

<sup>96</sup> Rüdiger Wolfrum, *Iraq – from Belligerent Occupation to Iraqi Exercise of Sovereignty: Foreign Power versus International Community Interference*, in 9 MAX PLANCK Y.B. UNITED NATIONS L. 1, 34–36 (2005).

<sup>97</sup> S.C. Res. 1546, *supra* note 23, ¶ 9 (“[T]he presence of the multinational force in Iraq is at the request of the incoming Interim Government of Iraq and therefore reaffirms the authorization for the multinational force under unified command established under Resolution 1511 (2003), having regard to the letters annexed to this resolution.”).

<sup>98</sup> *Id.* ¶ 10.

<sup>99</sup> *Id.* ¶ 11.

referendum.<sup>100</sup> Under this law, the IIG operated under a much more extensive and substantive government structure than the 25-member “Iraqi Governing Council” that existed under CPA rule. For example, the IIG included a Presidency, Prime Minister, Council of Ministers, Supreme Commission of Provincial Representatives, Interim National Council, and a Judicial Authority.<sup>101</sup>

Pursuant to Section 2 of the TAL Annex, the IIG was also empowered to undertake most of the same activities of an elected transitional government as outlined in the TAL, except those listed under Chapter 9 which related primarily to the drafting of a permanent constitution by an elected transitional government.<sup>102</sup> In turn, this Annex provision meant that the IIG was expressly permitted under Article 26 of the TAL to revise any CPA or other prior pieces of legislation, including legislation implemented during CPA rule.<sup>103</sup> Similarly, section 2 of the TAL Annex also reflects that the IIG was given authority under Article 25(E) of the TAL to manage the country’s natural resources, such as oil and petroleum products, thus reflecting another important piece of substantive authority that was withdrawn from the CPA and handed over to the new IIG.<sup>104</sup>

Additionally, the IIG was authorized to exercise “full sovereign powers,” specifically with respect to “the power to conclude international agreements in the areas of diplomatic relations and economic reconstruction, including Iraq’s sovereign debt.”<sup>105</sup> By comparison, the IIG was not authorized “to form agreements which permanently alter the destiny of Iraq,” as such powers were reserved for a government to be selected through nationwide elections.<sup>106</sup> This language suggests the IIG was specifically authorized to continue the process of implementing economic reforms, which it proceeded to do, by filing a formal

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<sup>100</sup> Law of Administration for the State of Iraq for the Transitional Period [Interim Iraqi Government] of 2004, available at <http://law.case.edu/saddamtrial/documsnets/TAL.pdf> [hereinafter “Law of Administration”]; Annex to the Law for the Administration of Iraq in the Transitional Period [Interim Iraqi Government] of 2004, available at <http://www.iraqwatch.org/government/Iraq/IGC/Iraq-igc-annextoTAL-060104.htm> [hereinafter “Annex”].

<sup>101</sup> Press Release, Iraqi Interim Government, Iraqi Interim Government Announcement Ceremony (2004), available at [http://dosfan.lib.uic.edu/ERC/cpa/english/government/press\\_packet.pdf](http://dosfan.lib.uic.edu/ERC/cpa/english/government/press_packet.pdf).

<sup>102</sup> Annex, *supra* note 100, § 2 (“Except for the purposes of Chapter Nine of this Law or as otherwise specified herein, references to the Iraqi Transitional Government and its institutions and officials in this Law will apply to the Interim Government and its institutions and officials.”).

<sup>103</sup> See Law of Administration, *supra* note 100, at art. 26(c).

<sup>104</sup> *Id.* at art. 25(E).

<sup>105</sup> Press Release, *supra* note 101.

<sup>106</sup> *Id.*

application for accession to the World Trade Organization in September 2004 and participating in the official Working Group on the Accession of Iraq established by the WTO.<sup>107</sup>

In sum, based on the relatively broad IIG powers outlined in the TAL and the formal recognition of the IIG as a sovereign government by the UN Security Council and the Arab League, as well as the explicit consent granted under Security Council Resolution 1546 for military forces to remain in Iraq as part of a Security Partnership, it appears that the IIG could reasonably be acting as a sovereign government.<sup>108</sup> This means that the period of “occupation” for purposes of international humanitarian law arguably had ended as of June 28, 2004, when the CPA disbanded and the IIG took control.<sup>109</sup> Provided that the period of occupation had ended, the additional economic reform efforts undertaken by the IIG would be legitimate acts of a sovereign government, and not in violation of the “principle of conservation” under Article 43 of the Hague Regulations of 1907 and Article 64 of the Fourth Geneva Convention of 1949.<sup>110</sup>

#### *4. Subsequent Governments of Iraq Reaffirmed Many of the Economic and Trade-Related Reforms and CPA Orders Since the Occupation Ended*

In the seven years since the CPA disbanded, Iraq’s sovereign government has been in a state of flux. Following IIG rule, in May 2005 the Iraqi Transitional Government (“ITG”) replaced the IIG and drafted a permanent constitution that was ratified through a national referendum in October 2005.<sup>111</sup> National parliamentary elections were then held pursuant to the permanent constitution, and the first duly elected Government of Iraq was formed in 2006.

As the Iraqi government has progressed through these various stages outlined in **Appendix A**, its new representatives and sovereign institutions have revisited many of the basic economic reform goals referenced in the CPA orders and in the UN documents quoted above. Generally speaking, Iraq’s new laws and permanent constitution continued to embrace the broad goals of creating a modern, market-based

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<sup>107</sup> See *Accessions: Iraq*, WORLD TRADE ORG., [http://www.wto.org/english/thewto\\_e/acc\\_e/a1\\_iraq\\_e.htm](http://www.wto.org/english/thewto_e/acc_e/a1_iraq_e.htm) (last visited Sept. 13, 2012); *Accession Working Parties Established for Afghanistan, Iraq*, WORLD TRADE ORG., [http://www.wto.org/english/news\\_e/news04\\_e/gc\\_afghanistan\\_iraq\\_13dec04\\_e.htm](http://www.wto.org/english/news_e/news04_e/gc_afghanistan_iraq_13dec04_e.htm) (last visited Oct. 8, 2012).

<sup>108</sup> S.C. Res. 1546, *supra* 23, ¶ 1; see also *Law of Administration*, *supra* note 100, at intro.

<sup>109</sup> See KATZMAN, *supra* note 15, at 1–2.

<sup>110</sup> See Hague Convention, *supra* note 49; Fourth Geneva Convention, *supra* note 49, at art. 64.

<sup>111</sup> See KATZMAN, *supra* note 15.

economy, developing a strong private sector, and promoting investment. Indeed, broad economic reform goals are specifically affirmed in Iraq's new constitution, which was ratified by nationwide vote in 2005, and states in Articles 25 and 26:

Article 25: The State shall guarantee the reform of the Iraqi economy in accordance with modern economic principles to insure the full investment of its resources, diversification of its sources, and the encouragement and development of the private sector.<sup>112</sup>

Article 26: The State shall guarantee the encouragement of investment in the various sectors, and this shall be regulated by law.<sup>113</sup>

Notably the TAL had provided both the IIG and the ITG with the explicit authority to rescind or amend any previous laws enacted by the CPA or prior regime.<sup>114</sup> Neither the IIG nor the ITG rescinded or revoked the economic reform laws and free market laws implemented by the CPA, and the IIG and ITG actively participated in the process of officially itemizing these laws with the World Trade Organization Working Group on Accession as part of Iraq's WTO Accession process that was ongoing in 2004 and 2005.<sup>115</sup> For example, the IIG participated in WTO working group meetings in 2004 and the ITG submitted a Memorandum on the Foreign Trade Regime in September 2005, which would have outlined all of the economic legislation that it deemed legally binding in Iraq at that time.<sup>116</sup> These facts suggest that the IIG and the ITG effectively reaffirmed the economic reforms that had been implemented to date.

While keeping these general legal and economic reform goals in place, the permanent Government of Iraq (GOI) that was elected following referendum on Iraq's permanent constitution has also taken ownership of the reform process through passage of new legislation that revises or replaces some of the key economic orders originally issued by the CPA. For example, CPA Order 39, which governs foreign

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<sup>112</sup> Art. 20–38, *Doustour Joumhouriat al-Iraq* [The Constitution of the Republic of Iraq] of 2005. Importantly, the new Constitution also provides significant human rights protections, including civil and political rights such as the right to vote (Art. 20) freedom of expression/press/peaceful assembly (Art. 38); the right of work and to join trade unions (Art. 22); “social and health security” (Art. 30); education for all Iraqi children (Art. 34); and protection of the natural environment (Art. 33), among others.

<sup>113</sup> *Id.* at art. 25.

<sup>114</sup> See Law of Administration, *supra* note 100, at art. 26.

<sup>115</sup> See *Technical Note by the Accession Process (Revision 6): Secretariat: State of Play and Information on Current Accessions*, WT/ACC/11/Rev.6 (Nov. 23, 2005).

<sup>116</sup> *Id.*

investment in Iraq, was replaced by the 2006 Iraqi National Investment Law, which was further amended on January 4, 2010.<sup>117</sup> The new investment law provides a more limited form of national treatment, exempting investment in oil and gas extraction, as well as investment in the production, banking, and insurance sectors.<sup>118</sup>

Since 2005, the GOI has made additional formal filings to the WTO as part of the accession process in which the GOI must itemize all of the economic and international trade related laws and regulations currently in force in Iraq.<sup>119</sup> By issuing new laws and regulations that reaffirm many of the basic reforms made in the CPA Orders, and then formally notifying and providing copies to the WTO of all economic laws and regulations, the government accepts the new sovereign government and has confirmed its acceptance of such legal and economic reforms as having the force of law in Iraq in the 2006 Investment Law.

Finally, the GOI has also outwardly reconfirmed to the international community its strong commitment to economic reform and international trade by undertaking a major initiative in collaboration with the United Nations to create the formal International Compact with Iraq (ICI). The Compact was first announced on July 27, 2006, and was formally introduced at the United Nations on March 16, 2007, before its official launch on May 3, 2007.<sup>120</sup> Through the ICI, the GOI expressly affirmed its intentions to implement substantial legal and economic reforms and even provided a legislative timetable for doing so.<sup>121</sup>

Based on the transitional processes and actions of the new Iraqi governments described above, it is my opinion that the GOI has reaffirmed that legal and economic reforms in Iraq are legitimate under principles of international law. Furthermore, a representative

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<sup>117</sup> See INT'L TRADE ADMIN., U.S. DEP'T OF COMMERCE, IRAQ INV. & RECONSTRUCTION TASK FORCE, LEGAL GUIDE TO INVESTING IN IRAQ 2-3 (Feb. 2011), available at <http://trade.gov/static/LegalGuide2008.pdf>.

<sup>118</sup> See *id.* at 4-5.

<sup>119</sup> See Appendix for a complete listing of all formal submissions made by the Government of Iraq to the World Trade Organization to date, along with the dates of each submission. Note that many of these materials remain in "restricted" status, and thus will not be made public by the WTO until the end of Iraq's accession process.

<sup>120</sup> See Press Release, United Nations, United Nations and Iraq Jointly Announce Launch of Five-Year International Compact Aimed at Achieving National Vision of United, Federal, Democratic Country, U.N. Press Release IK/552 (July 27, 2007), available at <http://www.un.org/News/Press/docs/2006/ik552.doc.htm>.

<sup>121</sup> See United Nations, *International Compact with Iraq*, art. 4.3, Annex III, available at [http://www.uniraq.org/ici/INTERNATIONAL\\_COMPACT\\_WITH\\_IRAQ\\_FINAL\\_English\\_final.pdf](http://www.uniraq.org/ici/INTERNATIONAL_COMPACT_WITH_IRAQ_FINAL_English_final.pdf)

Iraqi government has largely accepted and endorsed many of the same economic reform policies originally enacted by the CPA, while adjusting these policies where needed for specific issues such as management of natural resources and distribution of wealth from the nation's oil resources. As discussed in Section III below, this paper now, therefore, seeks to place economic reforms implemented during post war occupation into the larger context of shifting international norms related to UN peacekeeping, nation building, and establishing the rule of law in post-conflict countries.

### III. NEW NORMS FOR JUS POST BELLUM ARE EMERGING AS INTERNATIONAL ORGANIZATIONS ENGAGE IN PEACE-BUILDING OPERATIONS SEEKING TO ESTABLISH THE "RULE OF LAW" IN POST-CONFLICT COUNTRIES

The reconstruction experience of Iraq raises larger questions about the appropriate roles to be played by the UN and international multilateral organizations, such as the IMF, World Bank, and WTO, in promoting economic development, peace, and security in post-conflict countries.

Over the past three decades, the international community has begun to view economic reforms and development goals as a key component of promoting the "rule of law" in post-conflict countries.<sup>122</sup> One reason for this shift has been the growing body of empirical evidence that has emerged confirming direct links between economic stability and international peace and security. For instance, a study of forty-one African countries between 1981 and 1999 showed a strong correlation between economic growth and the incidence of civil conflict, concluding that a negative economic growth shock of five percentage points increased the likelihood of major civil conflict by more than fifty percent.<sup>123</sup> After conducting an extensive review of empirical literature on the relationship between economy and unrest, Yale Professor Nicholas Sambanis concluded: "The economic studies of civil war have successfully identified an empirically robust relationship between pov-

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<sup>122</sup> See Simon Chesterman, *The UN Security Council and the Rule of Law: The Role of the Security Council in Strengthening a Rules-based International System Final Report and Recommendations from the Austrian Initiative 2004-2008* at i-ii (Feb. 2008) (on file with Institute for International Law & Justice, New York University School of Law & Federal Ministry for European and International Affairs), available at [http://www.iilj.org/research/documents/UNSC\\_and\\_the\\_Rule\\_of\\_Law.pdf](http://www.iilj.org/research/documents/UNSC_and_the_Rule_of_Law.pdf); see also Secretary-General, *On the Rule of Law and Transitional Justice in Conflict and Post-Conflict Societies: Rep. of Secretary General*, U.N. Doc. S/2004/616 (Aug. 3, 2004); G.A. Res. 61/39, U.N. Doc A/RES/61/39 (Dec. 18, 2008).

<sup>123</sup> See Edward Miguel, Shanker Satyanath, & Ernest Sergenti, *Economic Shocks and Civil Conflict: An Instrumental Variables Approach*, 112 J. POLITICAL ECON., no. 4, 725-26, 740 (2004).

erty, slow growth, and an increased likelihood of civil war onset and prevalence.”<sup>124</sup>

Similarly, according to reports of the UN Conference on Trade and Development (UNCTAD), most of the developed countries in which civil conflict broke out in the 1990s had experienced either negative or sluggish economic growth rates in the 1980s, and the conflicts of the 1990s were a direct reaction to these economic difficulties of the 1980s.<sup>125</sup> Studies by the Conflict Prevention and Reconstruction Unit of the World Bank also present sobering statistics:

Conflicts are increasingly concentrated in low-income countries: 80 percent of the world’s poorest countries have suffered a major civil war in the past fifteen years. These countries have failed to sustain the policies, governance, and institutions that might give them a chance of achieving reasonable growth and diversifying out of dependence on primary commodities. Countries that have suffered conflict in the recent past are also likely to see conflict return: The risk that a country will fall back into conflict within the first five years of the end of a conflict is nearly 50 percent.<sup>126</sup>

These World Bank studies further identify specific economic factors that dramatically increase the likelihood of conflict, including a country’s heavy economic dependence on a major export commodity, such as oil, and high levels of unemployment among youth, both of which apply in Iraq.<sup>127</sup>

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<sup>124</sup> Nicholas Sambanis, *A Review of Recent Advances and Future Directions in the Quantitative Literature on Civil War*, in 13 DEFENCE AND PEACE ECONOMICS, no. 3, 215–43 (2002). For detailed qualitative and empirical analyses of the connection between economics and peace/stability, see generally TODD SANDLER & KEITH HARTLEY, *THE ECONOMICS OF CONFLICT* (Edward Elgar 2004); NICHOLAS SAMBANIS & MICHAEL DOYLE, *MAKING WAR AND BUILDING PEACE: THE UNITED NATIONS SINCE THE 1990s* (Princeton Univ. Press 2006); 2 NICHOLAS SAMBANIS & PAUL COLLIER, *UNDERSTANDING CIVIL WAR: EVIDENCE AND ANALYSIS: EUROPE, CENTRAL ASIA, AND OTHER REGIONS* (World Bank Publ’ns 2005); PAUL COLLIER ET AL., *BREAKING THE CONFLICT TRAP: CIVIL WAR AND DEVELOPMENT POLICY* (Oxford Univ. Press & World Bank Publ’ns 2003).

<sup>125</sup> See Rep. of U.N.C.T.A.D., p. 3, UNCTAD/DGS/AFRICA/1, U.N. Doc. TD/B/48/12 (2001), available at <http://unctad.org/en/Docs/pogdsafricad1.en.pdf>; see also Rep. of U.N.C.T.A.D., U.N. Doc. UNCTAD/LDC/2004 (2004), available at [http://unctad.org/en/docs/ldc2004\\_en.pdf](http://unctad.org/en/docs/ldc2004_en.pdf).

<sup>126</sup> See Kazuhide Kuroda, World Bank Seminar Series: Conflict and Development 2 (2006) (unpublished), available at <http://siteresources.worldbank.org/EXTA/BOUTUS/Resources/Conflictpaper.pdf>; see also COLLIER, *supra* note 124, at forward.

<sup>127</sup> See Kuroda, *supra* note 126, at 2.

In the decade since the September 11, 2001 attacks on the World Trade Centers and the subsequent launch of the “war on terror,” a broad consensus has emerged within the UN system regarding the direct link between economic instability and the risks of social unrest, armed conflict, and terrorist activity.<sup>128</sup> This consensus has resulted in fundamental changes in UN policy approaches to international peacekeeping programs, with a growing emphasis on economic stabilization and development as a key to the preventing further conflict through “peacebuilding.” As a result, there has been a basic shift within the U.N. General Assembly and the U.N. Security Council towards policies aimed at establishing the “rule of law” in post-conflict societies, including a strong emphasis on economic law and policy reforms and integration into the international trading system.<sup>129</sup>

This growing focus on promoting the “rule of law” began in the 1990s and picked up steam in 2006, such that this is now a primary policy focus of UN peacebuilding operations in post-conflict zones:

Promoting the rule of law at the national and international levels is at the heart of the United Nations’ mission. Establishing respect for the rule of law is fundamental to achieving a durable peace in the aftermath of conflict, to the effective protection of human rights, and to sustained economic progress and development.<sup>130</sup>

Within the UN system, the term “rule of law” is now defined as:

A principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards. It requires, as well, measures to ensure adherence to the principles of supremacy of law, equality before the law, accountability to the law, fairness in the application of the law, separation of powers, participation in decision-making, legal certainty,

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<sup>128</sup> See Rep. of the Panel on United Nations Peace Operations, transmitted by letter dated Aug. 21, 2000 from the Secretary-General, ¶¶ 24, 29, U.N. Doc. S/2000/809 (Aug. 21, 2000).

<sup>129</sup> See U.N. Secretary-General, *Uniting Our Strengths: Enhancing United Nations Support for the Rule of Law: Rep. of the Secretary General*, ¶ 5, U.N. Doc. S/2006/980 (Dec. 14, 2006).

<sup>130</sup> See *United Nations and the Rule of Law Website & Document Repository*, UNITED NATIONS, <http://www.un.org/en/ruleoflaw/index.shtml> (last visited Nov. 19, 2012).

avoidance of arbitrariness and procedural and legal transparency.<sup>131</sup>

As part of this increased focus on rule of law issues, UN Security Council resolutions have increasingly endorsed legal and judicial reform initiatives in post-conflict countries, including efforts in which UN-affiliated and other international organizations have provided direct technical and legislative drafting assistance to countries in restructuring their economic, financial, and trade systems.<sup>132</sup>

The UN General Assembly has also articulated the emerging international consensus relating to the economic dimensions in rule of law initiatives. The UN convened the 2005 World Summit as “a once-in-a-generation opportunity to take bold decisions in the areas of development, security, human rights and reform of the United Nations,” in order to initiate reforms of UN policies and programs to reflect these changing priorities.<sup>133</sup> The summit resulted in an important General Assembly resolution that downplays a reactive, sanctions-driven “peace-keeping” approach in favor of a more preventative “peace-building” approach, in part by applying rule of law principles to creating legal and regulatory systems that support and facilitate trade and economic development.<sup>134</sup> The resolution specifically emphasizes the role of economic reform, international trade, the private sector, and private property rights in supporting sustained economic growth in Iraq, stating, for example, the following declarations and goals:<sup>135</sup>

We acknowledge that good governance and the rule of law at the national and international levels are essential for sustained economic growth, sustainable development and the eradication of poverty and hunger.

We further reaffirm our commitment to sound policies, good governance at all levels and the rule of law, and to mobilize domestic resources, attract international flows, promote international trade as an engine for develop-

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<sup>131</sup> U.N. Secretary-General, *The Rule of Law and Transitional Justice in Conflict and Post-conflict Societies: Rep. of the Secretary-General*, ¶ 6, U.N. Doc. S/2004/616 (Aug. 23, 2004).

<sup>132</sup> See Kristen E. Boon, “Open for Business”: *International Financial Institutions, Post-Conflict Economic Reform, and the Rule of Law*, 39 N.Y.U. J. INT’L L. & POL. 513, 514 (2007) (discussing actions of the United Nations, the World Bank, and the IMF).

<sup>133</sup> *United Nations Millennium Development Goals*, UNITED NATIONS, <http://www.un.org/millenniumgoals/bkgd.shtml> (last visited Sept. 14, 2011).

<sup>134</sup> See G.A. Res. 60/1, ¶¶ 6–7, U.N. Doc. A/RES/60/1 (Oct. 24, 2005), available at: <http://daccess-dds-ny.un.org/doc/UNDOC/GEN/N05/487/60/PDF/N0548760.pdf?OpenElement>.

<sup>135</sup> *Id.* ¶¶ 11, 20–32.

ment and increase international financial and technical cooperation for development, sustainable debt financing and external debt relief and to enhance the coherence and consistency of the international monetary, financial and trading systems.

To support efforts by developing countries to adopt and implement national development policies and strategies through increased development assistance, [and] the promotion of international trade as an engine for development. . .

[To] acknowledge the vital role the private sector can play in generating new investments, employment and financing for development;

To pursue good governance and sound macroeconomic policies at all levels and support developing countries in their efforts to put in place the policies and investments to drive sustained economic growth, promote small and medium sized enterprises, promote employment generation and stimulate the private sector;

To reaffirm that good governance is essential for sustainable development; that sound economic policies, solid democratic institutions responsive to the needs of the people and improved infrastructure are the basis for sustained economic growth, poverty eradication and employment creation; and that freedom, peace and security, domestic stability, respect for human rights, including the right to development, the rule of law, gender equality and market-oriented policies and an overall commitment to just and democratic societies are also essential and mutually reinforcing;

To encourage greater direct investment, including foreign investment, in developing countries and countries with economies in transition to support their development activities and to enhance the benefits they can derive from such investments. We underscore the need to sustain sufficient and stable private financial flows to developing countries and countries with economies in transition.<sup>136</sup>

The World Summit Resolution also articulates the General Assembly's consensus regarding the important role of international trade

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<sup>136</sup> *Id.*

in facilitating economic development, and the need for direct technical assistance from international organizations to ensure that developing countries are able to fully benefit from participating in the multilateral trading system, as follows:<sup>137</sup>

A universal, rule-based, open, non-discriminatory and equitable multilateral trading system, as well as meaningful trade liberalization, can substantially stimulate development worldwide, benefiting countries at all stages of development. In that regard, we reaffirm our commitment to trade liberalization and to ensure that trade plays its full part in promoting economic growth, employment and development for all.

We are committed to efforts designed to ensure that developing countries, especially the least-developed countries, participate fully in the world trading system in order to meet their economic development needs, and reaffirm our commitment to enhanced and predictable market access for the exports of developing countries.

We will work to accelerate and facilitate the accession of developing countries and countries with economies in transition to the World Trade Organization consistent with its criteria, recognizing the importance of universal integration in the rules-based global trading system.<sup>138</sup>

This World Summit resolution, taken together with UN practices on the ground in post-conflict countries (e.g., Iraq, Cambodia, Kosovo), reflects a UN commitment to providing technical assistance, capacity building programs, and other types of direct support for implementing the legal and economic reforms needed to achieve economic goals such as participation in the world trading system.<sup>139</sup>

#### IV. CONCLUSION

As discussed above, the increasing United Nations emphasis on establishing the “Rule of Law” in post-conflict countries reflects a focus that is shifting away from “peacekeeping” in favor of peace- and nation-building. As outlined in Sections I and II of this paper with respect to Iraq, this new emphasis on establishing the rule of law during periods of occupation may in some instances conflict with the tradi-

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<sup>137</sup> *Id.*

<sup>138</sup> *Id.* ¶¶ 27, 28, 31.

<sup>139</sup> Indeed, through this resolution, the UN General Assembly even established an entirely new UN Organization, the “Peacebuilding Commission,” to provide integration of the many different goals and organizations involved in reconstruction of post-conflict countries and rebuilding their economies. *Id.* ¶¶ 97–105.

tional principles of Conservation under Article 43 of the Hague Regulations of 1907 and Article 64 of the Fourth Geneva Convention of 1949. Traditionally, “conservation” requires that an occupying power shall keep in force the prior laws of the sovereign and respect existing institutions of justice and governance, unless “absolutely prevented” from doing so or unless derogation is essential to “ensure security” or “maintain orderly government” and “civil life.”<sup>140</sup>

In contrast to “conservation,” the “rule of law” actually implies that new peacekeeping efforts, legislative changes, economic reforms, security initiatives, and judicial frameworks may be necessary for stabilizing post-conflict countries and creating the conditions needed for a lasting peace. The emerging norms for UN peacekeeping and the Security Council resolutions that seek to establish the rule of law in post-conflict countries thus require a new legal framework to determine the parameters of a “*jus post bellum*.” As aptly explained by author Kristin Boon:

Transformative approaches to peacebuilding have revealed profound inadequacies in the current legal framework, and principles of international law have not developed sufficiently to fill the gaps. Neither the Charters of the UN, IMF, or World Bank, nor the law of occupation (codified in the Geneva Conventions and the Hague Regulations) are sufficient in and of themselves to provide general principles on transitional interventions to build the peace. These inadequacies have created complexities on the ground because the duties and obligations of the various international actors are uneven and often unclear.<sup>141</sup>

This lack of clarity is evident from the differing views outlined in Sections I and II above regarding whether economic reforms implemented in post war Iraq were consistent with international law.

The central goal of *jus post bellum* is to create a lasting and durable peace, whether through conflict prevention, peacekeeping,

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<sup>140</sup> For example, article 64 of the Fourth Geneva Convention provides that occupying powers can only change prior civil laws that “are essential to enable the Occupying Power to fulfill its obligations under the present Convention, to maintain the orderly government of the territory, and to ensure the security of the Occupying Power.” Fourth Geneva Convention, *supra* note 49. Article 43 of the Hague Convention further complements this provision of article 64 of Geneva IV. See Hague Convention, *supra* note 49. See also, Sassòli, *supra* note 50 (discussing the scope and applicability of art. 43 of the Hague Regulations in peacekeeping operations).

<sup>141</sup> Kristen E. Boon, *Obligations of the New Occupier: The Contours of a Jus Post Bellum*, 31-2 LOY. L.A. INT’L & COMP. L. REV. 101, 103 (2008).

peacebuilding, or via post-conflict economic reconstruction and development.<sup>142</sup> To build a credible foundation for establishing the rule of law, the United Nations system needs to further codify what range of legislative, economic, and judicial reforms are typically appropriate during a period of occupation in order to establish the rule of law. As in the case of Iraq, one approach is for the Security Council to pass resolutions on a case-by-case basis outlining what types of reforms the council is willing to support in any given country.<sup>143</sup> Of course, the danger in such a case-by-case approach is that it is subject to seemingly arbitrary or inconsistent resolutions being implemented from one country to the next, and it may become a politicized process rather than one based on a common core of widely accepted UN principles that are embodied in UN treaties and instruments and/or customary international law.

The rule of law fundamentally requires that no organization – including the UN itself, its authorized multilateral peacekeeping forces, or other international organizations (e.g., IMF, World Bank, WTO) that are collaborating with the UN to provide assistance in post-conflict countries – should be permitted to act in a manner that is perceived as “above the law.” For example, the “rule of law” has been defined as “a principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards.”<sup>144</sup>

Setting clear guidelines for post-conflict occupation will help to reinforce credibility and legitimacy in establishing a rule of law and achieving the key *jus post bellum* goal of building a lasting peace. To accomplish this, the UN system would benefit from more clearly defining a common set of standards, norms, rights, and boundaries regarding what actions by an occupying force should be deemed consistent with emerging norms for *jus post bellum* during transitional periods of post war occupation. In codifying such standards, the international community should review the strong empirical evidence of links between economic stability and international peace and security, and determine more specifically the extent to which economic reforms and market opening measures are appropriate during such transition periods.

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<sup>142</sup> *Id.* at 127.

<sup>143</sup> See also S.C. Res. 1483, ¶¶ 4, 8(e), U.N. Doc. S/RES/1483 (May 22, 2003); S.C. Res. 1511, ¶8, U.N. Doc. S/RES/1511 (Oct. 16, 2003).

<sup>144</sup> U.N. Secretary-General, *The Rule of Law and Transitional Justice in Conflict and Post-Conflict Societies: Rep. of the Secretary-General*, ¶6, U.N. Doc. S/2004/616 (Aug. 23, 2004).

APPENDIX A – TIMELINE OF KEY EVENTS IN IRAQI GOVERNANCE  
(2003 – 2010)

| DATE              | EVENT  |
|-------------------|--|
| March 2003        | <ul style="list-style-type: none"> <li>• US and British Coalition Forces Invade from Kuwait<sup>145</sup></li> </ul>   |
| April/May 2003    | <ul style="list-style-type: none"> <li>• Coalition forces take Baghdad<sup>146</sup></li> <li>• Saddam disappears<sup>147</sup></li> <li>• UN Security Council Resolution 1483 (May 22nd) on Reconstruction<sup>148</sup></li> </ul> |
| July 13, 2003     | <ul style="list-style-type: none"> <li>• The Iraqi Governing Council is established<sup>149</sup></li> <li>• 25 Iraqis selected under supervision of the Coalition Provisional Authority<sup>150</sup></li> </ul>                    |
| August 19, 2003   | <ul style="list-style-type: none"> <li>• Suicide truck bomb at U.N. headquarters in Baghdad<sup>151</sup></li> <li>• Kills 22 persons, including U.N. envoy Sergio Vieira de Mello<sup>152</sup></li> </ul>                          |
| December 13, 2003 | <ul style="list-style-type: none"> <li>• US troops capture Saddam near Tikrit<sup>153</sup></li> </ul>   |
| February 4, 2004  | <ul style="list-style-type: none"> <li>• Iraq files request for “Observer Status” at the WTO<sup>154</sup></li> </ul>  |
| March 8, 2004     | <ul style="list-style-type: none"> <li>• Governing Council signs interim constitution<sup>155</sup></li> </ul>   |

<sup>145</sup> *Frontline: Operation Iraqi Freedom*, PBS, <http://www.pbs.org/wgbh/pages/frontline/shows/invasion/cron/> (last visited Oct. 10, 2012).

<sup>146</sup> Simon Jeffery & Rebecca Allison, *US Forces Occupy Palaces*, *GUARDIAN* (London), Apr. 7, 2003, <http://www.guardian.co.uk/world/2003/apr/07/iraq.politics>.

<sup>147</sup> *The Rise and Fall of a Dictator*, CNN, Dec. 14, 2003, [http://articles.cnn.com/2003-12-14/world/sprj.irq.saddam.profile\\_1\\_saddam-hussein-iraqi-leader-coalition-troops?\\_s=PM:WORLD](http://articles.cnn.com/2003-12-14/world/sprj.irq.saddam.profile_1_saddam-hussein-iraqi-leader-coalition-troops?_s=PM:WORLD).

<sup>148</sup> S.C. Res. 1483, *supra* note 70.

<sup>149</sup> *Iraqi Governing Council Members*, BBC NEWS, July 14, 2003, [http://news.bbc.co.uk/2/hi/middle\\_east/3062897.stm](http://news.bbc.co.uk/2/hi/middle_east/3062897.stm).

<sup>150</sup> *Id.*

<sup>151</sup> *Iraq Profile: Timeline*, BBC NEWS, <http://www.bbc.co.uk/news/world-middle-east-14546763> (last updated Oct. 10, 2012); *Timeline of Events in Iraq*, BOSTON.COM (Mar. 26, 2010), [http://www.boston.com/news/world/middleeast/articles/2010/03/26/timeline\\_of\\_events\\_in\\_iraq](http://www.boston.com/news/world/middleeast/articles/2010/03/26/timeline_of_events_in_iraq).

<sup>152</sup> *Id.*

<sup>153</sup> *Id.*

<sup>154</sup> Request for Observer Status by Iraq, WT/L/560 (Jan. 23, 2004).

<sup>155</sup> *Timeline*, *supra* note 151.

|                   |  |
|-------------------|--|
| June 1, 2004      | <ul style="list-style-type: none"> <li>• Governing Council dissolved to make way for Iraqi Interim Government<sup>156</sup></li> <li>• Iyad Allawi Ghazi al-Yawar named president<sup>157</sup></li> </ul> |
| June 8, 2004      | <ul style="list-style-type: none"> <li>• UN Security Council Res 1546 on transfer of authority to Iraqi Interim Government<sup>158</sup></li> </ul>  |
| June 28, 2004     | <ul style="list-style-type: none"> <li>• US formally returns sovereignty to Iraqi Interim Government<sup>159</sup></li> <li>• CPA dissolved and Paul Bremer leaves Iraq<sup>160</sup></li> </ul>           |
| July 2004         | <ul style="list-style-type: none"> <li>• Trial of Saddam Hussein Begins<sup>161</sup></li> </ul>   |
| Sept. – Dec. 2004 | <ul style="list-style-type: none"> <li>• Iraq Files WTO Accession Application<sup>162</sup></li> <li>• WTO Working Group on Iraq Accession Established<sup>163</sup></li> </ul>                            |
| January 30, 2005  | <ul style="list-style-type: none"> <li>• Elections for Transitional Government<sup>164</sup></li> </ul>  |
| March–April, 2005 | <ul style="list-style-type: none"> <li>• Iraqi National Assembly holds first meeting<sup>165</sup></li> <li>• Kurdish Jalal Talabani Selected as President of Iraq<sup>166</sup></li> </ul>                |
| May 3, 2005       | <ul style="list-style-type: none"> <li>• Iraqi Transitional Government Replaces the Iraqi Interim Government<sup>167</sup></li> </ul>  |
| May 2005          | <ul style="list-style-type: none"> <li>• Parliamentary Commission drafts new Constitution<sup>168</sup></li> </ul>   |
| October 15, 2005  | <ul style="list-style-type: none"> <li>• Constitution Ratified by National Referendum<sup>169</sup></li> </ul>   |

<sup>156</sup> *Iraq Council Disbands; CPA Still in Power*, CHINA DAILY, June 6, 2004, [http://www.chinadaily.com.cn/english/doc/2004-06/02/content\\_335630.htm](http://www.chinadaily.com.cn/english/doc/2004-06/02/content_335630.htm).

<sup>157</sup> *Id.*; *Interim Iraqi Government*, BBC NEWS, June 1, 2004, [http://news.bbc.co.uk/2/hi/middle\\_east/3766401.stm](http://news.bbc.co.uk/2/hi/middle_east/3766401.stm).

<sup>158</sup> S.C. Res. 1546, *supra* note 23.

<sup>159</sup> *Timeline*, *supra* note 151.

<sup>160</sup> Associated Press, *U.S. Transfers Sovereignty to Iraq 2 Days Early*, MSNBC (June 28, 2004), [http://www.msnbc.msn.com/id/5312795/ns/world\\_news-mideast\\_n\\_africa/t/us-transfers-sovereignty-iraq-days-early/#.UHWFR\\_kWm6N](http://www.msnbc.msn.com/id/5312795/ns/world_news-mideast_n_africa/t/us-transfers-sovereignty-iraq-days-early/#.UHWFR_kWm6N).

<sup>161</sup> Hamza Hendawi, *A Defiant Saddam Hussein Appears at Hearing in Court*, SEATTLE TIMES (July 1, 2004), <http://community.seattletimes.nwsourc.com/archive/?date=20040701&slug=websaddam01>

<sup>162</sup> *Accessions: Iraq*, WTO, [http://www.wto.org/english/thewto\\_e/acc\\_e/a1\\_iraq\\_e.htm](http://www.wto.org/english/thewto_e/acc_e/a1_iraq_e.htm) (last visited Oct. 10, 2012).

<sup>163</sup> *Id.*

<sup>164</sup> KATZMAN, *supra* note 15, at 1.

<sup>165</sup> *Timeline: Iraq Votes on New Government*, REUTERS (Dec. 21, 2010), <http://www.reuters.com/article/2010/12/21/us-iraq-politics-events-idUSTRE6BK3D020101221> (Dec. 21, 2010).

<sup>166</sup> *Iraq Profile*, BBC News Middle East, <http://www.bbc.co.uk/news/world-middle-east-14546763> (last updated Oct. 2, 2012).

<sup>167</sup> *See* KATZMAN, *supra* note 15, at 1–2.

<sup>168</sup> *Id.* at 2.

<sup>169</sup> *Id.*

|                   |   |
|-------------------|---|
| December 15, 2005 | <ul style="list-style-type: none"> <li>• National Parliamentary Elections Held . . More Sunnis vote than in January 2005 Parliamentary Elections<sup>170</sup></li> </ul>   |
| February 10, 2006 | <ul style="list-style-type: none"> <li>• Final Election results Shi'ite-led UIA gets near majority with 128 seats; Sunni Arabs have 58; Kurds 53.<sup>171</sup></li> </ul>  |
| May 20, 2006      | <ul style="list-style-type: none"> <li>• The new Iraqi Government replaces Iraqi Transitional Government<sup>172</sup></li> <li>• After much difficulty forming government, Nouri al-Maliki eventually selected as Prime Minister<sup>173</sup></li> </ul>          |
| December 2006     | <ul style="list-style-type: none"> <li>• Saddam Hussein found guilty of Crimes Against Humanity and Executed<sup>174</sup></li> </ul>   |
| January 2007      | <ul style="list-style-type: none"> <li>• US announces "Troop Surge" to counter escalating violence<sup>175</sup></li> </ul>   |
| May 2007          | <ul style="list-style-type: none"> <li>• WTO Iraq Accession Working Party Meetings held in Geneva<sup>176</sup></li> </ul>  |
| May 2007          | <ul style="list-style-type: none"> <li>• Iraq Oil law proposed by Parliament<sup>177</sup></li> </ul>   |
| January 2008      | <ul style="list-style-type: none"> <li>• Parliament votes to allow return of junior members of Saddam's Baath Party to government posts (key to reconciliation)<sup>178</sup></li> </ul>  |
| November 17, 2008 | <ul style="list-style-type: none"> <li>• The U.S. &amp; Iraq Sign "Status of Forces Agreement" Stipulating that U.S. troops will be out of Iraq by the end of 2011<sup>179</sup></li> </ul>   |
| November 2008     | <ul style="list-style-type: none"> <li>• Treaty ratified by the Iraqi Parliament<sup>180</sup></li> </ul>   |
| March 7, 2010     | <ul style="list-style-type: none"> <li>• National Iraqi Parliamentary Elections<sup>181</sup></li> <li>• Iyad Allawi's Iraqiya coalition wins 91 seats<sup>182</sup></li> <li>• Nuri al-Maliki's State of Law bloc is second with 89 seats<sup>183</sup></li> </ul> |

<sup>170</sup> *Id.* at 3.

<sup>171</sup> Trumbull IV, Charles P. and Julie B. Martin, *Elections and Government Formation in Iraq: An Analysis of the Judiciary's Role*, 44 VAND. J. TRANSNAT'L L. 331, 338 (2011).

<sup>172</sup> KATZMAN, *supra* note 15, at 3–6.

<sup>173</sup> *Id.*

<sup>174</sup> *Timeline, supra* note 151.

<sup>175</sup> *Id.*

<sup>176</sup> *See Accessions: Iraq, supra* note 162.

<sup>177</sup> Kamil Mahdi, *Iraq's Oil Law: Parsing the Fine Print*, 24 WORLD POL'Y J. 11, 11 (June 2007).

<sup>178</sup> *Timeline: Iraq votes on new government, supra* note 165.

<sup>179</sup> UK BORDER AGENCY COI SERVICE, IRAQ: COUNTRY OF ORIGIN FORMATION REPORT 26 (Mar. 2011).

<sup>180</sup> *Id.*

<sup>181</sup> KATZMAN, *supra* note 15, at 14.

<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

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| August 2010   | <ul style="list-style-type: none"><li>American combat operations in Iraq end as its last combat brigade departs for Kuwait<sup>184</sup></li></ul>  |
| November 2010 | <ul style="list-style-type: none"><li>Eight month deadlock ends on formation of government as factions agree on top 3 posts<sup>185</sup></li></ul> |
| December 2010 | <ul style="list-style-type: none"><li>AI Maliki to serve as PM, with Kurdish president, and Allawi promised new post<sup>186</sup></li></ul>        |

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<sup>184</sup> *Last U.S. Combat Brigade Leaves Iraq*, NPR, Aug. 19, 2010, <http://www.npr.org/templates/story/story.php?storyId=129288654>.

<sup>185</sup> Trumbull et al., *supra* note 171, at 375.

<sup>186</sup> *Id.*



## TARGETING DEMAND: A NEW APPROACH TO CURBING HUMAN TRAFFICKING IN THE UNITED STATES

*Morgan Brown*<sup>1</sup>

*“And by virtue of the power, and for the purpose aforesaid, I do order and declare that all persons held as slaves within said designated States, and parts of States, are, and henceforward shall be free; and that the Executive government of the United States. . . will recognize and maintain the freedom of said persons.”*

- Abraham Lincoln, 16th President of the United States,  
Jan. 1, 1863

*“The 4th right in the Universal Declaration of Human Rights is that there can be no slavery. Virtually every human being agrees that it is a moral wrong. Those key battles were won by people who went before us, who had the really tough job. Our job is simply to make sure that countries enforce their own laws and that slaves, when freed, have an opportunity for rehabilitation, reintegration, education, and so forth.”*

- Kevin Bales, Co-founder of Free the Slaves

### INTRODUCTION

On December 6, 1865, Congress ratified the Thirteenth Amendment to the United States Constitution, and with it, released the last 40,000 slaves in the U.S. South. And yet today, 150 years after Abraham Lincoln gave notice of the Emancipation Proclamation, it is estimated that as many as 27 million individuals are trafficked around the world, and between 14,500 and 17,500 of those individuals are trafficked into the United States each year for purposes ranging from domestic servitude and forced labor, to prostitution and other forms of sexual exploitation, to organ harvesting.<sup>2</sup> Although human trafficking dates back to the slave trade, improvements in communication and

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<sup>1</sup> J.D., 2013, University of Richmond School of Law, B.A., 2010, University of North Carolina at Chapel Hill. Thank you to the executive boards and staff of Volume XI and Volume XII of the *Richmond Journal of Global Law and Business* for your guidance, support, and editing assistance, my clients and mentors throughout the world for your encouragement, advice, and willingness to tell the stories that helped shape this paper, and my family for your never-ending support and encouragement.

<sup>2</sup> Office to Monitor and Combat Trafficking in Persons, U.S. Dep’t of State, *Trafficking in Person’s Report 2011* (June 27, 2011), available at <http://www.state.gov/g/tip/rls/tiprpt/2011>; see also Office to Monitor and Combat Trafficking in Persons,

transportation in recent decades, combined with the latest global financial crisis, have led to an exponential increase in the number of people traded around the world each year. Advances in transportation have increased the ease and decreased the time required to move human cargo from one side of the world to the other, privatization and liberalization of markets have created more accessible marketplaces, and improvements in technology have increased the volume and complexity of international financial transactions.<sup>3</sup>

Coerced into travel under the guise of a job or an education, trafficking victims face a different reality upon arrival in their destination country. Traffickers capitalize on victims' scarce knowledge of the language and laws of their new host country to keep victims in a state of disorientation and to prevent the individuals from attempting to escape. Because many victims come from developing countries with high rates of corruption, they are often distrustful of law officials in their new country and will not turn to them for help. As a result, many victims quickly become trapped in their situations, racking up their "debt" to their employer, too fearful to speak out or report their captors to the police.

International protocols and U.S. legislation have been passed to combat human trafficking worldwide. The United Nations Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children ("UN Protocol") defines trafficking as

- (a) the recruitment, transportation, transfer, harboring or receipt of persons, by means of threat or use of force or other forms of coercion, of abduction, of fraud, of deception, of the abuse of power or of a position of vulnerability or of the giving or receiving of payments or benefits to achieve the consent of a person having control over another person, for the purpose of exploitation. Exploitation shall include, at a minimum, the exploitation of the prostitution of others or other forms of sexual exploitation, forced labor or services, slavery or practices similar to slavery, servitude or the removal of organs. . .
- (b) The consent of a victim of trafficking in persons to the intended exploitation. . . shall be irrelevant where any of the means set forth above have been used.<sup>4</sup>

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U.S. Dep't of State, *Trafficking in Person's Report 2012* (June 19, 2012), available at <http://www.state.gov/j/tip/rls/tiprpt/2012/index.htm>.

<sup>3</sup> Donna M. Hughes, *The "Natasha" Trade: Transnational Sex Trafficking*, 246 NAT'L INST. JUST. J. 9, 10 (Jan. 2001) (discussing the global climate for trafficking).

<sup>4</sup> G.A. Res. 55/25 (III), art. 3, U.N. Doc. A/RES/55/25 (Nov. 15, 2000).

The wording of the UN Protocol paints a broad picture of human trafficking, including within its definition instances of both nonconsensual exploitation and those situations in which the victim consents to the labor. This definition has since served as a template for the Trafficking Victims Protection Act (“TVPA”), which was passed by the U.S. Congress in 2000, and which adopts a more restrictive definition than the U.N. Protocol.<sup>5</sup> Although Congress’s adopted definition generally follows the U.N. Protocol’s definition, the TVPA narrows the definition of trafficking by requiring proof of violence or coercion before an act qualifies as trafficking under the statute.<sup>6</sup>

Whereas the U.N. Protocol provides protections for all victims of trafficking, the TVPA only guarantees protection for victims of “severe forms of trafficking in persons.”<sup>7</sup> Under the TVPA, if a person consents to the labor, the labor does not constitute trafficking *per se*,<sup>8</sup> which means a person may qualify as a trafficking victim in the United States by the U.N.’s definition, but still be ineligible for certain relief under the Act.<sup>9</sup> Further, the TVPA includes any person under eighteen years old who is sexually exploited, but does not extend such expansive protection to minors coerced into other subsets of trafficking, such as labor exploitation.<sup>10</sup> The U.N. Protocol, however, includes all children recruited, transported, transferred, harbored, or received by any means, regardless of their final destination or the work they are forced to do.<sup>11</sup> The result is situations in which the international community would offer protection to the individual, but the narrower U.S. definition precludes that same level of protection. The TVPA’s definition thus operates to withhold protection from workers who come to the United States under the guise of legitimate work and promises of work visas, and who subsequently find themselves trapped and working off high debts, without legal identification and subject to their employer’s abuses.

Although these differences in definition create enforcement issues for anti-trafficking laws throughout the world, they are not the biggest pitfalls of these provisions. Instead, the more prominent issue seems to be the provisions’ focus. Rather than focusing on the demand for the services provided by trafficked individuals, lawmakers and en-

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<sup>5</sup> Victims of Trafficking and Violence Protection Act of 2000, H.R. 3244, 106th Cong. (2000).

<sup>6</sup> *Id.* §§ 103(2) and (8).

<sup>7</sup> *Id.* § 103(8).

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> Jennifer M. Chacon, *Misery and Myopia: Understanding the Failures of U.S. Efforts to Stop Human Trafficking*, 74 *FORDHAM L. REV.* 2977, 2984–85 (May 2006).

<sup>11</sup> H.R. 3244.

forcement agencies focus heavily on attacking the supply of the labor, preferring to frame human trafficking as a foreign problem with unfortunate domestic manifestations rather than as a domestic problem.<sup>12</sup> To more effectively combat human trafficking, therefore, future anti-trafficking legislation and enforcement efforts should recognize human trafficking as a domestic problem and supplement the current approach, which focuses on victims and supply, with measures to limit the demand for services provided by trafficking victims.

Part I of this paper will provide a general framework for understanding human trafficking in the United States by laying out basic statistics relevant to human trafficking, describing the basic economic model under which the business of human trafficking should be understood, and discussing the major legislative approaches the United States has taken to curtail the increase in human trafficking in the country in the past ten years. Part II will then analyze the shortcomings of this approach and the successes of unique efforts to combat trafficking in Sweden. Part III recommends an approach the United States should take moving forward that complements its current anti-trafficking legislation, to more effectively combat human trafficking within its borders.

#### I. THE BUSINESS OF HUMAN TRAFFICKING: UNDERSTANDING THE TRADE'S GLOBAL ECONOMIC IMPACT

Before any meaningful analysis of human trafficking in the United States can be undertaken, it is important to identify the key players and motivating factors behind the human trafficking model, as well as the current state of efforts to combat the trade.

##### 1. *Understanding the Breadth and Depth of the Problem: Basic Statistics*

Although the number of victims trafficked into the United States each year is decreasing, the number is still high,<sup>13</sup> and with the recent global economic downturn, the number of countries and individuals involved in the trade globally is continuing to increase.<sup>14</sup> Trafficking is not isolated or restricted to developing countries; rather, trafficked individuals travel from 127 countries and are exploited in 137 countries, on every continent and in any type of economy.<sup>15</sup> The

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<sup>12</sup> Chacon, *supra* note 10.

<sup>13</sup> *A Horrible Business: The Modern Slave Trade Is Thriving*, ECONOMIST, June 14, 2008, <http://www.economist.com/node/11561082>.

<sup>14</sup> Judy Lin, *Human Trafficking Escalates as World Economy Plunges*, UCLA TODAY, June 5, 2009, <http://www.international.ucla.edu/print.asp?parentid=109082>.

<sup>15</sup> *Id.*

U.N. estimates that, overall, 161 countries are affected by trafficking as either a source, transit, or destination country.<sup>16</sup>

The International Labor Organization (ILO) further estimates that at any given time, there are 2.5 million individuals worldwide trapped in forced labor as a result of trafficking.<sup>17</sup> Of those, 1.2 million are children.<sup>18</sup> Victims are forced to work in brothels and strip clubs, private homes and on farms.<sup>19</sup> They work in restaurants and factories, the hotel industry and construction.<sup>20</sup> Victims are used for economic and commercial sexual exploitation, and suffer physical, psychological, and sexual abuse at the hands of their captors and clients.<sup>21</sup>

Poor record keeping and the nature of the trade make it impossible to know its exact profits, but recent estimates put the value of global human trafficking at approximately \$32 billion annually.<sup>22</sup> Of this, approximately 49% (\$15.5 billion) is generated in industrialized economies.<sup>23</sup> A single person can bring in between \$4,000 and \$50,000 for a trafficker, depending on the particular victim's country of origin and destination.<sup>24</sup> Once in the United States, a trafficked individual has a value of, on average, \$100,000.<sup>25</sup> These figures make human trafficking one of the most lucrative crimes in the world, second only to the illegal drug trade.<sup>26</sup> Crime experts expect human trafficking to surpass drug trafficking in profitability within the next ten years.<sup>27</sup>

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<sup>16</sup> United Nations Office on Drugs and Crime, *Trafficking in Persons: Global Patterns* (2006).

<sup>17</sup> International Labor Organization, *Forced Labor Statistics Factsheet* (2012).

<sup>18</sup> United Nations Children's Fund, *UK Child Trafficking Information Sheet* (2003).

<sup>19</sup> *2011 Trafficking in Persons Report*, *supra* note 2, at 121.

<sup>20</sup> *See generally id.*

<sup>21</sup> *Human Trafficking: Modern Enslavement of Immigrant Women in the United States*, AM. CIV. LIBERTIES UNION (May 31, 2007), <http://www.aclu.org/womens-rights/human-trafficking-modern-enslavement-immigrant-women-united-states>.

<sup>22</sup> *A Horrible Business*, *supra* note 13.

<sup>23</sup> Patrick Belser, *Forced Labor and Human Trafficking: Estimating the Profits* 17 (Int'l Labor Office, Working Paper, 2005), available at <http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1016&context=forcedlabor>.

<sup>24</sup> *Human Trafficking's Dirty Profits and Huge Costs*, INTER-AM. DEV. BANK (Nov. 2, 2006), <http://www.iadb.org/en/news/webstories/2006-11-02/human-traffickings-dirty-profits-and-huge-costs,3357.html>.

<sup>25</sup> Elizabeth M. Wheaton et al., *Economics of Human Trafficking*, 48 INT'L MIGRATION 114, 124 (2010).

<sup>26</sup> *Human Trafficking's Dirty Profits and Huge Costs*, *supra* note 24, at 1. Drug trafficking brings in an estimated \$32 billion annually. U.N. President of the General Assembly, Letter dated May 18, 2012 from the President of the General Assembly to All Permanent Representatives and Permanent Observers of the United Nations (May 18, 2012).

<sup>27</sup> Wheaton, *supra* note 25, at 114.

Federal and state efforts to curb trafficking in the United States over the past decade have met varied success, but the majority of analysts and critics see these efforts as falling short of their ultimate goals. In 2006, for example, there were only 5,808 prosecutions and 3,160 convictions of human traffickers throughout the world, mostly outside of the U.S.,<sup>28</sup> or approximately one conviction for every 800 people trafficked.<sup>29</sup> In 2010, federal law enforcement officers in the United States obtained 141 convictions in 103 human trafficking prosecutions.<sup>30</sup>

Despite existing efforts to combat trafficking in the United States, the number of victims trafficked into and within the United States annually is not showing significant decreases because human trafficking is a crime that, despite its reach, has not until recently captured the public's attention or topped any political agendas.<sup>31</sup> Victims come cheap, and many countries either lack the laws to target traffickers or do not properly enforce the laws they do have in place.<sup>32</sup> Few cases even make it into a courtroom, and when they do, the brunt of the punishment usually falls on the victim, while traffickers receive light sentences.<sup>33</sup> Thus, even when efforts are made to deter traffickers, those efforts are often hampered because traffickers see the trade as a big business with a high reward and low risk as the incentives to stay in the market far outweigh the costs of getting caught.<sup>34</sup>

## 2. *Why Human Trafficking Continues: The Economic Model of Human Trafficking*

Trafficking is a successful business precisely because it exploits the best and worst aspects of globalization. Today, business can be conducted across national borders with ease.<sup>35</sup> Improvements in communication tools and relaxed banking laws make exchanging assets

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<sup>28</sup> Office to Monitor and Combat Trafficking in Persons, U.S. Dep't of State, *Trafficking in Person's Report 2007* 36 (June 12, 2007), available at <http://www.state.gov/g/tip/rls/tiprpt/2007>.

<sup>29</sup> *Id.*

<sup>30</sup> *2011 Trafficking in Persons Report*, *supra* note 2, at 373.

<sup>31</sup> *Human Trafficking's Dirty Profits and Huge Costs*, *supra* note 24. In 2010, the FBI opened 126 human trafficking investigations and made 115 arrests, and completely dismantled 12 human trafficking organizations. *Human Trafficking - FBI Initiatives*, FEDERAL BUREAU OF INVESTIGATION (Jan. 28, 2011), available at [http://www.fbi.gov/news/stories/2011/january/trafficking\\_012811](http://www.fbi.gov/news/stories/2011/january/trafficking_012811).

<sup>32</sup> *A Horrible Business*, *supra* note 13.

<sup>33</sup> See generally *2011 Trafficking in Persons Report*, *supra* note 2, at 343.

<sup>34</sup> *A Horrible Business*, *supra* note 13.

<sup>35</sup> *Trafficking and Globalization*, NOT FOR SALE, <http://www.notforsalecampaign.org/about/slavery> (last visited Jan. 7, 2012).

internationally both possible and easy.<sup>36</sup> Through virtual enterprises, businesses can operate everywhere and nowhere, choosing when, where, and to whom they are known, when they so choose.<sup>37</sup> For law-abiding, legitimate businesses, these are some of the key advantages of operating in our globalizing world. These are also key advantages for illicit, organized crime syndicates that take advantage of these improvements to create more efficient overseas networks.<sup>38</sup> Thus, as businesses continually seek the lowest-cost labor sources to maximize profits and as the world's financial situation grows dimmer, more people become vulnerable to exploitation as the significant profits associated with human trafficking give birth to a thriving market for the illicit trade.<sup>39</sup>

To understand the basic human trafficking model, it is important to recognize a few key components of that market, which follows the same basic economic model as any other monopolistically competitive business.<sup>40</sup> As with other industries, these markets have three key components – the product, the consumer, and the intermediary. The basic human trafficking model also includes each of these components — the product (the vulnerable individual) and a buyer (the employer) with a seller (the trafficker) that connects the two.<sup>41</sup> Current efforts to combat trafficking naturally tend to focus on these three components of the human trafficking model. When formulating anti-trafficking legislation, however, the U.S. government should also focus directly and indirectly on a fourth component of the market — the second group of consumers who use the trafficked individuals' products or services and thus drive the demand for those services.

Focusing on the first three groups of actors precludes current efforts to combat trafficking from being as effective as they could be because none of these groups will ever completely exit the market as long as there is a demand for trafficked labor within the global economy. There are several reasons for this. First, there is a steady group of potential sellers. This pool continues to drive the market because the benefits of entering the human trafficking market greatly outweigh the costs, ensuring a continuous source of individuals and networks willing to supply the market with goods.<sup>42</sup> Traffickers can easily enter the market, which they do when they see other traffickers mak-

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<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> Wheaton, *supra* note 25.

<sup>40</sup> A monopolistically competitive business is one in which many buyers and sellers make deals in differentiated products. Here, the differentiated product is trafficked individuals with different personal attributes. *Id.* at 118.

<sup>41</sup> *Id.* at 116-17.

<sup>42</sup> *See id.* at 118-19.

ing a high profit. Additionally, if the trafficker does not subsequently make the profit he or she expected or desires, there are few barriers to exiting the market with minimal cost. The ease of entry into and exit from the market combines with the differentiated nature of the product being sold to preclude the creation of a monopoly or oligopoly and to ensure that competition in the market will thrive.<sup>43</sup>

Second, there is a steady pool of buyers who demand trafficked individuals for different reasons ranging from sexual exploitation to domestic servitude.<sup>44</sup> By definition, trafficked individuals are exploited, having no right to decide whether and how many hours to work, what kind of work to do, or when to move to another job or another employer. These features make these victims ideal employees. As the number of individuals seeking work and the ease of moving humans and capital around the world each continue to increase, both buyers and sellers of trafficked individuals continue to have an endless pool of cheap, vulnerable workers from which to draw their victims and maximize their own profits.

Finally, the products being sold in this market are highly differentiated and readily available. The characteristics that make an individual suitable for work in a brothel differ greatly from those characteristics needed for an agricultural worker, which, in turn also differ from the characteristics desirable in a housekeeper. Because of this differentiation, the buyer and seller can negotiate over the price of the product until they reach a price upon which they both agree. Unlike markets for undifferentiated products, the seller here still maintains some control over the final selling price despite the large number of sellers in the market.<sup>45</sup> By taking advantage of and asserting this control, traffickers are able to make a heftier profit than if the buyers controlled the price, increasing the incentive for sellers to stay in the trade.

Further, the availability of the product, which depends heavily on vulnerable individuals, is also key to the market's survival. Income differentials between developed and developing countries, strict government immigration policies, and other factors provide a steady stock of individuals who are vulnerable to market exploitation.<sup>46</sup> It is no se-

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<sup>43</sup> In monopolistic and oligopolistic competitive markets, prices remain relatively stable because even the smallest price increase will lose many customers. *Id.* at 118.

<sup>44</sup> *See id.* at 119.

<sup>45</sup> *See* Wheaton, *supra* note 25, at 118.

<sup>46</sup> Other factors include globalization, political instability, worldwide capitalism and transnational corporations, the universal devaluation and marginalization of women and children, poverty, lack of education, urbanization and centralization of educational and employment opportunities, cultural thinking and attitude, traditional practices, domestic violence, corruption, and conflicts. *Id.* at 121.

cret that the number of people wishing to migrate to countries with better jobs, better government structures, and overall better life potential far outnumbers the capacity of those countries to absorb them. Thus, many countries enact strict immigration policies, desiring to accept more high-skilled, educated workers than low-skilled workers who have greater potential to be a burden on the State in the future. Because government immigration policies then tend to aim at restricting the entrance of low-skilled immigrants, this is the group most likely to try to migrate illegally, making them prime targets for traffickers who capitalize on the opportunity to make a profit.<sup>47</sup> Traffickers take advantage of these individuals' typically low education levels and hopes for higher wages and better lives by facilitating illegal border crossings and providing the funds and papers needed for relocation.<sup>48</sup> Upon arrival in the United States, the individuals then find themselves living as indentured servants, often spending years working off the debts they incurred traveling to the United States, subject to their employer's abuse and exploitation.

Additionally, it is important to note that, despite the factors discussed above, profit is the key motivating factor driving human trafficking. As with other trades, traffickers receive a price for their goods based on the availability and characteristics of the desired product.<sup>49</sup> When fewer desirable products are available, it is more expensive for traffickers to move their victims around the world. In return, however, traffickers can attach a higher price tag to the individuals to account for scarcity and those transportation costs. Inversely, when more individuals with the desired characteristics are available, it will be cheaper to move them, but the trafficker will secure a lower price from the buyer.

At very low prices, where costs exceed revenue and there is no profit, traffickers will be unwilling to supply trafficked individuals.<sup>50</sup> Similarly, employers will be unwilling to utilize trafficked labor at a price above that at which they are able to employ legal laborers. In this instance, when costs exceed revenue, there is no benefit to taking the risk of employing trafficked individuals.<sup>51</sup> Where employers are able to employ a trafficked individual cheaper than by using some other legitimate source of labor, however, they may be more likely to do so. The market thus works out a price for the individual product that falls somewhere below the cost of a legitimate worker and above the price of

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<sup>47</sup> *Trafficking and Human Smuggling: A European Perspective*, 38 INT'L MIGRATION 31-54 (2000).

<sup>48</sup> *Id.*

<sup>49</sup> See Wheaton, *supra* note 25, at 119.

<sup>50</sup> *Id.*

<sup>51</sup> See *id.*

trafficking the vulnerable individual. In this way, costs are depressed and revenue is maximized for the employer, and profits are increased for the trafficker, both of which continue to fuel the market and motivate both buyers and sellers to stay in the trade.

Furthermore, poor economic conditions at home and the dream of a new, better life continue to motivate individuals to take the risk of pursuing whatever work they can find abroad, and ensure there is a product available to drive the market.<sup>52</sup> As an increasing number of people in today's global economy search for better lives abroad and countries continue to tighten immigration policies, the profits for traffickers rise proportionately, continuing the trafficking cycle by maintaining incentives for traffickers to continue entering the market. The combination of incentives offered by the market to all involved parties thus makes this market difficult, though not impossible, to interrupt.

### 3. *Addressing the Problem: Current Efforts to Combat Trafficking in the United States*

The United States has not completely turned a blind eye to the cause of human trafficking; rather, it has taken some concrete steps to combat human trafficking within its own borders. Starting after the Civil War, Congress passed legislation that prohibited all forms of trafficking in persons.<sup>53</sup> Violations of the Thirteenth Amendment have not been prosecuted since 1947 when the Court in *United States v. Ingalls* defined a slave as "a person in a state of enforced or extorted servitude to another," and included psychological coercion within the definition of slavery.<sup>54</sup> Then, in 1988, the Supreme Court limited the Thirteenth Amendment's prohibitions to physical or legal coercion, ruling that the Thirteenth Amendment did not prohibit psychological coercion.<sup>55</sup> These definitions controlled modern day slavery until 2000 when Congress updated these laws with the Victims of Trafficking and Violence Protection Act of 2000 (TVPA), which includes psychological coercion as a form of slavery, even when there is no physical coercion.<sup>56</sup> Thus, if a person comes to the United States willingly, but under false pretenses, today that individual may still be considered trafficked, provided that the individual can provide proof of such psychological coercion. Although this is a vast improvement from defini-

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<sup>52</sup> See *Trafficking and Human Smuggling: A European Perspective*, *supra* note 47, at 47-48 (2000).

<sup>53</sup> 2011 *Trafficking in Persons Report*, *supra* note 2, at 372; 18 U.S.C.A. § 1583; U.S. CONST. amend. XIII.

<sup>54</sup> See *United States v. Ingalls*, 73 F. Supp. 76, 79 (S.D. Cal. 1947).

<sup>55</sup> See *United States v. Kozminski*, 487 U.S. 931, 951 (1988).

<sup>56</sup> *Trafficking Victims Protection Act of 2000*, P.L. No. 106-386, 114 Stat. 1464 (2000).

tions used in the past, this burden of proof is almost insurmountable for many victims in many cases, so although the language is included in the Act, in practice the burden placed on the workers operates to limit protection for trafficking victims.

Since the passage of the TVPA, Congress has passed the Trafficking Victims Protection Reauthorization Act of 2003, the Trafficking Victims Protection Reauthorization Act of 2005, and the Trafficking Victims Protection Reauthorization Act of 2008 to rectify the inadequacy of those old laws, and more specifically to address the ineffectiveness of their penalties.<sup>57</sup> The Acts recognize a broader range of activities within the umbrella term “trafficking,” with the specific aim to criminalize the conduct of sex traffickers and to penalize sex trafficking as a crime equally as serious as rape.<sup>58</sup> While the original TVPA focused narrowly on sex trafficking, the 2003 amendment added crimes including forced labor, peonage, slavery, and involuntary servitude to the previous provisions.<sup>59</sup> Later acts also added confiscation of documents, conspiracy, and attempts to violate the Acts to the list.<sup>60</sup> This broader scope and recognition is important to deterring trafficking within U.S. borders, but the most prominent changes in these recent Acts, greater criminal sentences for pre-existing labor crimes, did not significantly contribute to the fight against human trafficking.<sup>61</sup> Although these new provisions did grant a private right of action for workers who have been trafficked into peonage, slavery, or involuntary servitude, they did not address the lack of adequate legal workplace protections for undocumented migrants, again decreasing the potential and efficacy of these new provisions.<sup>62</sup> The result has been that although these measures represent a step forward in the fight against human trafficking in the United States, in reality they have proven insufficient to deter traffickers and to effectively combat trafficking within U.S. borders.

Individual states have also taken action to combat human trafficking within their borders, recognizing the important role state and local laws play in enforcing anti-trafficking laws. Most of the state anti-trafficking laws that have been passed follow the same basic for-

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<sup>57</sup> *See id.*

<sup>58</sup> *See* Susan Tiefenbrun, *The Saga of Susannah: A U.S. Remedy for Sex Trafficking in Women: The Victims of Trafficking and Violence Protection Act of 2000*, 2002 UTAH L. REV. 107, 115 (2002).

<sup>59</sup> U.S. Dep’t of State, *Victims of Trafficking and Violence Protection Act of 2000: Trafficking in Persons Report 23* (2004), available at <http://www.state.gov/documents/organization/34158.pdf>.

<sup>60</sup> 22 U.S.C. § 7102 (2008).

<sup>61</sup> A conviction under the Acts carries possible penalties ranging from five years to life imprisonment. *Id.*

<sup>62</sup> 18 U.S.C. § 1595(a) (West Supp. 2005).

mat as the federal law and a model law drafted by the Department of Justice.<sup>63</sup> They focus primarily on creating criminal sanctions for traffickers, but a few also grant benefits to victims. Additionally, a few states have developed their own, distinct anti-trafficking statutes that include activities within their provisions that those particular states perceive as important, and that are not included within the federal laws.<sup>64</sup> These provisions provide additional protections for victims within those states, but contribute to the patchwork of disparate state trafficking laws within the United States. They decrease the uniformity of the country's approach, leaving a victim's protections up to the luck of the draw, rather than a concrete definition or set of standards.

## II. SUCCESSES AND FAILURES: LEARNING FROM OTHER APPROACHES TO MORE EFFECTIVELY ADDRESS THE PROBLEM MOVING FORWARD

The effects of current efforts to curtail human trafficking within the United States should not be discounted, as they have successfully made a small dent in the number of individuals being trafficked into the country each year. A brief examination of differing approaches to combating sex and labor exploitation in the United States and abroad, however, reveals that changes must be made to ensure these efforts are more effective.

### 1. *The U.S. Approach to Combating Trafficking: Why Current Efforts are Insufficient*

Despite current efforts, the number of trafficking victims in the United States is not likely to significantly decrease without some changes to the U.S. approach to combating the sex trade. Federal and state efforts to address the issue thus far have focused primarily on the victims and the traffickers themselves, but because current trafficking laws are weak and rarely enforced, or are enforced primarily to the detriment of the victim, the benefits for traffickers still outweigh the costs of entering the market.<sup>65</sup>

Rather than address the forces that are driving the migration that in turn fuels human trafficking, the TVPA and other legislation take an *ad hoc* approach to deal with one specific effect of global migra-

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<sup>63</sup> Model State Anti-Trafficking Criminal Statute § XXX.01 (Dep't of Justice 2004), available at [http://pdba.georgetown.edu/Security/citizenssecurity/eeuu/documents/model\\_state\\_regulation.pdf](http://pdba.georgetown.edu/Security/citizenssecurity/eeuu/documents/model_state_regulation.pdf).

<sup>64</sup> These activities include pimping or patronizing a prostitute, with or without force, among others. Melynda H. Barnhardt, *Sex and Slavery: An Analysis of Three Models of State Human Trafficking Legislation*, 16 WM. & MARY J. WOMEN & L. 83, 84-90 (2009).

<sup>65</sup> Tiefenbrun, *supra* note 58, at 116.

tion.<sup>66</sup> Instead of aiming for the source of the problem, legislators have attempted to use a band-aid to stem a bleeding hemorrhage. It is no wonder then that this legislation has been ineffective in combating trafficking within the United States. Although punishments under the TVPA are double those contained in post-Civil War legislation, penalties are still relatively light for trafficking both in the United States and throughout the world.<sup>67</sup> To more effectively address human trafficking then, the United States should focus on decreasing the benefits and increasing the costs of human trafficking to both employers and traffickers.

The TVPA has three main goals: (1) offer statutory protection to the victims of severe forms of human trafficking, (2) increase criminal penalties for persons who commit such acts of trafficking, and (3) foster international cooperation in efforts to combat human trafficking.<sup>68</sup> The Act's objective to be tough on traffickers and generous to victims of trafficking is honorable; however, in reality it has failed to sufficiently combat human trafficking both in the United States and abroad. Although there have been many hypotheses as to why this has been the case, they can all be boiled down to this: U.S. law and policy actually facilitates human trafficking in the United States by ignoring the global and domestic forces that drive migration.<sup>69</sup> Before the United States can significantly curtail human trafficking in the country, it follows that the government must address these issues by, among other efforts, recognizing the fact that its laws and policies generate a viable market for trafficking. First, however, it is important to understand the structure and origins of the TVPA.

The Act was a compromise of three bills introduced during Congress's October 2000 legislative session and was passed with broad bipartisan support.<sup>70</sup> The language and legislative history of the Act indicate Congress's recognition of the need to change the relationship between trafficking victims and the state by reframing trafficked individuals as victims rather than as criminals, as was their classification before Congress passed the TVPA.<sup>71</sup> That new support for trafficking victims was meant to be complementary to the prosecution of traffickers and other measures aimed at stopping trafficking at its source.<sup>72</sup> Much of the anti-trafficking rhetoric, however, has been just that – nothing more than the words of legislators. Touted as a breakthrough

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<sup>66</sup> Chacon, *supra* note 10, at 2977.

<sup>67</sup> *Id.*

<sup>68</sup> *Id.* at 2978.

<sup>69</sup> *Id.* at 2979.

<sup>70</sup> *Id.* at 2989.

<sup>71</sup> *Id.* at 2990.

<sup>72</sup> Chacon, *supra* note 10, at 2990.

in the fight against human trafficking, the TVPA in practice has actually highlighted significant problems in preexisting legislation rather than make application of the laws more effective.<sup>73</sup>

One key problem with the TVPA and other subsequent federal legislation is that the federal government rarely prosecutes trafficking cases, leaving criminal enforcement of the laws primarily to state and local governments.<sup>74</sup> To encourage states to take action, the federal government has pressured state legislators to pass their own anti-trafficking legislation. It has also funded local task forces to handle trafficking cases,<sup>75</sup> but many local police forces are ill-equipped to handle these cases either because they lack training in recognizing trafficking victims or because they lack the resources to devote to such efforts.<sup>76</sup> As a result, many trafficking cases fall through the cracks of the legal system, leaving traffickers unpunished and undeterred from staying in the market.

The situation is worse for victims of labor trafficking than those exploited for the sex trade. Since 2001, there have only been a few hundred convictions under the TVPA, making human trafficking far less risky than trafficking illegal drugs or arms.<sup>77</sup> When agencies have prosecuted traffickers under the TVPA, the majority of those prosecutions have been for sex trafficking,<sup>78</sup> which has created a presumption among many state agencies that the traffickers to go after are those exploiting women sexually. Agricultural workers and housekeepers are thus more likely to pass under state officials' radars. In practice then the TVPA actually does a disservice to combating trafficking in the United States by limiting itself to a specific subgroup of trafficking victims, and in so doing, ignoring a broad range of labor exploitation.<sup>79</sup> These limitations, plus harsh penalties for undocumented migrant workers and insufficient labor protections for all

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<sup>73</sup> *Id.* at 2991; see *United States v. Todd*, 627 F.3d 329, 337 (9th Cir. 2010); *United States v. Evans*, 476 F.3d 1176, 1179 (11th Cir. 2007); *United States v. Strevell*, 185 Fed. App'x 841 (11th Cir. 2006); *United States v. Bonestroo*, 2012 U.S. Dist. LEXIS 981 (S.D.S.D. Jan. 4, 2012).

<sup>74</sup> See Barnhardt, *supra* note 64, at 97.

<sup>75</sup> *Id.*

<sup>76</sup> See *id.* at 128.

<sup>77</sup> See Wheaton, *supra* note 25, at 126. Compare the conviction rate for human trafficking with that of drug trafficking, where 49 percent of drug trafficking arrests led to incarceration, 28 percent led to a state prison sentence, and 71 percent led to a felony conviction. BUREAU OF JUSTICE, STATE COURT SENTENCING OF CONVICTED FELONS, 2004, STATISTICAL TABLES (2007), available at <http://bjs.ojp.usdoj.gov/index.cfm?ty=pbdetail&iid=1533>.

<sup>78</sup> In 2010, 71 convictions in the U.S. were for sex trafficking, while 32 were for labor trafficking. *2011 Trafficking in Persons Report*, *supra* note 2, at 123.

<sup>79</sup> Chacon, *supra* note 10, at 2979-80.

workers, work together to actually perpetuate trafficking within the United States rather than reduce it.<sup>80</sup>

2. *The European Approach to Combating Sex Trafficking: Lessons Learned to More Effectively Fight Sex Trafficking in the United States*

Whereas U.S. efforts to curtail human trafficking have focused on the traffickers and victims, other countries have focused on the demand for trafficked individuals, either through legalizing the sex trade or by directly going after the secondary consumers of the product. The United States can and should be informed by the successes of these approaches and, moving forward, should combine these lessons with the application of existing international instruments and the enforcement of current U.S. laws to more effectively combat human trafficking.

Approximately eighty international instruments currently address the issue of slavery, forced labor, and human trafficking. The first, the 1815 Declaration of the Eight Courts Relative to the Universal Abolition of the Slave Trade, establishes a duty to prohibit, prevent, prosecute, and punish slavery-related offenses.<sup>81</sup> Beginning in 1815 and continuing today, The Hague has also adopted the practice of incorporating protections against enslavement and forced labor into its international conventions.<sup>82</sup> Other international instruments addressing the issue of slavery and forced labor include the 1926 Slavery Convention,<sup>83</sup> the 1930 Forced Labour Convention,<sup>84</sup> and the 1948 Universal Declaration of Human Rights.<sup>85</sup> Each of these instruments addresses specific issues that overlap with those found within the umbrella of human trafficking, but none specifically addresses the problem of human trafficking itself.

The first major international treaty specifically addressing human trafficking was the Protocol to Prevent, Suppress and Punish Trafficking in Persons, which aimed to prevent and combat trafficking, to protect and assist victims, and to promote international cooperation

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<sup>80</sup> *Id.* at 2979.

<sup>81</sup> 2 Martens Noveuau Recueil 432, reprinted in 63 Parry's T.S. 473 (1969).

<sup>82</sup> *See, e.g.*, Laws and Customs of War on Land, 32 Stat. 103, T.S. No. 403 (July 29, 1899); Laws and Customs of War on Land, 36 Stat. 2277, T.S. No. 539 (Oct. 18, 1907).

<sup>83</sup> *See generally* Slavery Convention of 1926, Sept. 25, 1926, 46 Stat. 2183, 60 L.N.T.S. 253, 255.

<sup>84</sup> *See generally* Int'l Labour Org., Forced Labour Convention, 1930 (June 28, 1930) (explicitly recognizing forced labor as an international crime).

<sup>85</sup> G.A. Res. 217A, U.N. GAOR, 3d Sess., U.N. Doc. A/810 (Dec. 10, 1948) (recognizing the rights of all persons not to be held in slavery or servitude).

in fighting trafficking.<sup>86</sup> Unlike U.S. legislation, this protocol primarily focuses on providing protection and assistance to victims of human trafficking, and recognizing the needs of trafficking victims and the importance of victim assistance.<sup>87</sup> The protocol was adopted both as an end in and of itself, and as a means to secondarily support the prosecution of trafficking crimes. U.S. legislation typically has the opposite focus – prosecute the traffickers and when necessary, support the victims. Today, because of the evolution of these principles in the international community, the act of human trafficking has been deemed to violate general principles of law and is generally accepted as an international crime under both conventional and customary international law, which in turn affects the European legal response to trafficking.

Currently, European efforts to combat trafficking have focused primarily on sex trafficking and have proceeded in two directions. Most countries that have made any affirmative changes in their policies have chosen to legalize prostitution. Sweden has taken a different approach, choosing instead to prosecute the “johns,” or purchasers of the trafficked individuals’ sexual services.<sup>88</sup> A closer examination of each of these models reveals why the United States should adopt Sweden’s approach to stem the flow of sex trafficking victims into the United States.

In the first model, that followed by the majority of European countries that have taken affirmative steps to combat human trafficking, countries have legalized prostitution based on the assumption that doing so will regulate the trade and make girls less susceptible to being trafficked into the industry. In reality, however, the majority of trafficked women globally have actually ended up in countries and cities where there are large sex industries and where prostitution is legal because legalizing the sex industry actually makes convicting traffickers, and holding them accountable for their activities, more difficult.<sup>89</sup> A key element in prosecuting traffickers in countries with a legal sex trade is the use of force or physical coercion, an element that raises evidentiary issues<sup>90</sup> because many women do initially consent to travel or to work as a prostitute, not anticipating the conditions in which they will later be forced to work.<sup>91</sup> Because these men and wo-

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<sup>86</sup> Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children, Supplementing the United Nations Convention Against Transnational Organized Crime, Nov. 15, 2000, 2237 U.N.T.S. 319.

<sup>87</sup> *Id.*

<sup>88</sup> *The Battle Against Sex Trafficking: Sweden vs. Denmark*, CNN PROJECT: ENDING MODERN SLAVERY, Mar. 30, 2011, <http://thecnnfreedomproject.blogs.cnn.com/2011/03/30/sex-trafficking-countries-take-different-approaches-to-same-problem/>.

<sup>89</sup> Hughes, *supra* note 3, at 10.

<sup>90</sup> *Id.* at 14.

<sup>91</sup> *See id.*

men then do not qualify as victims of trafficking, traffickers actually benefit from policies legalizing prostitution and are, therefore, attracted to these countries.

Another disadvantage of legalization is that it actually increases the need for trafficking victims to meet the demand created by a legitimized sex industry.<sup>92</sup> In Denmark, for example, the government decriminalized prostitution in 1999 to make the sex trade easier to regulate.<sup>93</sup> In the past 12 years, the red light district there has grown exponentially and the number of foreign sex workers has increased drastically.<sup>94</sup> No studies reveal exactly how many of these women have been trafficked, but social workers believe the majority of these foreign workers are at least vulnerable to trafficking.<sup>95</sup> Additionally, many of the women work for pimps who are themselves victims of trafficking and who are attempting to work their way out of the system by recruiting new girls, creating a cyclical demand for trafficked individuals that keeps the market for trafficked women vibrant in Denmark.<sup>96</sup>

The Swedish model, on the other hand, targets the demand for trafficked labor rather than the supply. In Sweden, rather than legalize the trade, the government has focused its efforts on increasing the stigma attached to the sex trade. Men who purchase the product (the victim's sexual services) are prosecuted, rather than the pimps, while the women are still treated as victims.<sup>97</sup> As a result of these efforts, Sweden has seen a reduced demand for prostitution in the country and thus reduced market prices for girls in the country and reduced profits for traffickers.<sup>98</sup> In turn, the number of women trafficked into the country has declined as the benefits of trafficking into Sweden have decreased.<sup>99</sup> Traffickers now view Sweden as a poor market, and those who do enter the market there do so to a significantly smaller degree than they once did, suggesting that going after the fourth market player – the second group of consumers – is an effective means of targeting the sex trade.<sup>100</sup>

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<sup>92</sup> *Id.* at 13.

<sup>93</sup> *The Battle Against Sex Trafficking: Sweden vs. Denmark*, *supra* note 88.

<sup>94</sup> *See id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> Nicholas Kristof, *Seduction, Slavery and Sex*, N.Y. TIMES, July 14, 2010, <http://www.nytimes.com/2010/07/15/opinion/15kristof.html>.

<sup>98</sup> *Id.*

<sup>99</sup> *See id.*

<sup>100</sup> Similarly, efforts to shut down a few prominent brothels in Indonesia led to the closure of many neighboring brothels when clients realized there were repercussions for their activities and thus stopped seeking services, driving those brothels out of business. Beatrice Ask, *Sweden: Why We Criminalized Purchase of Sexual*

### 3. *Current International Efforts to Combat Labor Exploitation*

As discussed above, many of the anti-trafficking provisions enacted today have been construed primarily to protect victims against sexual, rather than labor, exploitation; however, labor exploitation is prominent in the United States. Although the FBI reports that eight of every ten trafficking arrests fall within the realm of sex trafficking,<sup>101</sup> in the United States, foreign victims of trafficking are more often victims of labor trafficking than sex trafficking.<sup>102</sup> Treaties, international conventions, customary international law, and U.S. legislation all protect undocumented workers' right to work and to do so free from discrimination based on race or national origin. As such, these legal mechanisms are applicable to trafficked individuals, many of whom remain undocumented and thus vulnerable to exploitation. To more effectively interrupt the international human trafficking market, therefore, governments should focus on enforcing these laws. By doing so, they will increase the costs and decrease the benefits to traffickers of trafficking individuals into forced labor, and thus more effectively combat the trade.

Among the rights guaranteed to undocumented immigrants within international agreements is a group of rights that relate to fair labor conditions. Addressed primarily in the International Covenant on Economic, Social, and Cultural Rights (ICESCR), States party to the treaty recognize the right to work, which includes the right not only to earn a living through work, but also the right to choose the work a person accepts for him- or herself.<sup>103</sup> The ICESCR also recognizes the right of every person to just and favorable working conditions, which include fair wages and equal pay for equal work, a decent living, safe and healthy working conditions, equal opportunity to be promoted in one's employment to an appropriate higher level, the reasonable limitation of working hours, and periodic holidays with pay.<sup>104</sup> Additionally, under the ICESCR, States play more than a passive role in allowing a person to work. They have a positive duty to ensure the full realization of these rights through vocational guidance and training programs, policies to achieve steady economic, social, and cultural development, and full and productive employment under conditions

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*Services*, CNN FREEDOM PROJECT: ENDING MODERN-DAY SLAVERY, Mar. 31, 2011, <http://thecnnfreedomproject.blogs.cnn.com/2011/03/31/sweden-why-we-criminalized-purchase-of-sexual-services>.

<sup>101</sup> *Human Trafficking – FBI Initiatives*, *supra* note 31.

<sup>102</sup> *2011 Trafficking in Persons Report*, *supra* note 2, at 342.

<sup>103</sup> International Covenant on Economic, Social, and Cultural Rights, G.A. Res. 2200A (XXI), U.N. GAOR, 21st Sess., Supp. No. 16, U.N. Doc. A/6316 (Dec. 16, 1966).

<sup>104</sup> *Id.* at art. 7.

safeguarding fundamental political and economic freedoms to the individual.<sup>105</sup> The International Convention on the Rights of Migrant Workers and their Families (ICRMW) further provides that migrant workers should enjoy treatment equal to that which applies to nationals of the state of employment.<sup>106</sup>

International law also protects migrant workers, including trafficked individuals, from racial discrimination. The International Convention on the Elimination of All Forms of Racial Discrimination (ICERD) defines “racial discrimination” as

Any distinction, exclusion, restriction, or preference based on race, color, descent, or national or ethnic origin which has the purpose or effect of nullifying or impairing the recognition, enjoyment or exercise, on an equal footing, of human rights and fundamental freedoms in the political, economic, social, cultural or any other field of public life.<sup>107</sup>

The ICERD requires States Parties to condemn racial discrimination and to pursue a policy of elimination of racial discrimination. States Parties can do this through means such as reviewing government policies and amending or rescinding any policies that have the effect of creating or perpetuating racial discrimination wherever it exists.<sup>108</sup> Along these lines, State Parties have a duty to

guarantee the right of everyone, without distinction as to race, color, or national or ethnic origin, to equality before the law, notably in the enjoyment of . . . the rights to work, to free choice of employment, to just and favorable conditions of work, to protection against unemployment, to equal pay for equal work, and to just and favorable remuneration. . .<sup>109</sup>

The International Covenant on Civil and Political Rights (ICCPR), which was ratified in 1992, similarly provides

All persons are equal before the law and are entitled without any discrimination to the equal protection of the law. In this respect, the law shall prohibit any discrimination and guarantee to all persons equal and effective

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<sup>105</sup> *Id.* at art. 6, § 2.

<sup>106</sup> International Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families, G.A. Res. 45/158, art. 18, 25, 27, U.N. Doc. A/Res/45/158 (Dec. 18, 1990).

<sup>107</sup> International Covenant on the Elimination of All Forms of Racial Discrimination, G.A. Res. 2106 (XX) art. 1, § 1 (Dec. 21, 1965).

<sup>108</sup> *Id.* at art. 2, § 1(c).

<sup>109</sup> *Id.* at art. 5(i).

protection against discrimination on any ground such as race, color, sex, language, religion, political or other opinion, national or social origin, property, birth, or other status.<sup>110</sup>

And the Universal Declaration on Human Rights (UDHR) declares

Everyone is entitled to all the rights and freedoms set forth in this Declaration, without distinction of any kind, such as race, color, sex, language, religion, political or other opinion, national or social origin, property, birth or other status. . . All are equal before the law and are entitled without discrimination to equal protection of the law.<sup>111</sup>

The plain language of each of these international documents provides for equal protection and non-discrimination for all persons. Although the United States is not a party to all of these conventions, as a country that sets a standard for the rest of the world to follow in many areas, it would be beneficial for the United States to recognize these standards, which have been recognized by many other countries, and to strive to enforce their principles to effectively help prevent and protect vulnerable laborers from falling into exploitative situations.

Domestic laws in the United States can also be used to directly and indirectly protect vulnerable individuals from traffickers within a labor context. The federal Fair Labor Standards Act (FLSA) is one such piece of legislation that, although not passed to directly combat human trafficking, can be used by state officials to deter traffickers. The Act regulates a broad range of working conditions, including minimum wage and maximum hours, and contains various enforcement provisions, including the right to institute a civil action on behalf of an employee for unpaid wages and overtime pay.<sup>112</sup> These provisions make the FLSA a prime candidate for curbing trafficking, as universal enforcement of these provisions would naturally include protections for trafficking victims.

Enforcement of Title VII of the Civil Rights Act (CRA) also holds promise for curbing human trafficking in the United States. The first piece of comprehensive legislation prohibiting discrimination in the workplace based on race and national origin, the CRA's coverage includes employees recruited from abroad to work in the United

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<sup>110</sup> International Covenant on Civil and Political Rights, G.A. Res. 2200A (XXI), art. 26 (Dec. 16, 1966).

<sup>111</sup> Universal Declaration of Human Rights, G.A. Res. 217 (III) A, art. 2, 7, U.N. Doc. A/RES/217(III) (Dec. 10, 1948).

<sup>112</sup> Fair Labor Standards Act, 29 U.S.C. §§ 201-19 (1938).

States.<sup>113</sup> It is often used to protect workers' rights, and its application to migrant workers holds promise for decreasing the benefits of trafficking to traffickers, and thus curtailing the trade in the United States.

For example, in April 2011, in its largest human trafficking case in agriculture to date, the Equal Employment Opportunity Commission filed suit under the CRA against a farm labor contractor, alleging severe abuse of Thai male farmworkers who were recruited to work in the United States.<sup>114</sup> In *EEOC v. Global Horizons*, the workers were promised steady, high-paying agricultural jobs and temporary work visas in exchange for high recruitment fees.<sup>115</sup> Upon arrival in the United States, however, the workers' passports were revoked and they were threatened with deportation if they reported their subsequent abuse.<sup>116</sup> Bound by their debt and lacking identification, the workers had little choice but to accept the conditions of their employment.<sup>117</sup>

The *Global Horizons* scenario is not uncommon. On the same day the EEOC also filed a complaint against Signal International, alleging abuse similar to that in *Global Horizons*.<sup>118</sup> Many of the plaintiffs in that case had taken out high interest loans and put their houses and land up as collateral to pay their recruiters' fees to come to the United States.<sup>119</sup> Significantly, the EEOC sought to hold the company, rather than the labor recruiters, responsible for the abuses.<sup>120</sup>

Using international conventions as a model for U.S. laws, enforcing workplace rights, and bringing FLSA and Title VII claims in these types of cases makes participating in this market less appealing. When employers are held accountable for their actions, they have less incentive to use trafficked labor and to subject their workers to these abuses, thus cutting off one key player in the human trafficking market. Without a buyer for the product, sellers will thus have to move to better, more lucrative markets, or else exit the market altogether.

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<sup>113</sup> Civil Rights Act of 1964, 78 Stat. § 241 (2006).

<sup>114</sup> *EEOC v. Global Horizons*, 860 F. Supp. 2d 1172 (D. Haw. 2012).

<sup>115</sup> *Id.* at 1177.

<sup>116</sup> Some workers were forced to live in rat-infested, dilapidated housing where they shared rooms with dozens of men. They were forbidden from leaving the property, endured threats and physical assaults from their supervisors, and were separated from other workers who appeared to be working in better conditions. *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> Dan Werner, *EEOC Action in Labor Trafficking Case Reinforces SPLC Claims of Abuse*, SOUTHERN POVERTY LAW CENTER (Apr. 20, 2011), <http://www.splcenter.org/get-informed/news/eec-action-in-labor-trafficking-case-reinforces-splc-claims-of-abuse>.

<sup>119</sup> *Id.*

<sup>120</sup> *Id.*

## III. RECOMMENDATIONS FOR FUTURE ANTI-TRAFFICKING LEGISLATION

As discussed above, effectively combating human trafficking requires governments and societies to increase the costs and decrease the benefits to traffickers of engaging in the activity. Efforts to combat human trafficking thus far have predominately addressed the supply side of the economic model, imposing monetary, physical, psychological, and criminal costs on traffickers for running their businesses; however, the increasing number of individuals being trafficked and low prosecution rates of traffickers throughout the world mean that costs stay low, while profits remain high. Few traffickers are deterred from entering the market, which in turn remains vibrant due to the steady supply of buyers, sellers, vulnerable individuals, and consumers.

As the incentives to enter the market continue to outweigh the costs, individuals remain vulnerable to traffickers. Victims of human trafficking continue to seek better lives following political and economic collapse in their home countries, and are increasingly vulnerable to trafficking because of ever-tightening immigration laws, improvements in technology that allow international financial transactions to be completed with ease, and improvements in transportation that allow people and goods to move from one side of the world to the other in a short amount of time. These conditions remain despite the presence of laws aimed at prosecuting traffickers, protecting victims, and preventing more individuals from becoming victims to trafficking and exploitation, suggesting that more needs to be done to address these factors to effectively stem the flow of trafficking victims into the United States.

Although the escape from poverty is a powerful push factor driving the human trafficking market, it would be unrealistic to expect the United States to ensure higher economic growth, stable political environments, fair competition, transparent state administration, and overall, to promote confidence in the opportunities available in vulnerable individuals' home countries.<sup>121</sup> Instead, the United States should focus its efforts and resources on two distinct areas of human trafficking – sex trafficking and labor trafficking — both of which are driven by demand and profits. In doing so, the United States should specifically target the demand for products in those arenas because it is the demand for slave labor that drives the illegal market in human labor, and the issue cannot be effectively addressed by solely looking at one side of the coin.<sup>122</sup>

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<sup>121</sup> Cf. Gijsbert Van Liemt, *Human Trafficking in Europe: An Economic Perspective* 24-25 (Cornell University ILR School, Working Paper No. 31, 2004).

<sup>122</sup> *The Battle Against Sex Trafficking*, *supra* note 88.

Traffickers achieve such high levels of success worldwide because they know their business and respond to market changes more quickly than even the most competitive corporations.<sup>123</sup> When one country successfully addresses human trafficking within its borders, traffickers move to a new country, as was the case with Sweden. To successfully curtail human trafficking, therefore, the issue needs to be addressed globally; otherwise, effective reductions in instances of trafficking in the United States will only result in shifting the market elsewhere. Although it would be difficult, if not impossible, to slow population growth, end world poverty, eradicate corruption, cancel international debts and ensure complete enforcement of every international and domestic law and policy against trafficking, countries can cooperate with one another to increase the costs and decrease the benefits of human trafficking.<sup>124</sup> Governments can take steps toward an agreement on one uniform definition of human trafficking that avoids the differences that can be seen, for example, between the U.N. Protocol and the TVPA definitions. In the meantime, however, the United States should focus on the situation within its own country, allowing other countries to retain their sovereignty and address the issue as they see necessary.

At the federal level, Congress should focus on decreasing the demand for trafficked individuals by regulating immigration and updating its immigration policies to address the concerns of so many individuals who feel they need to migrate illegally and thus subject themselves to the whims of traffickers. Doing so would decrease the demand for traffickers to provide the papers and funds for vulnerable individuals to come to the United States and other destination countries. Current restrictions on immigration, which push the trade underground and make trafficking difficult to uncover, have increased the demand and revenue for traffickers, and in turn, have perpetuated the cycle of human trafficking as the benefits of staying in the market continue to exceed the costs.<sup>125</sup> The federal government should also turn its efforts to prosecuting the clients of individuals trafficked into sexual exploitation, increasing the stigma associated with such crimes, and in turn decreasing the demand for trafficked individuals in the country.

At the same time, states should focus on enforcing the criminal provisions they have in place to directly combat human trafficking, and improving training programs to recognize not only victims of sex trafficking, but labor trafficking as well.<sup>126</sup> States should also focus on

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<sup>123</sup> *Trafficking and Globalization*, *supra* note 35, at 5.

<sup>124</sup> Wheaton, *supra* note 25, at 132.

<sup>125</sup> *Id.* at 135.

<sup>126</sup> Barnhardt, *supra* note 64, at 96, 132.

enforcing their immigration and labor laws across the board. This would decrease the benefits to employers of using trafficked labor. Enforcement would also indirectly decrease the benefits and increase the costs to traffickers of operating within individual states, and ultimately deter traffickers from entering the market for labor trafficking.

Specifically, to address the sex trade, the government should supplement current efforts by adopting Sweden's approach, and should start prosecuting the purchasers of the product at the federal level to increase the stigma associated with using the product. Studies have shown that crime prevention, rather than crime control and policing, is needed to combat human trafficking. Therefore, the United States should focus its efforts within the sex trade on prosecuting the clients instead of decriminalizing the industry.<sup>127</sup> As has been seen in the Netherlands and other countries that have legalized prostitution, that approach does not actually eliminate the market for human trafficking. Instead it encourages the establishment of two parallel markets: one for legalized, regulated brothels, and another for underage, trafficked girls.<sup>128</sup> Instead, focusing on prosecuting the purchasers of the goods attacks demand, which in turn reduces the incentive for traffickers to operate in the United States. With a decrease in client demand for the product, there would be a parallel decrease in employer demand for trafficked individuals. In turn, the cost to traffickers of operating within the United States would increase, making the country a less attractive market to traffickers. Further, with fewer trafficked individuals arriving in the country, there would be more resources available to prosecute traffickers and to address the needs of those individuals who are still trafficked into the country.

To combat labor trafficking, the government should allocate resources to enforcing state and federal labor and anti-discrimination laws in the workplace to increase the costs and decrease the demand for undocumented, and potentially trafficked, workers in the workplace, ensuring more jobs and better working conditions for legal workers. Lax enforcement of labor laws creates optimal conditions for absorbing undocumented immigrant workers into the United States and keeps the market for trafficked individuals alive. These workers are subject to abuse and exploitation by employers who use the workers' irregular status as a threat and a justification for poor and dangerous working conditions. Because undocumented workers are less likely to report workplace abuse, and because capital flows wherever labor is the cheapest, employers have an incentive to employ undocumented migrant workers and to exploit trafficked individuals.<sup>129</sup> Improving

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<sup>127</sup> Wheaton, *supra* note 25, at 131.

<sup>128</sup> See *The Battle Against Sex Trafficking*, *supra* note 88.

<sup>129</sup> Van Liemt, *supra* note 121, at 25.

enforcement of workplace laws and reducing the appeal of employing undocumented migrant workers would thus have a direct impact on human trafficking into the United States.

Current state approaches, like recent anti-immigrant legislation in Arizona and Alabama, are not the appropriate response to combating the increasing number of undocumented immigrants in the country. In theory, these new anti-immigrant laws drive migrant workers out of the state, and back to their country of origin. While these laws could arguably cut down on trafficking into individual states, they also encourage discrimination and racial profiling in violation of the U.S. Constitution and subsequent federal and state legislation. Instead of promoting subjective and individualized assessments of a person's legal status within the United States based on skin color and accent, states should focus on enforcing state labor and employment laws wholesale. By so doing, they would avoid violating individuals' constitutional and statutory rights, and would avoid facing the same identification and enforcement problems they are dealing with under current anti-trafficking laws. Additionally, enforcing labor laws across the board, while not directly targeting undocumented immigrants or trafficking victims, reduces the economic incentive for traffickers to bring vulnerable individuals into the United States because it ensures that all workers' workplace rights are met.<sup>130</sup> It also has a positive effect on other workers by increasing wages, and allowing citizens and documented workers to compete fairly in the marketplace. Documented workers will no longer be forced to lower their own expectations and standards just to get a job that would otherwise go to an undocumented worker whom the employer could easily exploit with few, if any, repercussions.

#### CONCLUSION

When a person is trafficked, his or her agency is limited. A majority of the efforts taken to combat human trafficking thus far have focused on restoring that agency. However, those efforts have focused primarily on impacting the supply side of the economic model. It is essential then, following the ineffectiveness of current efforts to curb trafficking in the United States, that complementary efforts be made that focus more specifically on the demand side of the economic model. By addressing both sides of the market, the government will have a greater chance of successfully interrupting the market in human labor and forcing traffickers to exit what is quickly threatening to become the most lucrative illegal business in the world.

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<sup>130</sup> *Id.* at 24-25.



# ARBITRATION AGREEMENTS THAT DISCRIMINATE IN THE SELECTION AND APPOINTMENT OF ARBITRATORS

*By Jeff Dasteel*<sup>1</sup>

## I. INTRODUCTION

In 2010, an English appellate court rocked the world of international arbitration when it declared that a provision in an arbitration agreement restricting the selection of arbitrators to members of a particular religious group violated European Union laws banning discrimination in employment.<sup>2</sup> While the case of *Jivraj v. Hashwani* was on appeal to the United Kingdom Supreme Court, there was concern in the international arbitration community that more common restrictions on the qualifications of arbitrators related to national origin might also be subject to challenge. In that regard, two major international arbitration rule sets give preference to the appointment of arbitrators who are not of the same national origin as any of the parties.<sup>3</sup> These international rule sets may have needed to change, at least when used in England, if *Jivraj v. Hashwani* had withstood appeal to the Supreme Court.

One year later, in July 2011, the world of international arbitration breathed a collective sigh of relief when the Supreme Court overruled the Court of Appeal. The Supreme Court determined that arbitrators were not “employees” as the term was defined in European Union employment laws, and, therefore, the European Union’s ban on employment discrimination on the basis of religious affiliation, national origin, or gender did not apply to the selection and appointment of an arbitrator.<sup>4</sup>

Was that collective sigh of relief warranted? This article discusses (1) whether arbitration agreements that discriminate in the selection and appointment of arbitrators may be prohibited under United States law, and (2) the possible effects of anti-discrimination

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<sup>2</sup> *Jivraj v. Hashwani*, [2010] EWCA (Civ) 712, [24], [35], [2010] ICR 1435 (Eng.).

<sup>3</sup> International Chamber of Commerce [ICC], Arbitration and ADR Rules, art. 13, ¶ 5; International Centre for Dispute Resolution, International Dispute Resolution Procedures, art. 6, ¶ 4.

<sup>4</sup> *Jivraj v. Hashwani*, [2011] UKSC 40, [23], [43] (appeal taken from Eng.).

laws on the validity and enforceability of those agreements and the arbitration awards resulting from them. This article accepts the premise that arbitrators are not “employees” of the parties as found by the United Kingdom Supreme Court. However, there are anti-discrimination laws in the United States that apply to independent contractors. Indeed, there are anti-discrimination laws in the United States that apply to all manner of contracts regardless of the character of the contracting parties’ relationship. This article concludes that arbitrators may fall within the scope of anti-discrimination laws in the United States raising the risk that arbitration agreements that include discriminatory qualifications may be invalid under the Federal Arbitration Act. Finally, this article explores the possibility that non-domestic arbitration agreements with discriminatory qualifications may also be unenforceable under both the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and Chapter 2 of the Federal Arbitration Act, both of which are applicable to non-domestic arbitrations, where a non-domestic arbitration proceeds under United States law or where a party seeks to enforce a foreign arbitral award in the United States.

## II. THE DECISIONS OF THE ENGLISH COURT OF APPEAL AND THE UNITED KINGDOM SUPREME COURT IN *JIVRAJ V. HASHWANI*

In *Jivraj v. Hashwani*, the parties to an arbitration agreement stipulated that “[a]ll arbitrators shall be respected members of the Ismaili community and holders of high office within the community.”<sup>5</sup> The agreement further provided that “[t]he arbitration shall take place in London and the arbitrators’ award shall be final and binding on both parties.”<sup>6</sup>

The underlying dispute in *Jivraj v. Hashwani* concerned a joint venture to make investments in real estate around the world.<sup>7</sup> It was a secular contract made for a secular purpose and governed by English law.<sup>8</sup> When a dispute arose between the parties, the claimant initiated arbitration and appointed a well-respected English barrister as its arbitrator, but the barrister was not a member of the Ismaili community as required by the arbitration agreement.<sup>9</sup>

The claimant contended that the religious affiliation requirement within the arbitration agreement violated European Union regulations against employment discrimination on the basis of religious

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<sup>5</sup> *Id.* ¶ 2.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* ¶¶ 2, 3.

<sup>8</sup> *Id.* ¶ 2.

<sup>9</sup> *Id.* ¶ 4.

belief.<sup>10</sup> The Court of Appeal determined that an arbitrator is an employee of the parties and that being of a particular religious affiliation was not a genuine occupational requirement for the job.<sup>11</sup> Therefore, the subject arbitration clause amounted to a refusal to employ based on religious belief in violation of European Union employment law.<sup>12</sup> The Court also determined that the religious affiliation requirement was central to the arbitration clause and could not be severed from the arbitration agreement.<sup>13</sup> The Court of Appeal, therefore, declared the whole arbitration agreement invalid and unenforceable.<sup>14</sup>

The Supreme Court reversed this decision.<sup>15</sup> The key question was whether arbitrators are “employees,” who are covered by provisions prohibiting employment discrimination, or independent contractors, who are not covered under the European Union anti-discrimination rules.<sup>16</sup> In determining that an arbitrator is not an “employee,” the Court noted, “The arbitrator is in critical respects independent of the parties. His functions and duties require him to rise above the partisan interests of the parties and not to act in, or so as to further, the particular interests of either party.”<sup>17</sup>

The Supreme Court, therefore, held that European Union and United Kingdom anti-discrimination regulations do not apply to arbitrators.<sup>18</sup> The UK Supreme Court further stated in dicta that, even if the anti-discrimination regulations did apply, the requirement that the arbitrator be Ismaili was both objectively and subjectively justified as a genuine occupational requirement.<sup>19</sup>

The Supreme Court’s ruling in *Jivraj v. Hashwani* confirmed party autonomy to set up arbitration regimes designed to satisfy the interests of the parties, even if those interests result in discrimination in the selection and appointment of arbitrators. The ruling also confirmed that arbitrator qualifications based on national origin, which are allowed under the ICC Rules of Arbitration and the ICDR Rules of Arbitration, do not violate English or European Union anti-discrimina-

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<sup>10</sup> *Jivraj v. Hashwani*, [2011] UKSC 40, [23], [43] (appeal taken from Eng.).

<sup>11</sup> *Jivraj v. Hashwani*, [2010] EWCA (Civ) 712, [13], [2010] ICR 1435 (Eng.).

<sup>12</sup> *Id.* ¶¶ 27, 30.

<sup>13</sup> *Id.* ¶ 34.

<sup>14</sup> *Id.* ¶ 35.

<sup>15</sup> *Jivraj v. Hashwani*, [2011] UKSC 40, [70], [74] (appeal taken from Eng.).

<sup>16</sup> *Id.* ¶¶ 15, 23.

<sup>17</sup> *Id.* ¶ 41.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* ¶¶ 54-59. The concurring opinion, however, casts doubt on this conclusion. Instead, it opines that someone not of the Ismaili community may be schooled in its culture and principles such that he or she could qualify as an arbitrator of disputes between individuals of that community.

tion laws. However, does the same hold true for anti-discrimination laws in the United States?

### III. DO ANTI-DISCRIMINATION LAWS IN THE UNITED STATES APPLY TO INDEPENDENT CONTRACTORS?

It is well established that discrimination in hiring employees is barred in the United States under a slew of federal and state laws, most notably Title VII of the Civil Rights Act of 1964.<sup>20</sup> However, it is equally well established that Title VII and the majority of similar laws do not apply to the selection and hiring of independent contractors, who are not considered to be “employees” under state or federal law.<sup>21</sup> For the same reasons the UK Supreme Court discussed in *Jivraj v. Hashwani*, it is almost certain that courts in the United States would declare that arbitrators are not “employees,” and, therefore, not covered by those laws that restrict themselves to banning discrimination in the selection and hiring of employees.<sup>22</sup>

However, that is not the end of the story as it was in *Jivraj v. Hashwani*. The United States has laws that ban discrimination in the hiring of independent contractors or when contracting with any person, no matter how the relationship is characterized. Most notably, Section 1981 of the Civil Rights Act of 1866 bans discrimination on the basis of race or ethnicity when entering into all manner of contracts, including when selecting and hiring independent contractors.<sup>23</sup> Furthermore, the Third Circuit recently confirmed that an independent contractor can bring an action for discrimination under Section 1981.<sup>24</sup> Other circuits similarly have found a private remedy for discrimination against independent contractors under Section 1981.<sup>25</sup> However, Section 1981 is limited to claims for discrimination based on race or

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<sup>20</sup> Civil Rights Act of 1964, 42 U.S.C. § 2000(e) (West 2012).

<sup>21</sup> *E.g.*, *Spirides v. Reinhardt*, 613 F.2d 826, 829 (D.C. Cir. 1979).

<sup>22</sup> The United States Equal Employment Opportunity Commission provides a test to determine whether an individual is an “employee” or an “independent contractor” for the purposes of anti-discrimination laws. EEOC COMPLIANCE MANUAL § 2-III, available at <http://www.eeoc.gov/policy/docs/threshold.html#2-III-A-1>. In *Nationwide Mutual Insurance Co. v. Darden*, the Supreme Court construed the question of whether an individual is an employee to turn on “the hiring party’s right to control the manner and means by which the product is accomplished.” *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 323 (1992). As the appellate court noted in *Jivraj v. Hashwani*, once appointed, the parties generally do not control the arbitrator’s method and means of carrying out his or her duties. See *Jivraj v. Hashwani*, [2010] EWCA (Civ) 712, [40], [2010] ICR 1435 (Eng.).

<sup>23</sup> The Civil Rights Act of 1866, 42 U.S.C. § 1981 (West 2012).

<sup>24</sup> *Brown v. J. Kaz, Inc.*, 581 F.3d 175 (3d Cir. 2009).

<sup>25</sup> See *Bains, LLC v. ARCO Prods. Co.*, 405 F.3d 764 (9th Cir. 2005); *Carey v. FedEx Ground Package Syst., Inc.*, 321 F. Supp. 2d 902 (S.D. Ohio 2004); *Danco*,

ethnicity and does not apply to discrimination based on gender, national origin, religion, age, or disability.<sup>26</sup>

There also are state and municipal laws that ban discrimination when contracting with or hiring independent contractors. Some of these laws are quite expansive, covering many forms of discrimination, including those based on race, ethnicity, gender, national origin, religion, age, and disability. For example, New Jersey appellate courts have found that the state's ban on discrimination in contracting based on race, creed, color, national origin, ancestry, age, and sex applies to contracts that employ independent contractors.<sup>27</sup> Like Section 1981, the New Jersey statute appears to apply to any contract.<sup>28</sup> Therefore, it does not matter how the contracting party is characterized, whether as an employee or an independent contractor, and it is a violation of New Jersey law to discriminate on the basis of race, ethnicity, gender, religious affiliation, or national origin when contracting with anyone.<sup>29</sup>

In addition to New Jersey's very broad ban on discrimination, there are other jurisdictions with laws banning discrimination in the hiring of independent contractors. Pennsylvania has a broad anti-discrimination statute that applies to independent contractors who are required to get professional licenses under Pennsylvania law.<sup>30</sup> The New York City municipal code also prohibits discrimination in the employment of independent contractors as part of the New York City Human Rights Law.<sup>31</sup>

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Inc. v. Wal-Mart Stores, 178 F.3d 8 (1st Cir. 1999); *Zaklama v. Mt. Sinai Med. Ctr.*, 842 F.2d 291 (11th Cir. 1988).

<sup>26</sup> See *Zemsky v. City of New York*, 821 F.2d 148, 150 (2d Cir. 1987) ("A plaintiff states a viable cause of action under §§ 1981 or 1982 only by alleging a deprivation of his rights on account of his race, ancestry, or ethnic characteristics."). Some courts have extended § 1981 to include what may be discrimination based on national origin. See Danielle Tarantolo, *From Employment to Contract: Section 1981 and Antidiscrimination Law for the Independent Contractor Workforce*, 116 YALE L.J. 170, 193 n.139 (2006).

<sup>27</sup> See *J.T.'s Tire Serv., Inc. v. United Rentals N. Am.*, 985 A.2d 211 (N.J. Super. Ct. App. Div. 2010); *Perlowski v. Elson T. Killam Assoc.*, 894 A.2d 1251 (N.J. Super. Ct. 2005); *Rubin v. Forest S. Chilton Mem'l Hosp.*, 819 A.2d 22 (N.J. Super. Ct. App. Div. 2003).

<sup>28</sup> N.J. STAT. ANN § 10:5-12 (West 2008).

<sup>29</sup> *Id.*

<sup>30</sup> 43 PA. CONS. STAT. § 955 (2012).

<sup>31</sup> N.Y.C. ADMIN. CODE tit. 8 §§ 101–131 (2012). Although not free from doubt, as discussed below, § 8-102(5) appears to make the New York City law banning discrimination in employment specifically applicable to independent contractors who are not themselves employers. As a municipal law, its terms do not apply outside New York City, and there is no New York State law of comparable scope applicable to independent contractors.

#### IV. APPLICATION OF ANTI-DISCRIMINATION STATUTES TO ARBITRATORS

In principle, there is no reason why the federal, state, and municipal laws banning discrimination when contracting with independent contractors should not apply to the selection and appointment of arbitrators. Therefore, Section 1981, within its limits, and state and municipal statutes prohibiting discrimination in the hiring of independent contractors should apply equally to the selection and appointment of arbitrators.<sup>32</sup>

The idea that an arbitrator should be treated as an independent contractor is not free from doubt. The concurring opinion in *Jivraj v. Hashwani* adopts noted commentator Gary Born's characterization of the relationship of the arbitrator to the parties as "sui generis."<sup>33</sup> In a world where a party contracting to perform services is either an employee or an independent contractor, it is proposed that an arbitrator is neither fish nor fowl due to the arbitrator's independent adjudicative, quasi-judicial responsibilities.

A third, exempt category for arbitrators is difficult to justify in the context of anti-discrimination laws. Arbitrators are hired to perform a service on behalf of the parties to an arbitration agreement. The arbitrator is under contract to do so and receives payment to perform work within the scope of the arbitration agreement.<sup>34</sup> Although a party has no unilateral right to order the arbitrator to decide an issue in a particular manner, the parties have the autonomy to jointly agree to terminate the arbitration process and the arbitrator's services at any time.<sup>35</sup> Thus, the parties jointly retain the power to hire and fire the arbitrator. They also can void any arbitrator decision by mutual agreement.<sup>36</sup> In other words, the parties jointly retain control over the arbitrator even if each party individually lacks such power due to the

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<sup>32</sup> The limitations on the scope of 42 U.S.C. § 1981 probably make it of limited practical application to arbitration agreements, as there are very few examples of arbitration agreements that mandate that the arbitrators be of one "race" or "ethnicity" or another. Certainly, none of the major arbitration rule sets base arbitrator appointments on race or ethnicity. It is much more common to see arbitration agreements that restrict arbitrators to a particular religious affiliation or declare a preference regarding national origin (i.e., the arbitrator should not be of the same national origin as any of the parties to the arbitration agreement). As noted above, however, there may be some basis to argue that Section 1981 extends to forms of national origin discrimination (e.g., where national origin and ethnicity are considered to be synonymous).

<sup>33</sup> *Jivraj v. Hashwani*, [2011] UKSC 40, [77] (citing 1 GARY B. BORN, INTERNATIONAL COMMERCIAL ARBITRATION 1607-09 (2009)).

<sup>34</sup> *See, e.g., id.* at [40]-[41].

<sup>35</sup> *See, e.g., id.* at [42].

<sup>36</sup> *See, e.g., id.*

contractual nature of the arbitration process.<sup>37</sup> In the context of contracting, therefore, a third category other than employee or independent contractor does not appear warranted for arbitrators.

The distinctions between “employee,” “independent contractor,” and a “sui generis” arbitrator-party relationship probably do not matter for application of Section 1981 and its New Jersey analogue because those statutes ban discrimination in contracting with any party, no matter how the relationship is characterized.<sup>38</sup> There is little doubt that the parties at least have a contractual relationship with the arbitrator either directly or through an administrative body hired by the parties to administer the arbitration. The categorization of the relationship as “sui generis,” however, may carry more force in regards to laws like the New York City Human Rights Law, whose application depends on the characterization of the arbitrator as either an employee or an independent contractor hired to further the employer’s business.

## V. QUALIFICATION RESTRICTIONS IN AD HOC ARBITRATION AGREEMENTS

Suppose an ad hoc arbitration agreement<sup>39</sup> has a provision similar to that at issue in *Jivraj v. Hashwani*, but it calls for arbitration in New York City under the laws of the United States instead of arbitration in England.<sup>40</sup> This hypothetical arbitration agreement requires that all arbitrators shall be respected members of a particular religious community and holders of high office within that community. The arbitration’s purpose is to resolve secular disputes arising out of a real estate development agreement between a real estate developer and a construction manager, both of whom are parties to the arbitra-

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<sup>37</sup> *Id.*

<sup>38</sup> The Civil Rights Act of 1866, 42 U.S.C. § 1981 (West 2012); N.J. STAT. ANN § 10:5-12 (West 2008).

<sup>39</sup> An “ad hoc” arbitration agreement is an agreement where there is no third party administrator, such as the American Arbitration Association, tasked with administering the selection and appointment of arbitrators. Domestic courts resolve disputes that arise in the selection of arbitrators under ad hoc arbitration agreements. RESTATEMENT (THIRD) OF THE U.S. LAW OF INTERNATIONAL COMMERCIAL ARBITRATION ch. 1, n.c (Tentative Draft No. 2, 2012).

<sup>40</sup> Had the hypothetical concerned an arbitration agreement under the laws of the state of New Jersey, there could be little dispute that, unless the parties could establish a bona fide occupational requirement, discrimination in the selection and appointment of an arbitrator would violate New Jersey law. Similarly, if the hypothetical arbitration agreement concerned discrimination based on ethnicity or race, the agreement would violate federal law under Section 1981 unless the parties could establish the restriction as a bona fide occupational requirement. See *Jivraj v. Hashwani*, [2010] EWCA (civ) 712, [24], [35].

tion agreement. Would such an agreement violate either United States federal law or New York City's Human Rights Law?

As discussed above, United States federal law banning discrimination in the workplace under Title VII applies only to "employees."<sup>41</sup> Although there may be a dispute as to whether an arbitrator is an independent contractor, there should be little dispute that an arbitrator is not an "employee" of the parties. Accordingly, Title VII's proscription against discrimination on the basis of religion will not apply.<sup>42</sup> Section 1981 does apply to all manner of contracts including those with arbitrators, but it is limited to discrimination based on race, color, and ethnicity.<sup>43</sup> Had the hypothetical arbitration agreement limited arbitrators to "white citizens" there would be little doubt that the arbitration agreement would prima facie violate United States federal law. This hypothetical, however, concerns discrimination on the basis of religion and, therefore, falls outside the scope of Section 1981.

Discrimination on the basis of religion does fall within the scope of the New York City Human Rights Law.<sup>44</sup> Section 8.107(1) of the New York City Human Rights Law provides that:

It shall be an unlawful discriminatory practice:

(a) For an employer or an employee or agent thereof, because of the actual or perceived age, race, creed, color, national origin, gender, disability, marital status, partnership status, sexual orientation or alienage or citizenship status of any person, to refuse to hire or employ or to bar or to discharge from employment such person or to discriminate against such person in compensation or in terms, conditions or privileges of employment.<sup>45</sup>

Whether this proscription extends to arbitrators acting as independent contractors depends on the definition of "employer," "any person," and "employ."

Section 8.102(5) of the New York City Human Rights Act provides that:

For purposes of subdivisions one, two, and three of section 8-107 and section 8-107.1 of this chapter the term "employer" does not include any employer with fewer than four persons in his or her employ. *For purposes of*

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<sup>41</sup> See Jivraj, *supra* note 22.

<sup>42</sup> *Id.*

<sup>43</sup> Civil Rights Act of 1964, 42 U.S.C. § 1981(a) (West 2012).

<sup>44</sup> The scope of the New York City Human Rights Law is such that the hypothetical could consider race, ethnicity, national origin, gender, sexual orientation, age, disability, and other protected classes. N.Y.C., N.Y., ADMIN. CODE § 8.107 (2012).

<sup>45</sup> *Id.*

*this subdivision, natural persons employed as independent contractors to carry out work in furtherance of an employer's business enterprise who are not themselves employers shall be counted as persons in the employ of such employer.* <sup>46</sup>

This section appears to capture within its terms any employer with at least four persons in its employ, including natural persons employed as independent contractors.

There may be a question as to whether an arbitrator as an “independent contractor” is employed “to carry out work in furtherance of an employer’s business enterprise.” In the hypothetical, the arbitrator has been hired to resolve disputes arising out of the conduct of a secular real estate development business. So long as either the real estate developer or the construction manager in the hypothetical employs at least four persons including independent contractors, at least one of the parties to the arbitration agreement should qualify as an “employer.”<sup>47</sup> Acting as an arbitrator to resolve disputes arising out of an employer’s business enterprise, however, may not be considered “work in furtherance of an employer’s business enterprise.” In the Supreme Court’s analysis in *Jivraj v. Hashwani*, an arbitrator has no partisan interest and, therefore, does not act in the specific interests of either party.<sup>48</sup> The characterization of the arbitrator’s relationship to the parties as *sui generis* due to the adjudicative, quasi-judicial nature of the position also supports exclusion from the New York City Human Rights Law.

It could also be argued that an arbitrator is no different from, for example, an appraiser hired by buyers and seller, or buyers and lending institutions, to give an independent valuation of property. There is little doubt that the appraiser would be considered an independent contractor hired to further the collective business interests of the parties. The idea that an arbitrator is a special class of independent contractor, which is exempt from the laws relating to all other independent contractors, is a narrow interpretation of what it means to “work in furtherance of an employer’s business enterprise.” Courts that do not believe arbitrators should be beneficiaries of anti-discrimination laws, however, could adopt this idea. On the other hand, it is at least equally as likely that a court would find that arbitration agreements are made for the joint benefit of the parties to the agreement

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<sup>46</sup> N.Y.C., N.Y., ADMIN. CODE § 8.102 (2012).

<sup>47</sup> The question of whether all persons employed by the employer must be employed within the confines of New York City is unclear, but the administrative code implies that may be the case. See N.Y.C., N.Y., ADMIN. CODE § 8.123 (2012).

<sup>48</sup> *Jivraj v. Hashwani*, [2011] UKSC 40, [41] (appeal taken from Eng.).

and are, therefore, created in furtherance of the parties' business enterprises.

The final question of coverage under the New York City Human Rights Law is whether the discriminatory arbitrator qualification requirement amounts to a refusal "to *hire or employ* or to bar or to discharge from employment such *person* or to discriminate against such *person* in compensation or in terms, conditions or privileges of employment (emphasis added)."<sup>49</sup> The use of the term "person" in this section of the Act applies to any "natural person."<sup>50</sup> The use of the term "hire or employ" customarily refers to "employees"; however, the second clause in Section 8.102(5), as quoted above, indicates a clear intent to include independent contractors within the definition of "employ."<sup>51</sup>

One possible interpretation of Section 8.102(5)'s use of the term "employ" to include independent contractors is that the statute's drafters only intended to include independent contractors for two purposes. The first purpose was determining whether a party was an "employer" based on the number of employees and independent contractors employed. The second was to determine employer liability for the acts of an independent contractor employed "to carry out work in furtherance of an employer's business enterprise."<sup>52</sup> When interpreting the New York Human Rights Law, however, courts are required to give the law

. . . an independent liberal construction analysis in all circumstances, even where state and federal civil rights laws have comparable language. The independent analysis must be targeted to understanding and fulfilling what the statute characterizes as the City [Human Rights Law's] 'uniquely broad and remedial' purposes, which go beyond those of counterpart state or federal civil rights laws. . . . In short, the text and legislative history represent a desire that the City [Human Rights Law] 'meld the broadest vision of social justice with the strongest law enforcement deterrent. [w]hether or not that desire is wise as a matter of legislative policy . . . .'<sup>53</sup>

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<sup>49</sup> N.Y.C., N.Y. ADMIN. CODE § 8-107(1) (2012).

<sup>50</sup> N.Y.C., N.Y. ADMIN. CODE § 8-102(1) (2012).

<sup>51</sup> N.Y.C., N.Y. ADMIN. CODE § 8-102(5) (2012).

<sup>52</sup> *Id.*

<sup>53</sup> *Williams v. N.Y.C. Hous. Auth.*, 61 A.D.3d 62, 66, 69 (N.Y. App. Div. 2009); see also Craig Gurian, *A Return to Eyes on the Prize: Litigating under the Restored New York City Human Rights Law*, 33 FORDHAM URB. L.J. 255, 288 (2005); Rep. of the Legal Div., Comm. on General Welfare, 1991 Amendments to the N.Y.C. Human Rights Law, available at <http://antibiaslaw.com/sites/default/files/files/LL39CommitteeReport.pdf>; Local Civil Rights Restoration Act of 2005, 2012 N.Y. Legal Advance Serv. (N.Y. Legal Publ'g Corp.) No. 85 (2005) ("It is the sense of the

Accordingly, though not free from doubt, an arbitrator hired by a covered business enterprise to resolve a dispute regarding the conduct of that enterprise may fall within the protections of the New York City Human Rights Law.

Once covered by the New York City Human Rights Law, the question is whether the provision in the hypothetical requiring the arbitrator to be of a particular religious affiliation is a bona fide occupational requirement. The Supreme Court held in *Jivraj v. Hashwani* that the religious requirement in that particular arbitration agreement was a bona fide occupational requirement. It is uncertain whether a court in the United States would arrive at the same result given the strict scrutiny usually applied to discriminatory qualifications.<sup>54</sup>

In the end, there are defenses to applying the New York Human Rights Law to arbitrators including issues of how to apply the definitions under the Law, and whether such restrictions on arbitrators' qualifications are bona fide occupational requirements. There is a substantial risk, however, that a court considering this hypothetical would determine that the religious affiliation requirement included in the arbitration agreement would violate the New York City Human Rights Law.

## VI. RESTRICTIONS ON ARBITRATOR QUALIFICATIONS IN AN ADMINISTERED ARBITRATION RULE SET

The above hypothetical concerned an ad hoc arbitration agreement. Suppose the same parties entered into a standard form arbitration agreement calling for the selection and appointment of an arbitrator under the International Chamber of Commerce Rules of Arbitration under the administration of the ICC's International Court of Arbitration. Under those rules, there is a preference for selection of an arbitrator who is not of the same nationality as any of the parties.

Article 13(5) of the ICC Arbitration Rules provides that:

The sole arbitrator or the president of the arbitral tribunal shall be of a nationality other than those of the parties. However, in suitable circumstances and provided

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Council that New York City's Human Rights Law has been construed too narrowly to ensure protection of the civil rights of all persons covered by the law.”).

<sup>54</sup> EEOC Decision No. 915.003, Directives Transmittal (2008) (providing that “Title VII permits employers to hire and employ employees on the basis of religion if religion is “a bona fide occupational qualification [“BFOQ”] reasonably necessary to the normal operation of that particular business or enterprise. It is well settled that for employers that are not religious organizations and therefore seek to rely on the BFOQ defense to justify a religious preference, the defense is a narrow one and can rarely be successfully invoked.”).

that none of the parties objects within the time limit fixed by the Court, the sole arbitrator or the president of the arbitral tribunal may be chosen from a country of which any of the parties is a national.<sup>55</sup>

This preference, based on the national origin of the arbitrator, raises the question of whether the ICC's standard arbitrator selection process runs afoul of the New York City Human Rights Law.<sup>56</sup> The question is not idle because New York City is a major center for arbitration both domestic and international. Indeed, the ICC has a regional office located in New York City and administers cases in that office.<sup>57</sup>

When parties designate a set of rules in their arbitration agreement, they are deemed to incorporate those rules in the arbitration agreement as though fully set forth in the agreement.<sup>58</sup> In that respect, the restrictions on national origin found in the arbitration rules are deemed to be restrictions imposed by the parties unless the parties provide otherwise. After all, it is customary to allow parties to override certain rules and procedures by agreement so that such rules do not apply to a particular arbitration agreement.<sup>59</sup>

The parties in this hypothetical could mutually agree to countermand the provision in ICC Rule 13(5) by mandating that an arbitrator appointed by the International Court of Arbitration could be of any nationality regardless of the nationalities of the parties. Failure to countermand the national origin qualification in ICC Rule 13(5) is considered adoption of the rule by the parties with the national origin restriction intact.<sup>60</sup> The International Court of Arbitration acts on behalf of the parties when applying its rules to the selection of an arbitrator.

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<sup>55</sup> International Chamber of Commerce Arbitration & ADR Rules, art. 13, ¶ 5, available at [http://www.iccwbo.org/products-and-services/arbitration-and-adr/arbitration/icc-rules-of-arbitration/#article\\_1](http://www.iccwbo.org/products-and-services/arbitration-and-adr/arbitration/icc-rules-of-arbitration/#article_1).

<sup>56</sup> Although independent contractors are covered under § 1981, because that section is limited to discrimination based on race or ethnicity, the national origin provisions of the ICC Rules would not be covered except in cases where national origin and religious affiliation are considered synonymous. See CIVIL RIGHTS ACT OF 1964, 42 U.S.C. § 1981.

<sup>57</sup> INT'L CHAMBER OF COMMERCE, available at <http://www.iccwbo.org/products-and-services/arbitration-and-adr/appointing-authority/contact-us/> (last visited Aug. 20, 2012).

<sup>58</sup> See, e.g., International Chamber of Commerce Arbitration & ADR Rules, art. 6, ¶¶ 1-2, available at [http://www.iccwbo.org/products-and-services/arbitration-and-adr/arbitration/icc-rules-of-arbitration/#article\\_1](http://www.iccwbo.org/products-and-services/arbitration-and-adr/arbitration/icc-rules-of-arbitration/#article_1)

<sup>59</sup> See, e.g., *Jivraj v. Hashwani*, UKSC at [42].

<sup>60</sup> See International Chamber of Commerce Arbitration & ADR Rules, art.13, ¶ 5.

The proscriptions in the New York City Human Rights Act apply equally to the “employer” and its “agent.”<sup>61</sup>

Otherwise assuming coverage under the New York City Human Rights Law, the defense to the national origin requirement must be that it is a bona fide occupational qualification.<sup>62</sup> The rationale behind the ICC Rule regarding national origin is to preserve the appearance of fairness and lack of bias in international arbitration. Where the parties are of different nationalities there is a greater appearance of neutrality if the sole arbitrator or the chair of a three-person tribunal is not of the same nationality as any one of the parties.

The ICC Rules expressly require that all arbitrators, whether party appointed or not, “must be and remain impartial and independent of the parties involved in the arbitration.”<sup>63</sup> At the same time, the ICC Rules do not prohibit party appointed arbitrators, even the sole arbitrator or chair of the tribunal, from being of the same nationality as one or more of the parties.<sup>64</sup> Even if one party objects to the appointment of a party appointed arbitrator on the ground that he or she is of the same nationality as the appointing party, the ICC Court will not consider that alone as grounds for disqualification.<sup>65</sup> The International Court of Arbitration must, therefore, believe that an arbitrator of the same nationality as one or more of the parties or their counsel has the capacity, indeed the obligation, to act independently and impartially.

The question then becomes whether the appearance of neutrality gained by ICC Rule 13(5) over the impartiality and independence requirements in ICC Rule 11(1) sufficiently justifies discrimination in the selection and appointment of arbitrators on the basis of national origin. It is unknown how a court would rule on this issue but, as with the hypothetical concerning ad hoc arbitrations, there is, at minimum, a risk that a United States court would not sustain a bona fide occupational qualification defense to the national origin occupational requirement.

## VII. RESTRICTIONS ON ARBITRATOR QUALIFICATIONS WHEN USING A ROSTER OF ARBITRATORS

One final tweak to the hypothetical is to have the parties insert a rule set into their arbitration agreement that relies on an administrative body to select arbitrators from its own roster of approved arbitrators. An example of this type of rule set is the International Rules

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<sup>61</sup> N.Y.C., N.Y. ADMIN. CODE § 8-107(1) (2012).

<sup>62</sup> *See, e.g.*, *Jivraj v. Hashwani*, [2011] UKSC 40, [7] (appeal taken from Eng.).

<sup>63</sup> International Chamber of Commerce Arbitration & ADR Rules, art. 11, ¶ 1.

<sup>64</sup> *Id.* at art. 13, ¶ 5.

<sup>65</sup> *Id.*

and Procedures of the International Center for Dispute Resolution (ICDR), the international arm of the American Arbitration Association.<sup>66</sup> The ICDR Rules provide that, “[a]t the request of any party or on its own initiative, the administrator may appoint nationals of a country other than that of any of the parties,”<sup>67</sup> and thus insert consideration of an arbitrator’s national origin into the arbitrator appointment equation. This provision would be implemented by having the ICDR prepare a list of potential arbitrators for consideration by the parties, but excluding otherwise qualified candidates from ICDR’s roster of arbitrators who are of the same nationality as a party.

Although generally the same analysis would apply as to the above versions of the hypothetical, the use of an arbitration service to engage in the selection of an arbitrator from its own roster of potential arbitrators presents an additional issue. Does the ICDR constitute an “employment agency” under the New York City Human Rights Law and therefore itself become subject to the anti-discrimination requirements in Section 8.107(1)(b) of the Act concerning employment agencies? An employment agency is defined as “any person undertaking to procure employees or opportunities to work.”<sup>68</sup> “Person” includes “one or more, natural persons, proprietorships, partnerships, associations, group associations, organizations, governmental bodies or agencies, corporations, legal representatives, trustees, trustees in bankruptcy, or receivers.”<sup>69</sup> The ICDR may be considered an employment agency under the terms of the Act simply by providing a roster of arbitrators for employment by disputants.

Section 107(1)(b) prohibits an employment agency from discriminating when considering applications for its services or when referring applicants to an employer.<sup>70</sup> Accordingly, assuming jurisdictional and definitional requirements are met, there is a real possibility that restricting the roster of potential arbitrators based on national origin violates the New York City Human Rights Law. As above, there

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<sup>66</sup> As with the ICC Rules, the question regarding ICDR’s rules is not an idle one like the ICC. The ICDR has a regional office in New York City. See INT’L CTR. FOR DISPUTE RESOLUTION, available at <http://www.adr.org/aaa/faces/oracle/webcenter/portalapp/pages/contactUs> (last visited Aug. 20, 2012).

<sup>67</sup> INTERNATIONAL CENTER FOR DISPUTE RESOLUTION, INTERNATIONAL DISPUTE RESOLUTION PROCEDURES, art. 6, ¶ 4 (June 1, 2009), available at [http://www.adr.org/aaa/faces/aoe/icdr/i\\_search/i\\_rule/i\\_rule\\_detail?doc=ADRSTG\\_002008&\\_afLoop=386827565043905&\\_afWindowMode=0&\\_afWindowId=14wxizc1jy\\_263#%40%3F\\_afWindowId%3D14wxizc1jy\\_263%26\\_afLoop%3D386827565043905%26doc%3DADRSTG\\_002008%26\\_afWindowMode%3D0%26\\_adf.ctrl-state%3D14wxizc1jy\\_319](http://www.adr.org/aaa/faces/aoe/icdr/i_search/i_rule/i_rule_detail?doc=ADRSTG_002008&_afLoop=386827565043905&_afWindowMode=0&_afWindowId=14wxizc1jy_263#%40%3F_afWindowId%3D14wxizc1jy_263%26_afLoop%3D386827565043905%26doc%3DADRSTG_002008%26_afWindowMode%3D0%26_adf.ctrl-state%3D14wxizc1jy_319).

<sup>68</sup> N.Y.C., N.Y. ADMIN. CODE §8-102(2) (2012).

<sup>69</sup> *Id.* § 8-102(1).

<sup>70</sup> *Id.* § 8-107(1)(b).

is then a question of whether national origin is a bona fide occupational consideration for arbitrators acting under the ICDR Rules.

#### VIII. VALIDITY OF ARBITRATION AGREEMENTS THAT VIOLATE U.S. ANTI-DISCRIMINATION LAWS

The above hypotheticals make two points. First, it is very possible that arbitrators are protected from discrimination in their selection and appointment by state and federal laws to the extent those statutes apply to independent contractors. Second, administrative bodies handling the selection and appointment of arbitrators may also be subject to laws prohibiting discrimination in the selection and appointment of arbitrators. These two conclusions, however, do not completely define the scope of risk associated with application of the anti-discrimination laws to arbitration agreements. Arbitration agreements that run afoul of anti-discrimination laws may be invalid and unenforceable under applicable law.

##### A. *Domestic Arbitration Agreements*

The Federal Arbitration Act governs the recognition and enforcement of arbitration agreements in the United States.<sup>71</sup> Chapter 1 of the Federal Arbitration Act concerns domestic arbitrations.<sup>72</sup> It mandates the recognition and enforcement of arbitration agreements “save upon such grounds as exist at law or in equity for the revocation of any contract.”<sup>73</sup> The United States Supreme Court has interpreted this clause to mean that an arbitration agreement might be unenforceable if the provisions of the agreement violate state or federal laws that are generally applicable to contracts rather than laws specific to arbitration agreements.<sup>74</sup> Such laws would include those that prohibit discrimination in the making of contracts with independent contractors.<sup>75</sup> Accordingly, it is likely that the subject agreement to arbitrate would not be enforceable under the Federal Arbitration Act (FAA), at least as originally written by the parties, if a court found that an arbitration agreement violated the laws prohibiting discrimination against independent contractors.

If a court determines that an arbitration agreement violates laws banning discrimination in the selection and appointment of arbi-

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<sup>71</sup> See *AT&T Mobility, LLC v. Concepcion*, 131 S. Ct. 1740, 1747 (2011) (citing *Preston v. Ferrer*, 522 U.S. 346, 353 (2008) (stating that the provisions of the Federal Arbitration Act preempt state laws that act as obstacles to the purposes of the Act)).

<sup>72</sup> See 9 U.S.C. §§ 1-16.

<sup>73</sup> *Id.* § 2.

<sup>74</sup> *AT&T Mobility, LLC*, 131 S. Ct. at 1746.

<sup>75</sup> *Id.*

trators, it faces the choice of whether to void the arbitration agreement as a whole or to uphold the agreement and remove the offending clause.<sup>76</sup> Thus, if an arbitrator qualification violates state or federal anti-discrimination laws, a court might opt to use its powers to appoint an arbitrator under Section 5 of the FAA and “blue pencil” the offending clause.<sup>77</sup> The decision whether to blue-pencil an arbitration agreement is generally made by a case-by-case inquiry as to whether the offending provision is essential to the purposes of the agreement to arbitrate.

*B. Non-Domestic Arbitration Agreements Subject to the Laws of the United States*

So far the hypotheticals in this article have assumed that the arbitration agreements were subject to United States laws applicable to domestic arbitrations. Now change the facts of the hypothetical so that it qualifies as a “non-domestic” arbitration agreement where the parties have agreed that the seat of the arbitration shall be in New York City.

Chapter 2 of the Federal Arbitration Act concerns the recognition and enforcement of non-domestic arbitrations under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.<sup>78</sup> FAA Chapter 2, Section 208 provides, “Chapter 1 applies to actions and proceedings brought under this chapter to the extent that chapter is not in conflict with this chapter or the Convention as ratified by the United States.”<sup>79</sup> Accordingly, the provisions of FAA Chapter 1 relating to domestic arbitrations also apply to non-domestic arbitrations under certain circumstances.<sup>80</sup>

Under Article V, Section 1(e) of the New York Convention, the country where arbitration takes place, or under whose laws arbitration is conducted, has supervisory authority over the conduct of the arbitration.<sup>81</sup> Thus, non-domestic arbitrations held in the United States fall under the provisions applicable to domestic arbitrations under the Federal Arbitration Act for the purposes of vacating or enforcing arbitration awards under FAA Chapter 1.<sup>82</sup>

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<sup>76</sup> See, e.g., *Rent-a-Center, West, Inc. v. Jackson*, 130 S. Ct. 2772, 2778 (2010).

<sup>77</sup> See 9 U.S.C. § 5.

<sup>78</sup> See 9 U.S.C. §§ 201-08.

<sup>79</sup> 9 U.S.C. § 208.

<sup>80</sup> *Id.*

<sup>81</sup> See Convention on the Recognition & Enforcement of Foreign Arbitral Awards, art. 5, § 1(e), 330 U.N.T.S. 38 (June 7, 1959) [hereinafter *New York Convention*].

<sup>82</sup> See *Yusuf Ahmed Alghanim & Sons, W.L.L., v. Toys “R” Us, Inc.*, 126 F.3d 15, 20 (2d Cir. 1997).

The New York Convention further provides that an arbitration award may not be enforced if the “agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made.”<sup>83</sup> Therefore, if an arbitration agreement is invalid under United States law but is still subject to the laws of the United States, then an arbitration award arising out of such an agreement may also be unenforceable in the United States or in another country. Therefore, Section 2 of the Federal Arbitration Act regarding the validity of domestic arbitration agreements applies equally to non-domestic arbitration agreements where the seat is in the United States or where the arbitration agreement is governed by United States law.<sup>84</sup>

As with domestic arbitrations, it is unknown how a court would rule on this hypothetical with regard to application of a municipal law like the New York City Human Rights Law. However, if a court were to determine that the facts in the hypothetical violated the New York City Human Rights Law and, therefore, made the arbitration agreement unenforceable as written, that same conclusion likely would apply equally to domestic arbitrations and non-domestic arbitrations where the seat of the arbitration is in New York City.<sup>85</sup>

### *C. Enforcement of Non-Domestic Arbitration Awards Made Outside the United States*

Finally, modify the hypothetical to consider the possible outcome for an arbitration agreement substantially identical to the one in *Jivraj v. Hashwani*. That is, the arbitration agreement concerns a secular, commercial dispute requiring that all arbitrators be members of a particular religion and that the arbitration take place in England. What would happen if one of the parties to that arbitration attempted to enforce the arbitration award in the United States? Could a United States court rely on an applicable anti-discrimination statute at the forum of enforcement to refuse to enforce the award?

The provisions of Federal Arbitration Act Chapter 2 apply when determining whether a court will enforce the award since it is an arbitration award issued outside the United States. Under FAA Chapter 2, Section 207,

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<sup>83</sup> Convention on the Recognition & Enforcement of Foreign Arbitral Awards, *supra* note 81, at art. 5, § 1(a).

<sup>84</sup> See *Yusef Ahment Alghanim & Sons, W.L.L.*, 126 F.3d at 19.

<sup>85</sup> Federal arbitration law as implemented in the Federal Arbitration Act does not preempt state or local law unless the state or local law acts to obstruct the purposes of the FAA. Although the case law on this issue distinguishes between federal and state law, the same rule applies to a potential conflict between federal and municipal law. See *AT&T Mobility, LLC*, *supra* note 71.

The court shall confirm the award unless it finds one of the grounds for refusal or deferral of recognition or enforcement of the award specified in the said Convention.<sup>86</sup>

The grounds specified in the Convention are considered the exclusive grounds on which a court may refuse to confirm a foreign arbitral award covered by Chapter 2 of the Federal Arbitration Act.<sup>87</sup> Accordingly, the question is whether there are any grounds under the New York Convention to refuse enforcement of the hypothetical award.

All New York Convention grounds for refusal to enforce a foreign arbitral award appear in Article V. First, it is clear that Article V.1(a) does not apply. That provision permits refusal to enforce an arbitration agreement where:

said [arbitration] agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made.<sup>88</sup>

Under the hypothetical, although the arbitration agreement might be invalid had it been made in New York City, the arbitration agreement would be valid under the laws where it was made. Based on the outcome of *Jivraj v. Hashwani*, the hypothetical arbitration agreement is valid in England where the award was made and under whose law the arbitration agreement was made.

New York Convention Article V.1(d), concerning the composition of the arbitral tribunal, also does not apply to this hypothetical. That provision provides that recognition and enforcement may be refused where:

The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place.<sup>89</sup>

In the hypothetical, the arbitral tribunal's composition is in accordance with the arbitration agreement, and that agreement is in accord with the laws of England, where the hypothetical arbitration took

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<sup>86</sup> 9 U.S.C. § 207 (West 2012).

<sup>87</sup> See *Yusuf Ahmed Alghanim & Sons, supra* note 82; *Int'l Standard Elec. Corp. v. Bidas Sociedad Anonima Petrolera, Indus. y Comercial*, 745 F. Supp. 172, 181-82 (S.D.N.Y. 1990); *Int'l Trading & Indus. Inv. Co. v. Dyncorp Aero. Tech.*, 763 F. Supp. 2d 12, 19-20 (D.C. Cir. 2011).

<sup>88</sup> New York Convention, *supra* note 81, at art. V, § 1(d).

<sup>89</sup> *Id.*

place. None of the other grounds under Article V.1 of the New York Convention apply to this hypothetical.

The only further potential ground for refusal to enforce the hypothetical arbitration award is found in Article V.2(b):

Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

\* \* \* (b) The recognition or enforcement of the award would be contrary to the public policy of that country.<sup>90</sup>

The question for Article V.2(b), therefore, is whether an arbitration agreement that is legal where made but that violates anti-discrimination laws in the United States can be enforced in the United States, or whether it is barred as a matter of public policy.

The public policy exception is narrowly construed.<sup>91</sup> In *Parsons & Whittemore Overseas Co. v. Societe Generale de L'Industrie du Papier*, the United States Court of Appeals for the Second Circuit held that the public-policy defense should be narrowly construed lest it become a "major loophole in the [New York] Convention's mechanism for enforcement."<sup>92</sup> Therefore, "[e]nforcement of foreign arbitral awards may be denied . . . only where enforcement would violate the forum state's most basic notions of morality and justice."<sup>93</sup>

The public policy "must be well defined and dominant."<sup>94</sup> Furthermore, the public-policy defense "must be construed in light of the overriding purpose of the [New York] Convention, which is 'to encourage the recognition and enforcement of commercial arbitration agreements in international contracts and to unify the standards by which agreements to arbitrate are observed and arbitral awards are enforced in the signatory countries.'"<sup>95</sup>

A party urging a court to refuse enforcement under the public policy exception would have to argue that the enforcement of an arbitral award violates public policy because the manner of selecting the arbitrators would violate United States anti-discrimination laws and

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<sup>90</sup> *Id.* at art. V, §2.

<sup>91</sup> See *Europcar Italia, S.P.A v. Maiellano Tours, Inc.*, 156 F.3d 310, 315 (2d Cir. 1998); *M & C Corp. v. Erwin Behr GMBH & Co., KG*, 87 F.3d 844, 851 (6th Cir. 1996); *Parsons & Whittemore Overseas Co. v. Societe Generale de L'Industrie du Papier (RAKTA)*, 508 F.2d 969, 973 (2d Cir. 1974).

<sup>92</sup> *Parsons & Whittemore Overseas Co.*, 508 F.2d at 974.

<sup>93</sup> *Id.*

<sup>94</sup> *Northrop Corp. v. Triad Int'l Mktg. S.A.*, 811 F.2d 1265, 1271 (9th Cir. 1987) (quoting *W.R. Grace & Co. v. Local 759, Int'l Union of United Rubber Workers*, 461 U.S. 757, 766 (1983)).

<sup>95</sup> *Waterside Ocean Navigation Co. v. Int'l Navigation Ltd.*, 737 F.2d 150, 152 (2d Cir. 1984) (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 520 n.15 (1974)).

that such laws constitute the most basic notions of morality and justice.<sup>96</sup> This argument would also depend, however, on whether a procedural issue, rather than the substance of the award itself, is sufficient to qualify as a violation of public policy under the New York Convention, an issue that is not free from doubt.

The public-policy defense to enforcement of a non-domestic arbitral award is rarely successful in U.S. Courts.<sup>97</sup> Nonetheless, several courts have suggested that the public policy ground might be available where the makeup and constitution of the arbitral tribunal is in question.<sup>98</sup> In *Transmarine Seaways Corp. v. Marc Rich & Co.*, the court stated that,

Under Article V(2)(b) [of the New York Convention], enforcement of an award may be denied if contrary to this country's public policy. The Supreme Court's elucidation of arbitral propriety in *Commonwealth Coatings* [393 U.S. 145 (1968)] is a declaration of public policy. If [the arbitrator's] presence on the panel offended the principles declared in that case and its progeny, the award will not be enforced.<sup>99</sup>

*Transmarine Seaways* concerned a non-domestic arbitration held in New York City, where the court could have applied FAA Chapter 1 grounds to determine whether to enforce the award because the arbitration was under the supervision of an United States domestic court. The court, however, applied New York Convention Article V(2)(b)'s public policy grounds.<sup>100</sup> The court found no bias and did not refuse to enforce the award on that ground.<sup>101</sup> Significantly though, at least one court believed that the appointment and selection of an arbitrator in violation of *Commonwealth Coatings*, discussed below, could be a

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<sup>96</sup> See *Parsons & Whittemore Overseas Co.*, *supra* note 92, at 974.

<sup>97</sup> See Andrew M. Campbell, *Refusal to Enforce Foreign Arbitration Awards on Public Policy Grounds*, 144 A.L.R. FED. 481 (2005). However, there have been rare cases where the public policy exception was partially successful. See *Laminoirs-Trefileries-Cableries de Lens, S.A. v. Southwire Co.*, 484 F. Supp. 1063, 1069 (N.D. Ga. 1980) (portion of French interest rate in international arbitration award not enforced because it violated Georgia public policy: "[A] foreign law will not be enforced if it is penal only and relates to the punishing of public wrongs as contradistinguished from the redressing of private injuries.").

<sup>98</sup> *Brandeis Intsel Ltd. v. Calabrian Chemicals Corp.*, 656 F. Supp. 160, 169 (S.D.N.Y. 1987) ("I accept that the propriety of the makeup of an arbitration panel sufficiently implicates public policy to fall within article V(2)(b) of the convention. . . ."); *Transmarine Seaways Corp. v. Marc Rich & Co.*, 480 F. Supp. 352, 357 (S.D.N.Y. 1979).

<sup>99</sup> *Transmarine Seaways Corp.*, 480 F. Supp. at 357.

<sup>100</sup> *Id.*

<sup>101</sup> *Id.* at 358.

basis for a public policy refusal to enforce an award under Article V(2)(b) of the New York Convention.<sup>102</sup>

In *Commonwealth Coatings v. Continental Casualty Co.*, the United States Supreme Court held that an arbitration award must be vacated where the arbitrator had the appearance of bias based on his failure to disclose a close business relationship with one of the parties.<sup>103</sup> The Court held:

This rule of arbitration and this canon of judicial ethics rest on the premise that any tribunal permitted by law to try cases and controversies not only must be unbiased, but also must avoid even the appearance of bias. We cannot believe that it was the purpose of Congress to authorize litigants to submit their cases and controversies to arbitration boards that might reasonably be thought biased against one litigant and favorable to another.<sup>104</sup>

Although *Commonwealth Coatings* was a domestic arbitration case, based on the international arbitration cases referred to above, at least some courts will apply the principles of *Commonwealth Coatings* and refuse to enforce foreign arbitral awards on the basis of the public policy exception when the respondent establishes arbitrator bias or the appearance of bias.

There are no published U.S. cases where discrimination in the makeup of the arbitral tribunal was asserted as the basis for refusing to enforce the arbitration award on public policy grounds,<sup>105</sup> but laws banning discrimination are no less important than the public policy

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<sup>102</sup> *Id.* at 357.

<sup>103</sup> *Commonwealth Coatings Corp. v. Cont'l Cas. Co.*, 393 U.S. 145, 147 (1968).

<sup>104</sup> *Id.* at 150.

<sup>105</sup> One U.S. case that raises the issue of discrimination in connection with the enforcement of an international arbitration award is *Karen Maritime Ltd. v. Omar International Inc.*, in which the respondent argued that confirmation of a non-domestic arbitration award would violate public policy and, therefore, should be refused under Article V(2)(b) of the New York Convention because the underlying contract between the parties violated U.S. public policy. In that case, a charter agreement entered into by the parties included a requirement that the contracted vessel "is not Israeli owned or controlled, and will not call at Israeli ports." The respondent contended that the contract on which the award was based violated anti-boycott laws and anti-discrimination laws. With respect to the anti-discrimination laws (notably, § 1981 of the Civil Rights Act), the court held that this ground did not apply because "[t]he charter party's objectionable language . . . applies to individuals outside the jurisdiction of the United States." The court found the anti-boycott ground to be a much closer question, but ultimately ruled that the basis for the arbitration award had nothing to do with the anti-boycott laws and, in any event, the respondent had unclean hands. *Karen Maritime Ltd. v. Omar Int'l Inc.*, 322 F. Supp. 2d 224, 225, 228-30 (E.D.N.Y. 2004).

banning arbitrator bias. Indeed, selecting an arbitrator based on race, ethnicity, national origin, gender or other protected class very well may violate the principles of *Commonwealth Coatings* and constitute the appearance of bias.<sup>106</sup>

There is no doubt that federal and state laws banning discrimination are a clear statement of public policy.<sup>107</sup> Indeed, the New York City Human Rights Law (used in the above hypothetical) declares:

[T]here is no greater danger to the health, morals, safety and welfare of the city and its inhabitants than the existence of groups prejudiced against one another and antagonistic to each other because of their actual or perceived differences, including those based on race, color, creed, age, national origin, alienage or citizenship status, [or] gender. . . .<sup>108</sup>

It is yet to be seen whether a court will refuse to enforce a foreign arbitral award where the selection and appointment of the arbitrator was done in a manner that violates the anti-discrimination policies at the place of enforcement, but existing case law suggests that such a risk exists.

## XII. CONCLUSION

From time-to-time, parties to arbitration agreements insert qualifications for arbitrators that would violate federal, state, or municipal laws in the United States that bar discrimination when contracting with any persons, including independent contractors. It is possible that such discriminatory arbitration agreements made in United States jurisdictions where such discrimination is prohibited as a matter of public policy would be declared completely or partially invalid unless the proponents of the discriminatory qualification could establish a bona fide occupational qualification.

This also holds true for non-domestic arbitrations where the parties have selected United States law to govern their arbitration agreement and the seat of the arbitration is in the United States. For arbitration agreements whose seat is outside the United States and

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<sup>106</sup> It would be difficult to attribute actual bias to the appointed arbitrator on the basis of discrimination in the selection and appointment process to which the selected arbitrator is not a party. *See* *Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 429 F.3d 640, 645 (6th Cir. 2005) (quoting *Consolidation Coal Co. v. Local 1643, United Mine Workers of Am.*, 48 F.3d 125, 129 (4th Cir. 1995)) (alleging partiality of an arbitrator must be direct, definite, and capable of demonstration to vacate an arbitration award).

<sup>107</sup> *See, e.g.*, Exec. Order No. 10925, 26 Fed. Reg. 1977 (Mar. 8, 1961); *Burks v. Poppy Constr. Co.*, 57 Cal. 2d 463, 471 (1962).

<sup>108</sup> N.Y.C., N.Y. ADMIN. CODE § 8-101 (2011).

where the arbitration agreement's discriminatory aspects are legal but violate the anti-discrimination laws of the place of enforcement, it is possible that a United States court would refuse to enforce such an award on public policy grounds. For example, a United States court might find an arbitration agreement prohibiting the appointment of "non-white" arbitrators repugnant to United States public policy and, on that basis, refuse enforcement of the arbitration agreement and any resulting award.

What does this mean for the legacy of *Jivraj v. Hashwani*? Due to the narrow grounds on which the public policy exception to enforcement of foreign arbitral awards historically has been permitted in the United States, one would expect there to be a great deal of difficulty in opposing enforcement of a foreign arbitral award even where the non-domestic arbitration agreement would violate U.S. anti-discrimination laws on the selection and appointment of arbitrators had the agreement been made in the United States. Where the parties' arbitration agreement has selected a location in the United States where anti-discrimination laws apply to arbitrators, however, there is a risk that the arbitration agreement, or the arbitrator selection provisions, will be declared invalid. As a practical matter, arbitration agreements that incorporate rule sets that provide preferences based on national origin may be declared invalid in places like New York City and New Jersey unless the parties to such agreements disavow the institutional restrictions on national origin, something generally permitted by the major rule sets.



# BUSINESS INSOLVENCY AND THE IRISH DEBT CRISIS

*Paul B. Lewis\**

## I. INTRODUCTION

Among the volume of material written about the Irish debt crisis and its impact over the past few years, strikingly little has been written about the ability to save a financially distressed company under Irish law and whether corporate restructuring could have mitigated some of the financial damage to Irish companies, particularly those in the property and construction industries. There is a reason for this. The number of filings under the Examinership law – the rough equivalent of Chapter 11 in the United States – remained small and relatively constant during both the recent boom and the more immediate bust periods of the Irish economy. This article examines the Irish approach to corporate restructuring and questions whether the law could have been put to good effect over the past couple of years.

While much has changed in Ireland since the advent of the Irish debt crisis, the Examinership law has remained unchanged. In fact, in distinct juxtaposition issues with consumer insolvency – where the European Union demanded reform to the personal bankruptcy laws of Ireland as a condition to Ireland obtaining bailout money<sup>1</sup> – no such demand was made as related to business insolvency by the European Union, nor was there any meaningful internal discussion in Ireland about revising the Examinership law. There may be a good reason why no such changes to Examinership were contemplated. Examinership is a moderate and seemingly effective method of dealing with financially distressed businesses. The question then is why the law hasn't been applied better.

Irish Examinership came into being under rather unique and hurried circumstances. Despite its shaky origins, Examinership remains a sensible balance between the two extremes of corporate rescue regimes in the common law world. On one end of the business bankruptcy approach is the pro-debtor United States Chapter 11, where creditor considerations generally are subordinated in the reorganization process to the more compelling desire of providing maximum res-

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<sup>1</sup> Saranna Enraght-Moony & Dudley Solan, *New Personal Insolvency Legislation Intended for Ireland*, MAPLES (May 16, 2012), <http://www.maplesandcalder.com/news/article/new-personal-insolvency-legislation-intended-for-ireland-240/>.

cue opportunity to the business debtor. This is in large part to protect related third parties, such as employees, suppliers, and neighboring businesses. At the other end of the continuum is the Australian version of business restructuring, known as Voluntary Administration, where debtor considerations are clearly subordinate to ensuring creditor recovery. Examinership strikes a balance between the U.S. and Australian approaches, empowering both debtors and creditors. It makes a rational effort to effectively distinguish distressed but viable firms from those firms that have little prospect of long-term viability.

In this article, I examine the core of Irish insolvency law in comparison to its common law counterparts and question why, in an era where insolvency law is frequently employed elsewhere, it has been put to so little use in Ireland. Part II of the article provides a brief overview of the much-covered territory both of the Irish debt crisis and the cultural factors that led to it. Part III describes Examinership law in Ireland. Part IV places the Irish insolvency approach in context by comparing it to two radically different models of business rescue – American Chapter 11 and Australian Voluntary Administration. Part V addresses the viability of Examinership under the peculiar circumstances that existed in Ireland over the past few years and considers whether it could have been better employed as a tool to deal with the economic woes the Republic of Ireland has faced.

## II. THE IRISH DEBT CRISIS — A PRIMER

The causes and the evolution of the Irish debt crisis have been well documented.<sup>2</sup> A brief primer of significant dates and events here will suffice. In the middle of 2008, after more than a decade of economic growth, signs began to appear that the Irish economy might be in trouble.<sup>3</sup> Government deficits increased,<sup>4</sup> many businesses began experiencing significant financial problems,<sup>5</sup> the rate of unemploy-

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<sup>2</sup> See generally Philip R. Lane, *The Irish Crisis, THE EURO AREA AND THE FINANCIAL CRISIS* (forthcoming), available at <http://www.tcd.ie/iis/documents/discussion/pdfs/iisdp356.pdf>.

<sup>3</sup> *Lenihan Admits 'Serious Problem' in Economy*, RTE NEWS (June 24, 2008) (Ir.), available at <http://www.rte.ie/news/2008/0624/economy.html>.

<sup>4</sup> *Irish Economy*, ECON. & SOC. RES. INST., available at [http://www.esri.ie/irish\\_economy/](http://www.esri.ie/irish_economy/) (last visited Feb. 6, 2012); see also *End-2008 Exchequer Returns*, DEP'T FIN., available at <http://www.finance.gov.ie/viewdoc.asp?DocID=5614> (last visited Feb. 6, 2012).

<sup>5</sup> Press Release, Bank of Ir., Latest Bank of Ireland Barometer Indicates Fall in Entrepreneurial Activity (Oct. 10, 2008), <http://www.bankofireland.com/about-boi-group/press-room/press-releases/item/142/latest-bank-of-ireland-barometer-indicates-fall-in-entrepreneurial-activity/>; *Company Liquidations in Ireland More Than Doubled in 2008*, FINFACTS IR. (Jan. 5, 2009), [http://www.finfacts.ie/irish-finance/news/article\\_1015605.shtml](http://www.finfacts.ie/irish-finance/news/article_1015605.shtml).

ment began to rise,<sup>6</sup> and the Irish Stock Index began to fall.<sup>7</sup> By September of 2008, the Irish government officially announced that the country was in a recession, thus becoming the first State in the Eurozone to officially recognize the existence of a recession.<sup>8</sup>

In response to the deteriorating economic situation, the Irish government expedited the introduction of its 2009 budget, introducing it in early October 2008 rather than during the more traditional December period.<sup>9</sup> Also, in September of 2008, recognizing the tremendous vulnerability of Irish banks, the Irish government announced a two-year blanket guarantee of the liabilities of Irish-controlled banks.<sup>10</sup>

In January of 2009, the Irish government announced plans to nationalize the Anglo Irish Bank, the country's third largest lender.<sup>11</sup> By February 2009, unemployment in Ireland had reached 11% – the highest it had been since 1996.<sup>12</sup> Protests began to arise in opposition to the government's handling of the economic situation.<sup>13</sup> In response, the Irish government announced that it would inject 7 billion euros

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<sup>6</sup> Int'l Monetary Fund [IMF], *Ireland: Extended Arrangement – Interim Review Under the Emergency Financing Mechanism*, at 5, 9, IMF Country Report No. 11/47 (Feb. 2011), available at <http://www.imf.org/external/pubs/ft/scr/2011/cr1147.pdf>; CENT. STATISTICS OFFICE IR., SEASONALLY ADJUSTED STANDARDISED UNEMPLOYMENT RATES (SUR), available at <http://www.cso.ie/en/statistics/labourmarket/principalstatistics/seasonallyadjustedstandardisedunemploymentratesur/>.

<sup>7</sup> *ISEQ Falls to 14-Year Low*, RTE NEWS (Feb. 24, 2009) (Ir.), available at <http://www.rte.ie/news/2009/0224/markets.html>; see also *Ireland Stock Market*, TRADING ECON., <http://www.tradingeconomics.com/ireland/stock-market> (last visited Sept. 25, 2012).

<sup>8</sup> ECON. & FIN. COMM. (ECOFIN), FINANCIAL CRISIS IN IRELAND 1, available at <http://www.romun.org/semunna/Background/ECOFIN11%20Ireland.pdf> (last visited Feb. 6, 2012).

<sup>9</sup> See Government Statement, Dep't of the Taoiseach (Sept. 8, 2008), available at [http://www.taoiseach.gov.ie/eng/News/Archives/2008/Government\\_Press\\_Releases\\_2008/Government\\_Statement1.html](http://www.taoiseach.gov.ie/eng/News/Archives/2008/Government_Press_Releases_2008/Government_Statement1.html).

<sup>10</sup> Patrick Honohan, *Resolving Ireland's Banking Crisis*, 40 ECON. & SOC. REV. 207, 207 (Summer 2009), available at [http://www.esr.ie/Vol40\\_2/Vol40-2-Honohan.pdf](http://www.esr.ie/Vol40_2/Vol40-2-Honohan.pdf); *The Economic Adjustment Programme for Ireland*, at 12, EUR. COMM'N (Feb. 2011), Occasional Papers 76, available at [http://ec.europa.eu/economy\\_finance/publications/occasional\\_paper/2011/pdf/ocp76\\_en.pdf](http://ec.europa.eu/economy_finance/publications/occasional_paper/2011/pdf/ocp76_en.pdf) [hereinafter *Economic Adjustment Programme*].

<sup>11</sup> *Minister's Statement*, DEP'T OF FIN. (Jan. 15, 2009), available at <http://www.finance.gov.ie/viewdoc.asp?DocID=5627>.

<sup>12</sup> Henry McDonald, *Ireland's Unemployment Rises to 11.4%*, GUARDIAN, Apr. 29, 2009, <http://www.guardian.co.uk/business/2009/apr/29/economy-ireland-jobless-rise>.

<sup>13</sup> *Protest in Ireland of Government Handling of Economy*, CNN, Feb. 22, 2009, <http://www.cnn.com/2009/BUSINESS/02/21/ireland.economy/index.html>.

into the Bank of Ireland and Allied Irish Bank in return for guarantees on lending, a decrease in senior bankers' pay, delaying collection of mortgage arrearages, and a government-held 25% indirect stake in each bank.<sup>14</sup>

In March of 2009, the Republic of Ireland lost its AAA credit rating.<sup>15</sup> Following this, in April 2009, the Irish government unveiled its second budget in six months.<sup>16</sup> It proposed a National Asset Management Agency to function as a "bad bank" which would acquire non-performing development loans in order to improve the availability of credit broadly to aid the Irish economy.<sup>17</sup>

In October of 2009, the Irish voted in favor of the Lisbon treaty,<sup>18</sup> which was expected both to protect tens of billions of dollars invested in Ireland by American companies and to save the government up to 200 million euros.<sup>19</sup>

By March of 2010, the Anglo Irish Bank had reported losses of 12.7 billion euros, the largest such loss in Irish corporate history.<sup>20</sup> By September of 2010, the Irish government had agreed to additional bailouts, increasing the cost of bailing out Ireland's banking system to 35 billion euros,<sup>21</sup> and raising the country's deficit to about one third of its Gross Domestic Product.<sup>22</sup>

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<sup>14</sup> Paul O'Brien et al., *AIB and BoI To Get 3.5bn Euros Each in Bailout*, IRISH EXAMINER, Feb. 12, 2009, <http://www.irishexaminer.com/ireland/ideymhmoj/>.

<sup>15</sup> Ian Guider & Fergal O'Brien, *Ireland Loses AAA Rating at S&P on Deficit, Slump*, BLOOMBERG, Mar. 30, 2009, [http://www.bloomberg.com/apps/news?pid=newsarchive&sid=A69.9\\_yL6P.w](http://www.bloomberg.com/apps/news?pid=newsarchive&sid=A69.9_yL6P.w).

<sup>16</sup> *Ireland Unveils Emergency Budget*, BBC NEWS, Apr. 7, 2009, <http://news.bbc.co.uk/2/hi/business/7986862.stm>.

<sup>17</sup> See Quentin Fottrell, *Ireland Sets Up Its 'Bad Bank' Agency*, WALL ST. J., Apr. 9, 2009, <http://online.wsj.com/article/SB123918353240000679.html>; see also *The National Asset Management Agency: A Brief Guide*, IRISH TIMES, Mar. 30, 2010, <http://www.irishtimes.com/focus/2010/namaguide/index.pdf>.

<sup>18</sup> Henry McDonald, *Ireland Votes Yes to Lisbon Treaty*, GUARDIAN, Oct. 3, 2009, <http://www.guardian.co.uk/world/2009/oct/03/ireland-votes-yes-lisbon-treaty>.

<sup>19</sup> Graham Ruddick, *Lisbon Treaty Approval Could Save Ireland 200m Euros a Year in Debt Costs*, TELEGRAPH, Oct. 3, 2009, <http://www.telegraph.co.uk/finance/economics/6258132/Lisbon-Treaty-approval-could-save-Ireland-200m-a-year-in-debt-costs.html>.

<sup>20</sup> Henry McDonald, *Anglo Irish Bank Reports 12.7bn Euros Loss As EU Launches Enquiry into State Aid*, GUARDIAN, Mar. 31, 2010, <http://www.guardian.co.uk/business/2010/mar/31/anglo-irish-bank-10-billion-rescue>.

<sup>21</sup> Finbarr Flynn & Louisa Fahy, *Anglo Irish Cost May Exceed 35 Billion Euros, S&P Says*, BLOOMBERG NEWS, Sept. 28, 2010, <http://www.bloomberg.com/news/2010-09-28/anglo-irish-cost-may-exceed-35-billion-euros-s-p-says-update1-.html>.

<sup>22</sup> *Irish Deficit Balloons After New Bank Bailout*, BBC NEWS, Sept. 30, 2010, <http://www.bbc.co.uk/news/business-11441473>.

Markets did not respond well to Ireland's self-imposed measures, which in large part served only to greater illuminate the scope of its problems. As a result, the Irish government agreed in November 2010 to an 85 billion euro rescue package with the European Union and the International Monetary Fund.<sup>23</sup> The bailout was for a 16-year term with interest at just under 6%, and it included, among other elements, an austerity program comprising four years of both tax increases and spending cuts.<sup>24</sup>

The result was that the Irish banking system effectively was a life support system.<sup>25</sup> The banking problems were largely the result, as has been exhaustively documented, of too much mortgage lending into an unsustainable housing and construction market in a classic speculative bubble.<sup>26</sup> Much of this lending was in turn financed by foreign entities.<sup>27</sup> The property and construction boom had at least an air of credibility that it was more than just a bubble.<sup>28</sup> Such confidence in the long-term viability of the real estate boom was based on the presence of lower interest rates in Ireland following the advent of the euro, as well as the continuing expansion during the 1990's of output, employment, and population.<sup>29</sup> And while a number of economists foresaw a market correction in housing, few anticipated the eventual solvency problems of the Irish banking industry.<sup>30</sup>

All of this is set against the backdrop, of course, of one of the great economic rises in European history. When Ireland joined the European Economic Community in 1973, it was the poorest member of that group, and its economic performance significantly underperformed that of the other members until the late 1980s.<sup>31</sup> In a country where nearly one-third of its citizens lived below the poverty

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<sup>23</sup> Lane, *supra* note 2, at 17, 19; *see also* James G. Neuger & Simon Kennedy, *Ireland Gets \$113 Billion Bailout as EU Ministers Seek To Halt Debt Crisis*, BLOOMBERG NEWS, Nov. 29, 2010, <http://www.bloomberg.com/news/print/2010-11-28/ireland-wins-eu85-billion-aid-germany-drops-threat-on-bonds.html>.

<sup>24</sup> Lisa O'Carroll, *Ireland Bailout: Full Irish Government Statement*, GUARDIAN, Nov. 28, 2010, <http://www.guardian.co.uk/business/ireland-business-blog-with-lisa-ocarroll/2010/nov/28/ireland-bailout-full-government-statement>.

<sup>25</sup> *See* Honohan, *supra* note 10, at 207.

<sup>26</sup> *Id.* at 208.

<sup>27</sup> *Id.*

<sup>28</sup> *See id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *See* KLAUS REGLING & MAX WATSON, A PRELIMINARY REPORT ON THE SOURCES OF IRELAND'S BANKING CRISIS 21 (2010), *available at* <http://www.bankinginquiry.gov.ie/Preliminary%20Report%20into%20Ireland's%20Banking%20Crisis%2031%20May%202010.pdf>.

level as recently as the 1980s,<sup>32</sup> by the start of the millennium, Ireland had transformed itself into the second wealthiest country in the world, according to the Bank of Ireland, with an unemployment rate as low as 4%.<sup>33</sup> In 1996, Ireland's per capita gross national income was 83% of the EU-15 average, but by 2006 that number had reached 113%.<sup>34</sup>

Myriad explanations have been offered as to how Ireland became a destination country rather than a country of departure for workers. The key elements typically noted in such explanations included the fact that Ireland had eliminated trade barriers and it had reduced corporate tax rates. Still, no consensus seems to ever have emerged as to how exactly the "Celtic Tiger" came to fruition. What is clear is that the Celtic Tiger was built largely around exports, with export growth averaging 17.8% between 1996 and 2000.<sup>35</sup> Ireland certainly benefited from the launch of the EU Single Market, but it is noteworthy that Irish banks did not play a central part in export financing.<sup>36</sup>

In the early part of the twenty-first century, however, Irish banks were able to borrow enormous sums of money from abroad due to both the global savings glut and the lack of risk associated with exchange rates once the use of the euro became finalized.<sup>37</sup> Without this massive borrowing from abroad, the Irish property boom could not have exploded in the same fashion as it did during this period.<sup>38</sup> As

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<sup>32</sup> Tim Callan & Brian Nolan, *Income Inequality and Poverty in Ireland in the 1970s and 1980s* 14–17 (Econ. & Soc. Res. Inst., Working Paper No. 43, 1993), available at <http://www.esri.ie/UserFiles/publications/20071024100057/WP043.pdf>.

<sup>33</sup> Brian McCormick, *Unemployment Trends in Ireland 1997–2002*, FAS LAB. MARKET UPDATE, Nov. 2002, at 3, available at <http://www.fas.ie/en/pubdocs/UnemploymentTrends1997to2002.pdf>.

<sup>34</sup> *Economic Adjustment Programme*, *supra* note 10, at 6.

<sup>35</sup> *The Irish Economy in Perspective*, DEP'T OF FIN. (June 2011), available at <http://www.finance.gov.ie/documents/publications/economicstatsetc/irisheconomyjune2011.pdf>.

<sup>36</sup> See Patrick Honohan, *To What Extent Has Finance Been a Driver of Ireland's Economic Success?*, ESRI Q. ECON. COMMENT., Dec. 2006, at 59–72, available at [http://www.esri.ie/UserFiles/publications/20061220145614/QEC2006Win\\_SA\\_Honohan%20.pdf](http://www.esri.ie/UserFiles/publications/20061220145614/QEC2006Win_SA_Honohan%20.pdf).

<sup>37</sup> In 2003, Irish banking indebtedness to the rest of the world was approximately 10% of Irish GDP. By 2008, that number had grown to an astonishing 60% of gross domestic product. Jerome L. Stein, *The Diversity of Debt Crises in Europe*, 31 CATO J. 199, 202 (2011), available at <http://www.cato.org/pubs/journal/cj31n2/cj31n2-2.pdf>.

<sup>38</sup> Clearly other factors were at work as well, such as the lessening of tax restrictions in regard to construction. See Gordon Barham, *The Effects of Taxation Policy on the Cost of Capital in Housing – A Historical Profile (1976 – 2003)*, CBFSAI FIN. STABILITY REP., 2004.

additional wealth came into Ireland from thriving exports, a growing need developed for housing expansion, fueled not only by higher incomes but also by a larger population and lower interest rates. The result was not just a rise in housing prices, but also a dramatic increase in construction. The cost of housing and construction in turn skyrocketed, with housing price inflation the highest in Europe between the mid-1990s and 2006.<sup>39</sup>

Not surprisingly, the degree to which the Irish banks increased their lending share related to real property was significant as well, moving from less than 40% of their lending prior in 2002 to greater than 60% of their lending by 2006.<sup>40</sup> Total lending rose precipitously as well, with a growth in lending by the covered banks<sup>41</sup> rising from 120 billion euros in 2000 to almost 400 billion euros in 2007.<sup>42</sup> In fact, the average growth rate to Irish households between 2004 and 2006 was almost 30%.<sup>43</sup> A significant imbalance in the funding structure of Irish banks resulted from these lending changes. The loan-to-deposit ratio of Irish banks with respect to domestic resident clients grew from 133% in January of 2003 to 215% by May of 2008.<sup>44</sup> This gap could only be ameliorated by more borrowing from international capital markets.

Yet, all of this occurred despite the increasing recognition that housing prices had likely exceeded their equilibrium point and the scale of new construction had become a cause of concern.<sup>45</sup> As early as 2007, Morgan Kelly was the first to notably question whether the Irish banks could survive the anticipated drop in housing prices.<sup>46</sup> And fall they did, with estimates for the decline in housing prices ranging from a 38% decrease between 2006 and 2010 to a number as high as a 75%

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<sup>39</sup> *Economic Adjustment Programme*, *supra* note 10, at 6; see also David Rae & Paul van den Noord, *Ireland's Housing Boom: What Has Driven It and Have Prices Overshot?* (OECD Econ. Dep't, Working Paper No. 492, 2006); Janis Malzubris, *Ireland's Housing Market: Bubble Trouble*, 5 ECFIN COUNTRY FOCUS (Sept. 26, 2008), available at [http://ec.europa.eu/economy\\_finance/publications/countryfocus\\_en.htm](http://ec.europa.eu/economy_finance/publications/countryfocus_en.htm).

<sup>40</sup> See Honohan, *supra* note 10, at 209.

<sup>41</sup> The six primary domestic credit institutions were the Bank of Ireland, Allied Irish Banks, Anglo, Irish Bank, Irish Life and Permanent, Irish Nationwide Building Society, and the Educational Building Society.

<sup>42</sup> *Economic Adjustment Programme*, *supra* note 10, at fig. 3.

<sup>43</sup> *Id.* at fig. 5.

<sup>44</sup> *Id.* at 10.

<sup>45</sup> See IMF, *Ireland: Selected Issues*, at 35, IMF Country Report No. 04/349 (Nov. 2004), available at <http://www.imf.org/external/pubs/ft/scr/2004/cr04349.pdf>.

<sup>46</sup> See Morgan Kelly, *Banking on Very Shaky Foundations*, IRISH TIMES, Sept. 7, 2007, at 3, available at <http://www.tmcnet.com/usubmit/2007/09/07/2919218.htm>.

drop in value during this time period.<sup>47</sup> As in the United States, a credit crunch ensued. This was true of financing to individual households for housing and consumption as well as to the non-financial corporate sector.<sup>48</sup>

The Irish economy was effectively thrown into chaos.

On September 21, 2010, the Irish government established a Statutory Commission of Investigation into the Banking Sector in Ireland.<sup>49</sup> In March of 2011, the Commission issued a report entitled “Misjudging Risk: Causes of the Systemic Banking Crisis in Ireland.”<sup>50</sup> One key finding of the Commission was that the willingness of Irish banks to accept enormous risk and make “shockingly” large loans primarily for commercial property was a significant factor in the eventual instability of the Irish economy.<sup>51</sup> There was a gradual adaptation of lower credit standards by Irish banks as a way of ensuring market share and profitability.<sup>52</sup> Bank loans expanded enormously and quickly because “neither banks nor borrowers apparently really understood the risks they were taking,” as the long increase in property values “eroded the awareness both of banks and customers in Ireland.”<sup>53</sup> Thus, “both sides of the market assumed that the other side knew what it was doing.”<sup>54</sup>

What evolved was a self-reinforcing upward spiral. Easy credit increased property prices, and increased property prices resulted in easy credit. Meanwhile, regulation was clearly insufficient. Although both the Central Bank and the Financial Regulator noted the existence of macroeconomic risk in Ireland as the result of banking practice, neither took decisive action to restrain questionable banking

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<sup>47</sup> See *Economic Adjustment Programme*, *supra* note 10, at 10; see also Patrick Koucheravy, *Latest Figures Suggest a 75% Fall in Land Values*, DAFT.IE (Oct. 5, 2010), available at <http://www.daft.ie/report/patrick-koucheravy>.

<sup>48</sup> There are numerous statistics illustrating this. For example, during the last three months of 2010, the average net flow of lending to households decreased 413 million euros for the three months ending December 2010, and lending to the non-financial corporate sector declined 1.2% during calendar year 2010. See CENTRAL BANK OF IRELAND, *MONEY AND BANKING STATISTICS: DECEMBER 2010* (2011), available at [www.centralbank.ie/polstats/stats/cmab/Documents/2010m12\\_ie\\_monthly\\_statistics.pdf](http://www.centralbank.ie/polstats/stats/cmab/Documents/2010m12_ie_monthly_statistics.pdf).

<sup>49</sup> Commissions of Investigation Act 2004 (Act No. 23/2004) (Ir.), available at <http://www.irishstatutebook.ie/2004/en/act/pub/0023/index.html>.

<sup>50</sup> COMMISSION OF INVESTIGATION INTO THE BANKING SECTOR IN IRELAND, *MISJUDGING RISK: CAUSES OF THE SYSTEMIC BANKING CRISIS IN IRELAND* (2011), available at <http://www.bankinginquiry.gov.ie/Documents/Misjudging%20Risk%20-%20Causes%20of%20the%20Systemic%20Banking%20Crisis%20in%20Ireland.pdf>.

<sup>51</sup> *Id.* at ii.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at iii.

decision-making.<sup>55</sup> What's more, the International Monetary Fund, the European Union, and the Organization for Economic Cooperation and Development were, though occasionally nominally critical, on the whole, supportive of the direction of the Irish economy during the critical years at the start of the 21st century.

### III. IRISH INSOLVENCY LAW

There are, in essence, four forms of insolvency law in Ireland.<sup>56</sup> The first is bankruptcy, the insolvency procedure related to natural persons or partnerships comprised of natural persons.<sup>57</sup> Irish bankruptcy law is governed by the Bankruptcy Act of 1988.<sup>58</sup> The second form of an insolvency proceeding is liquidation, which can occur either

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<sup>55</sup> In fact, the Commission noted the following:

1.4.3: For a systemic financial crisis to occur, at least the following factors must be present (although the last two may not be as essential as the others):

- a sufficiently large number of households and investors who, at some point, start making serious mistakes in judging the value and liquidity of their major assets, holdings, and projects;
- banks that provide financing, large in relation to their own capital, for these investments without thoroughly and sufficiently evaluating prospects and the creditworthiness of borrowers in the longer term;
- providers of funds to such banks (often banks themselves but also depositors) that do not monitor bank soundness with sufficient diligence, in the case of private providers, possibly because of perceived implicit public support for at least important banks;
- a banking regulator that remains unwilling or unable to detect or prevent banks from engaging in excessively risky lending or funding practices;
- a government and a central bank that remains unaware of the mounting problems or is unwilling to do anything to prevent them;
- a parliament that remains unaware of the mounting problems or concentrates its attention on other things perceived to be of greater immediate importance; and
- media that are generally supportive of corporate and bank expansion, profit growth and risk taking while being dismissive of warnings of unsustainable developments. *Id.* at 5.

<sup>56</sup> The source of the laws governing liquidations in Ireland are a mix of corporate law, including the Companies Acts of 1963 and 2000, commercial law, contract law, property law, and equity and trust law. See ADRIAN BENSON & LOCRAH TIERNAN, CORPORATE INSOLVENCY IN IRELAND 1 (2009), available at <http://www.dillon-eustace.ie/download/1/Corporate%20Insolvency%20in%20Ireland.pdf>.

<sup>57</sup> Bankruptcy Act of 1988 (Act No. 27/1988) (Ir.), available at <http://www.irish-statutebook.ie/1988/en/act/pub/0027/index.html>.

<sup>58</sup> *Id.*

voluntarily<sup>59</sup> or by force.<sup>60</sup> The third option is receivership,<sup>61</sup> and the fourth – the corporate rescue provision – is known as examinership.

Liquidations are, in effect, a form of collective debt collection. They constitute a winding up of the affairs of the company.<sup>62</sup> Typically included in this process are gathering assets, fulfilling or terminating outstanding contractual obligations, discharging company debt, and distributing company assets to creditors.<sup>63</sup> Once the liquidation is complete, the company is dissolved and it is stricken from the company registry.<sup>64</sup>

Liquidations divide roughly into two kinds, those accomplished outside of court and those which transpire under court supervision, with the latter typically known as an involuntary, compulsory, or official winding up.<sup>65</sup> Company shareholders may opt to wind up the affairs of the company outside of court supervision – that is, on a voluntary basis.<sup>66</sup> This is known as a “members winding up,” and it requires that the company be solvent at the time the resolution is passed.<sup>67</sup> Under this form of proceeding, creditors must be paid in full.<sup>68</sup> In fact, directors of the company are obligated to file with the Registrar of Companies a statutory Declaration of Solvency, which indicates that the company will be able to pay its debts in full within 12 months of commencing the liquidation.<sup>69</sup> Upon such a filing, a liquidator is appointed, and upon his or her appointment, the powers of the directors are terminated.<sup>70</sup>

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<sup>59</sup> MICHAEL FORDE & HUGH KENNEDY, *COMPANY LAW* (4th ed. 2008).

<sup>60</sup> For example, by court order. *Id.*

<sup>61</sup> BENSON & TIERNAN, *supra* note 56.

<sup>62</sup> *Id.*; see Companies Act of 1963 (Act No. 33/1988) (Ir.), available at <http://www.irishstatutebook.ie/1963/en/act/pub/0033/index.html>.

<sup>63</sup> BENSON & TIERNAN, *supra* note 56, at 1–2.

<sup>64</sup> *Id.* at 1; see Companies Act, *supra* note 62, § 221.

<sup>65</sup> BENSON & TIERNAN, *supra* note 56, at 1–2.

<sup>66</sup> See Companies Act, *supra* note 62, §§ 257–64.

<sup>67</sup> See *id.* § 251(1)(a) and (b):

- (1) A company may be wound up voluntarily:
  - (a) when the period, if any, fixed for the duration of the company by the articles expires, or the event, if any, occurs, on the occurrence of which the articles provide that the company is to be dissolved, and the company in general meeting has passed a resolution that the company be wound up voluntarily;
  - (b) if the company resolves by special resolution that the company be wound up voluntarily . . .

<sup>68</sup> See *id.* § 256.

<sup>69</sup> *Id.*

<sup>70</sup> *Id.* § 267.

A second form of voluntary winding up is known as a “creditors winding up.” Creditors winding up deals with scenarios where the company is in fact insolvent and cannot pay its debts as they become due.<sup>71</sup> Under such circumstances, the shareholders, frequently on a recommendation from the board of directors, decide to put the company in liquidation. A creditors’ meeting is subsequently called, where a liquidator’s appointment is confirmed.<sup>72</sup>

Compulsory liquidations are situations where a court orders the winding up of a company.<sup>73</sup> Section 213 of the Companies Act of 1963 sets out a number of circumstances where this is appropriate, including, most commonly, when the company cannot pay its debts as they become due. One or more creditors with undisputed debts typically bring such a request. If a court grants a winding up order, the company is placed in liquidation and an official liquidator is appointed. The official liquidator becomes the company’s sole officer.<sup>74</sup>

Receivership is essentially a method of enforcing a security, and is not in fact a true collective proceeding; however, it is frequently treated as a form of insolvency procedure. There are a number of different types of receiverships. The most common form is the scenario where a secured creditor, usually a lending institution, appoints a receiver under contractual powers granted by the company in a debenture/charge.<sup>75</sup> The debenture is a contractual document and all of the powers of the debenture holder and of the receiver are governed by this document except for a small number of statutory provisions.<sup>76</sup> The receiver’s appointment extends only over the assets that have been charged. The appointment of the receiver does not alter the legal status of the company; rather, its result is that the directors cease to exert control over the assets on which the Receivership has been granted. The directors’ normal powers continue, however, with regard to other assets and liabilities of the company. Receivership is a temporary condition that does not necessarily lead to liquidation. The principal function of the receiver is to realize the charged assets and to distribute the

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<sup>71</sup> *Id.* § 251(c) (stating that a voluntary wind up may also occur “if the company in general meeting resolves that it cannot by reason of its liabilities continue its business, and that it be wound up voluntarily”).

<sup>72</sup> Companies Act, *supra* note 62, § 258.

<sup>73</sup> While called “compulsory,” an involuntary winding up may be initiated by shareholders. *Id.* § 215.

<sup>74</sup> The liquidator’s powers are set out in § 231.

<sup>75</sup> Dillon Eustace, *Corporate Insolvency in Ireland*, at 7, available at <http://www.dilloneustace.ie/download/1/Corporate%20Insolvency%20in%20Ireland.pdf>; see also Conveyancing and Law of Property Act, 1881, 44 & 45 Vict., c. 41, §§ 19-24 (Eng.), available at [http://www.legislation.gov.uk/ukpga/1881/41/pdfs/ukpga\\_18810041\\_en.pdf](http://www.legislation.gov.uk/ukpga/1881/41/pdfs/ukpga_18810041_en.pdf).

<sup>76</sup> *Id.*

proceeds to the holder of the charge, subject to any other valid priorities.<sup>77</sup>

Examinership, the corporate rescue scheme that is the focus of this article, is an attempt to facilitate the rescue of an insolvent, or nearly insolvent, company. Its origins are in the Companies Act of 1990, which was enacted under unusual circumstances. When Iraq invaded Kuwait in 1990, a United Nations trade embargo was imposed. The Irish company Goodman International, which exported the majority of Irish beef to Iraq, was therefore in serious financial straits. In response to the company's difficulties, the Irish government decided to introduce and enact a stand-alone piece of insolvency legislation.<sup>78</sup> This legislation, with minor amendments, was subsequently encompassed within The Companies (Amendment) Act, 1990.<sup>79</sup>

Like other corporate rescue regimes, the purpose of Examinership is to provide for the rescue and return to financial viability of economically troubled but potentially viable enterprises. And like other corporate rescue schemes, Examinership requires a balance, as the "laudable"<sup>80</sup> goal of preserving failing companies requires "an exceptional jurisdiction. . . which negatively affects the rights of creditors."<sup>81</sup> As Justice Clarke stated in *Re Traffic Group Limited*:<sup>82</sup>

"It is clear that the principal focus of the legislation is to enable, in an appropriate case, an enterprise to continue in existence for the benefit of the economy as a whole and, of equal, or indeed greater, importance to enable as many as possible of the jobs which may be at stake in such enterprise to be maintained for the benefit of the community in which the relevant employment is located. It is important both for the court and, indeed, for examiners, to keep in mind that such is the focus of the legislation. It is not designed to help shareholders whose investment has proved to be unsuccessful. It is to seek to save the enterprise and jobs."<sup>83</sup>

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<sup>77</sup> *Id.* at 8.

<sup>78</sup> 126 SEANAD DEB. col. 1059 (Aug. 29, 1990) (Ir.).

<sup>79</sup> Companies (Amendment) Act of 1990 (Act No. 27/1990) (Ir.) (as amended by the Companies (Amendment) (No. 2) Act of 1999) (Act No. 30/1999) (Ir.) (as amended by §§ 180-81 of the Companies Act of 1990) (Ir.) (providing for the appointment of an Examiner to a company); Rules of the Superior Court (S.I. No. 147/ 1991) (Ir.) (Order 74A of the Rules of the Superior Courts dealing with the procedure to be followed in Examinership applications), *available at* [www.irishstatutebook.ie/1991/en/si/0147.html](http://www.irishstatutebook.ie/1991/en/si/0147.html).

<sup>80</sup> *See* *Re Vantive Holdings Ltd.* (No. 2) [2009] I.E.S.C. 69 (Ir.).

<sup>81</sup> *See id.* ¶ 30.

<sup>82</sup> *Re Traffic Group Limited*, [2008] 2 I.L.R.M. 1 (Ir.).

<sup>83</sup> *Id.* ¶ 5.5.

Under Examinership, an insolvent, or nearly insolvent, company is entitled to a 70-day period during which it has “protection of the court.”<sup>84</sup> During this period, general creditors cannot pursue their claims, nor can guarantees be enforced.<sup>85</sup> In addition, subject to certain protections, secured creditors cannot exercise their security, except where permitted by the Examiner. Further, the company cannot be subject to a resolution to wind up the company, and no receiver can be appointed.<sup>86</sup>

The Examinership petition may be initiated by any of four parties or by some combination of the parties jointly. The parties are the company itself, the directors of the company, a creditor of the company, or contingent or prospective creditors of the company, including employees.<sup>87</sup> There is a duty to act with utmost good faith. The court may decline to hear the petition if the petitioner has either failed to disclose relevant, available information or has in any other way failed to exercise the utmost good faith.<sup>88</sup> Over-optimism about the company’s long-term prospects is not a per se indication of bad faith, however, and even where bad faith is established, whether to refuse the petition on that ground remains within the court’s discretion.<sup>89</sup>

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<sup>84</sup> Companies (Amendment) Act of 1990, *supra* note 79, §5(2) (Act No. 27/1990) (Ir.), available at <http://www.irishstatutebook.ie/1990/en/act/pub/0027/sec0005.html#sec5>. The petition must be filed with utmost good faith, and may be dismissed by the High Court as an abuse of process and no scheme of arrangement allowed in its absence. *See* *Re Wogans (Drogheda) Ltd*, [1993] 1 I.R. 157 (H. Ct.) (Ir.); *see also* Companies (Amendment) Act § 4A (indicating that a court may decline to hear a petition if it appears that the petitioner or the accountant have failed to disclose materially relevant information).

<sup>85</sup> *See* Companies (Amendment) Act of 1990, *supra* note 79, § 5(2)(f), available at <http://www.irishstatutebook.ie/1990/en/act/pub/0027.html>; *Credit Alliance Corp. v. Williams*, 851 F.2d 119, 121 (4th Cir. 1988).

<sup>86</sup> *Id.* § 5(2).

<sup>87</sup> *See* Companies (Amendment) Act of 1990, *supra* note 79, § 3. However, where a Petition is being presented by a contingent or prospective creditor the court shall not hear the Petition until such security for costs has been given as the court considers reasonable. *See id.* § (3)(5).

<sup>88</sup> *See* Companies (Amendment) Act of 1990, *supra* note 79, § 4; *In re Wogans (Drogheda) Ltd.*, [1993] 1991 H. Ct. 15465 (Ir.).

<sup>89</sup> *Re Tuskar Resources PLC*, [2001] 1 I.R. 668, 677 (Ir.); *see also* *Re Traffic Group Ltd.*, [2007] I.E.H.C. 445 (Ir.). In *Re Traffic Group Ltd.*, the court noted the “significant obligation” on the petitioners to ensure that the financial state of the company is presented to the court in as accurate a way as is practically possible in the circumstances. However, the Court held that the statement of the company’s financial position in the Petition need only be relatively accurate to form a proper basis for considering the scheme. *Id.*

Procedurally, under the E.C. Insolvency Regulation,<sup>90</sup> any primary insolvency proceeding, including Examinerships, must be commenced in the member state where the company has its center of main interests, though secondary proceedings solely for the purpose of liquidation – not to attempt an examinership restructuring – may be commenced in another member state in which the company has an establishment.<sup>91</sup> The verifying affidavit of the Petitioner should contain an averment that Ireland is the centre of main interests of the company.

The statutory test for the appointment of an Examiner requires a two-step process. First, the Petitioner must establish that the company has reasonable prospects of survival, as a whole or in any significant part of its undertakings as a going concern (the “reasonable prospects of survival” standard); and second, if there are reasonable prospects of survival, the court should, “in all the relevant circumstances of the case” exercise its discretion to appoint an Examiner.<sup>92</sup> Even if these standards are met, the decision to appoint an Examiner is not automatic; rather, the Court will weigh the competing interests in the case to determine if Examinership is in the best overall interest of all interested parties.<sup>93</sup>

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<sup>90</sup> Council Regulation 1346/2000, 2000 O.J. (L 160) 2 (EC), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:160:0001:001:en:PDF>.

<sup>91</sup> *Id.* at 5; see also Case C-341/04, Eurofood IFSC Ltd, 2006 E.C.R. I-3854, 59, 67, <http://curia.europa.eu/juris/showPdf.jsf?text=&docid=56604&pageIndex=0&doclang=en&mode=doc&dir=&occ=first&part=1&cid=296776>. Note, “secondary proceedings” may only concern “winding-up” proceedings and this does not include Examinerships. See Council Regulation 1346/2000, Annex B, 2000 O.J. (L 160) 2 (EC), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:160:0001:001:en:PDF>.

<sup>92</sup> See *Re Vantive Holdings*, [2009] I.E.H.C. 409 (Ir.).

<sup>93</sup> *Re Gallium Ltd.*, [2009] I.E.S.C. 8 (Ir.) (explaining:

“[A] petitioner does not, by getting over that threshold, acquire a right to have an order made. I still think it is fair to say that the section confers a ‘wide discretion’ on the court, or alternatively, that the court should take account of all the circumstances. The establishment of a *reasonable prospect of the survival* merely triggers the power, which remains discretionary. . . The court has the power to appoint an examiner if satisfied that there is a reasonable prospect of survival of the company. The entire purpose of examinership is to make it possible to rescue companies in difficulty. The protection period is there to facilitate examination of the prospects of rescue. However, that protection may prejudice the interests of some creditors. The court will weigh the existence and degree of any such prejudice in the balance. It will have regard to the report of the independent accountant.

Examinership is in force as soon as the petition for Examinership is presented, as long as the petition for Examinership is accompanied by a report of an independent accountant.<sup>94</sup> The independent accountant's report must include, among other things, the names and addresses of the officers of the company, a report on the company's assets and liabilities, a listing of creditors and a detailing of the security interests they hold, an opinion on what should be done in regard to any fraudulent conveyances or reckless trading that has transpired, recommendations as to which, if any, pre-petition liabilities of the debtor should be paid by the examiner, details as to how the company should be funded during the examination period, an opinion of whether the assets of the company have been satisfactorily accounted for, the accountant's opinion of whether the company has a reasonable likelihood of survival,<sup>95</sup> a statement of conditions necessary to ensure company survival, and an opinion on whether trying to continue the company in whole or in part would be advantageous to members and creditors.<sup>96</sup> Interestingly, the Court may allow certain information to be deleted before the report is made publicly available, most notably certain information which could act to the detriment of the long-term survival of the financially distressed entity.

When such conditions are met, the High Court may appoint an Examiner. According to section 2(2) of the Corporations Act: "The court

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The court has to take account of all relevant interests. The independent accountant must consider whether examinership would 'be more advantageous to the members as a whole and the creditors as a whole than a winding-up of the company. . .' This does not limit the range of interests to be taken into account by the court under section 2. The interests of employees cannot be excluded. In the case of an insolvent company, it is natural that the creditors will have the greatest interest in the future, if any, of the company. The court will take a balanced approach, as suggested by the reference to the creditors as a whole.")

<sup>94</sup> See Companies (Amendment) Act of 1990, *supra* note 79, § 3(3)(a), available at <http://www.irishstatutebook.ie/1990/en/act/pub/0027/sec0003.html#sec3>. If for some reason the report cannot immediately be made available, the Court retains the right to place the Company under interim protection for a period of time not to exceed 10 days. *Id.* § 3(3a(1)).

<sup>95</sup> See, e.g., *Re Gallium Ltd.* [2009], I.E.S.C. 8 (Ir.) ([N]oting the role of the independent accountant's report, Justice Fennelly stressed that it "must consider whether examinership would be 'be more advantageous to the members as a whole and the creditors as a whole than a winding-up of the company. . . ."; see also Companies (Amendment) Act of 1990 (Act No. 27/1990) (Ir.) § 3(b) (stating an individual reaching the conclusion that Examinership is an appropriate next step for the failing Company is not required); *Re Tuskar Resources PLC* [2001], 1 I.R. 668 (Ir.).

<sup>96</sup> Companies (Amendment) Act of 1990, *supra* note 79, § 2(2), available at <http://www.irishstatutesbook.ie/1990/en/act/pub/0027/index.html>.

shall not make an order under this section unless it is satisfied that there is a reasonable prospect of the survival of the company and the whole or any part of its undertaking as a going concern.”<sup>97</sup> This approach displaced a more liberal approach whereby mere likelihood of facilitating survival was enough to justify Examinership for companies that were effectively insolvent,<sup>98</sup> with insolvency encompassing a scenario where the company was either unable to pay its debts as they became due<sup>99</sup> or where the company’s liabilities exceeded its assets.<sup>100</sup> In terms of what constitutes “a reasonable prospect of survival,” the High Court stated in *Re Vantive Holdings (No. 2)*:

“Given that the whole purpose of the legislation is to facilitate the survival of enterprises and employment . . . , then it seems to me clear that that survival must be measured over a reasonable timeframe such as there would be some point from the perspective of society as a whole in facilitating that survival even at the cost of some creditors having to forgo their strict legal entitlements. In those circumstances, there does not seem to me to be any magic formula for the length of time which a company should be anticipated to survive after it comes out of a successful examinership. Each case needs to be considered on its own facts.”<sup>101</sup>

The Examiner’s function is to formulate proposals and prepare a report for a compromise or a scheme of arrangement between the company, its members, and its creditors. Such a scheme typically involves a combination of new investment, a write down of creditors’ claims, and a payout of dividends to creditors over a period of months.<sup>102</sup>

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<sup>97</sup> *Id.* Similar to the rule in regard to the report, § 3 of the Companies Act of 1990 allows for *in camera* proceedings when the Court is convinced that a public hearing would result in the disclosure of commercially sensitive information that would be financially damaging to the company’s survival prospects.

<sup>98</sup> *Id.* The Court can make such an appointment when three conditions are present. First, the company either is, or is likely to be, unable to pay its debts as they become due. Second, there is no resolution for the winding up of the company. Finally, there has been no order for the winding up of the company.

<sup>99</sup> *See* 11 U.S.C. § 303 (West 2012) (discussing the standard for “insolvency” for involuntary petitions under American Bankruptcy law).

<sup>100</sup> *See id.* § 2(3) (including prospective and contingent liabilities).

<sup>101</sup> *See* *Re Vantive Holdings* [2009], 2 I.E.H.C. 409 (Ir.).

<sup>102</sup> *See id.* at 3.11 (“In the normal sort of examinership to which I have referred, any such scheme of arrangement may involve the writing off of debt (which has, of course, to be seen in the context of the fact that a liquidation of the company - which is normally the only alternative - will probably lead to the writing off of the same, or a greater amount of debt, in any event), together with, in many cases, the

The Examiner's powers in terms of investigation and operation are broad. They include the same powers that would inhere in an auditor in terms of the supplying of information and cooperation. The Examiner can convene, set an agenda for, and preside at meetings of the Board of Directors.<sup>103</sup> He or she may supervise the management of the company and can enter into contractual relationships with third parties.<sup>104</sup> During the period of Examinership – as in other reorganization schemes globally – the company continues to trade. The directors generally remain in control of, and retain responsibility for, the day-to-day operations of the company, though the Court does have the ability to curtail any or all of the director's powers and transfer them to the Examiner for cause.<sup>105</sup> This is, of course, in stark contrast to liquidation, where the director's powers cease upon the appointment of a liquidator. In similar fashion, the ability to affirm or repudiate a contract involving some additional element of performance other than payment under § 20 is given to the company, not to the Examiner. As in the United States with executory contracts, this ability includes the right to repudiate or affirm leases.<sup>106</sup>

Subsequently, the Examiner calls one or more meetings of creditors and members to vote on the scheme of arrangement proffered. The Examiner's scheme will be deemed carried at a particular meeting if two voting criteria are met. First, a simple majority of the total number of creditors must favor the proposal; second, those creditors so voting must hold a majority of the total creditor claims in monetary value.<sup>107</sup> Additionally, the scheme of arrangement must incorporate a number of elements including each class of members and creditors of the company, which classes of creditors are impaired for voting purposes,<sup>108</sup> the implementation of the proposals, what changes

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injection of new capital. Any shortfall in the net assets of the company is normally proposed to be addressed in that way. On that basis, the court can form a reasonable estimate of whether the combination of debt write off and capital injection that might be anticipated would be sufficient to solve the problem. Likewise, the court will normally want to be satisfied that, providing that any such net deficiency in the company's assets can be met, what remains of the undertaking of the company, as of the date of the implementation of a possible scheme of arrangement, is such as will have reasonable prospects of survival into the future from that date.”)

<sup>103</sup> Companies (Amendment) Act of 1990, *supra* note 79, § 7.

<sup>104</sup> The Examiner is personally liable for such contracts, but is entitled to indemnification for any liability from the Company. *See id.* § 13(6).

<sup>105</sup> *See id.* § 3(8).

<sup>106</sup> *See* Re Chartbusters Ltd., [2009] 5 C.O.S. (Ir.).

<sup>107</sup> Companies (Amendment) Act of 1990, *supra* note 79, §18 (Act No. 27/1990) (Ir.), available at <http://www.irishstatutebook.ie/1990/en/act/pub/0027/index.html>.

<sup>108</sup> A creditor is impaired for purposes of the voting if it will not be paid the full amount owed under the proposals. *Id.* § 22(5).

will be made to the management or directors of the company, what changes will be made to the articles of the company, and whatever other matters the Examiner deems relevant.<sup>109</sup>

Further, § 24(4) of the Corporations Act provides that certain requirements must be satisfied before a court may confirm the proposals. For example, it requires that at least one class of creditors whose interests are impaired has accepted the plan. In the event this criteria is not met, the requirement may be satisfied if the Court determines that the proposals are fair and equitable in relation to any class of creditors that has not accepted the proposals and whose interests would be impaired by them, and that the proposals are not “unfairly prejudicial” to the interests of any interested parties.<sup>110</sup>

There is some debate as to what it means to be “unfairly prejudicial.” While it generally appears that the mere fact that a creditor neither receives full payment under the scheme of arrangement nor receives at least what it would get in a liquidation does not per se indicate that the scheme is “unfairly prejudicial”; yet, there is precedent suggesting that secured creditors cannot be forced over their objection to accept less than the value of their security in settlement of a debt.<sup>111</sup> Unsecured creditors, however, are not entitled to the amount they would have received in liquidation. Courts have differentiated between proposals that are prejudicial to the interests of the objector and those that are unfairly prejudicial.<sup>112</sup> While the position of the unsecured creditor is typically compared with the position in a winding-up, the fact that the unsecured creditor will fare worse in the Examinership is no prohibition to confirming the scheme so long as the discrepancy is not extreme and disproportionate to the disparity as it relates to other creditors.<sup>113</sup>

The Examiner is required to report to the Court on the outcome of the meetings of members and creditors.<sup>114</sup> This must occur within 35 days of his or her appointment, unless the court grants additional time.<sup>115</sup> While the Examiner should present his or her report as soon

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<sup>109</sup> *Id.* § 22(f)-(h).

<sup>110</sup> *Id.* § 24(4).

<sup>111</sup> *See, e.g.*, *Re Sharmand Ltd.*, [2008] 514 COS (where the secured creditor argued successfully that there is no precedent for the involuntary writing down of secured debt in an Examinership).

<sup>112</sup> *Re Holidair Ltd.*, [1994] I.L.R.M. 481 (Ir); *Re Antigen Holdings*, [2001] 4 I.R. 600, 604 (Ir.).

<sup>113</sup> *See Re Traffic Group Ltd.*, [2007] I.E.H.C. 445; [2008] 2 I.L.R.M. 1; [2008] 3 I.R. 253 (Ir.).

<sup>114</sup> Companies (Amendment) Act of 1990, *supra* note 79, § 23(4).

<sup>115</sup> Extensions beyond 35 days are common, as are extensions of up to 100 days. Companies (Amendment) Act of 1990, *supra* note 79, § 18(2); Companies (Amendment) (No. 2) Act § 22(b) (Act No. 30/1999) (Ir.).

as is practicable after appointment,<sup>116</sup> upon showing good cause, the Examiner may have up to 100 days from the date of the presentation of the Petition to present his or her report.<sup>117</sup> If the Examiner cannot formulate any proposals, he or she must report that fact to the court, and the court will then normally order the winding-up of the company.<sup>118</sup>

When the court confirms a scheme of arrangement, it becomes binding upon the company, its members, and the company's creditors.<sup>119</sup> The scheme becomes effective at the time the court orders, but no later than 21 days after the date of confirmation.<sup>120</sup> The company then resumes its ordinary operation with its affairs restructured, and the protection afforded the company ceases.<sup>121</sup> If the scheme is not confirmed by the court or is not successfully implemented, then protection of the court is removed.<sup>122</sup> Following the removal of such protection, the norm is that either a liquidation or receivership will follow in short order.

#### IV. COMMON LAW COUNTERPARTS – AUSTRALIA AND THE UNITED STATES

To establish the potential effectiveness of Examinership, a brief contrast with two of its common law counterparts is potentially revealing. The two approaches – one Australian, one from the United States – stand at opposite ends in terms of approach, with Examinership a seemingly reasonable hybrid middle ground.

##### A. *Australian Voluntary Administration*

Australian insolvency law is designed with creditor interests at the forefront. The modern law – enacted in 1993 and known as “Voluntary Administration” – is intended to maximize the value of the ongoing business and preserve the interests of employees and suppliers, while still fully protecting the value of the company's creditors' inter-

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<sup>116</sup> Companies (Amendment) Act § 22(1)(a).

<sup>117</sup> The Court cannot extend the time period for the Report. However, once the Report has been presented, the court may extend the protection period, if necessary, to enable the court to make the decision whether or not to approve the Examiner's proposals. *Id.* at §§ 18(3), (4); Companies (Amendment) (No. 2) Act § 22(c).

<sup>118</sup> Companies (Amendment) (No. 2) Act, *supra* note 79, §§ 22(3).

<sup>119</sup> Companies (Amendment) Act, *supra* note 79, §§ 24(5)-(6).

<sup>120</sup> *Id.* § 24(9).

<sup>121</sup> *Id.* § 26.

<sup>122</sup> *See id.* § 24(11).

ests should liquidation ultimately become unavoidable.<sup>123</sup> Voluntary Administration was expressly designed to be a rapid, inexpensive, straightforward, and flexible means of dealing with troubled companies<sup>124</sup> that are either insolvent or “likely to become insolvent.”<sup>125</sup> The system has two parts. First, there is an appointment of an Administrator; and second, the company operates under a deed of company arrangement.<sup>126</sup> The deed of company arrangement is a fairly simple document that largely serves the same function as an Irish scheme of arrangement and an American plan of reorganization in Chapter 11.<sup>127</sup>

An Administrator must be a registered Insolvency Practitioner,<sup>128</sup> and his or her appointment is typically accomplished by the

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<sup>123</sup> See Corporations Act 2007 (Cth) sub-reg 435A (Austl.) (“The object of this Part is to provide for the business, property, and affairs of an insolvent company to be administered in a way that:

- (a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or
- (b) if it is not possible for the company or its business to continue in existence – results in a better return for the company’s creditors and members than would result from an immediate winding up of the company.”)

<sup>124</sup> See 1 The Law Reform Commission, Report No. 45, General Insolvency Inquiry, ¶ 54 (1988) (Austl.) (“The procedure proposed was designed with the aim that it would be capable of swift implementation, as uncomplicated and inexpensive as possible and flexible, providing alternative forms of dealing with the financial affairs of the company.”).

<sup>125</sup> See *Corporations Act 2001* (Cth) sub-reg 436A (Austl.). By “Insolvent,” what is meant is a company that is unable to pay its debts as they become due. See *id.* reg 95A. While the name suggests the voluntary nature of the proceedings, Voluntary Administration can occur involuntarily. Pursuant to § 436B(1), “A liquidator or provisional liquidator of a company may by writing appoint an administrator of the company if he or she thinks that the company is insolvent, or is likely to be insolvent at some future time.” *Id.* § 436B(1). In addition, pursuant to § 436C, it can also be commenced by a creditor holding a lien over all or substantially all of the Company’s assets. See *id.* § 436C(1) (“A person who is entitled to enforce security interest in the whole, or substantially the whole, of a company’s property may by writing appoint an administrator of the company if the security interest has become, and is still, enforceable.”).

<sup>126</sup> See The Law Reform Commission, *supra* note 124, ¶ 56.

<sup>127</sup> A deed of arrangement is by design far more straightforward than other methods available to insolvent companies in Australia. It is a “simplified document of much less size and complexity than the present forms of ‘scheme documents’ that oppress creditors and others. The deed will incorporate (by simple reference) standard provisions contained in a schedule to the company’s legislation. . . .” *Id.* ¶ 8.

<sup>128</sup> See *Corporations Act 2001* (Cth) sub-reg 448B (Austl.). A person must consent to the appointment and can only act as administrator of a company or a deed of trust if he or she is a registered liquidator.

company's directors merely signing a form.<sup>129</sup> In juxtaposition to Examinership, there is no need for a court filing.<sup>130</sup> The role of the courts in a Voluntary Administration is nominal and is largely limited to general supervision.<sup>131</sup> The rationale for keeping courts at a distance is telling. What transpires in a Voluntary Administration concerns solely the company and its creditors. As the restructuring is not seen as having broad social import, despite the potential effect on the company's employees, its suppliers, and its neighboring businesses, the ultimate resolution should be a reflection of that which is in the creditors' best interests.<sup>132</sup> Indeed, one of the express aims of the law is to protect creditor interests if the company is unsalvageable by providing "a more advantageous realization of the company's assets than would be effected" by an immediate winding-up.<sup>133</sup>

Upon the appointment of an Administrator, with certain exceptions, an immediate moratorium on all claims is established.<sup>134</sup> The Administrator cannot wind up the company via liquidation,<sup>135</sup> nor, may liens be enforced, save one major exception.<sup>136</sup> Further, neither owners nor lessors of property the company uses may reclaim their

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<sup>129</sup> In addition to directors, liquidators and creditors with liens over substantially all of the company's assets can also appoint an administrator. *Id.* §§ 436A-C. Empirical studies have shown that 98% of administrations, in fact, commence by appointment made by the company's directors. See ROMAN TOMASIC & KETURAH WHITFORD, AUSTRALIAN INSOLVENCY AND BANKRUPTCY LAW 168 (2d ed. 1997). Neither unsecured nor undersecured creditors may appoint an administrator.

<sup>130</sup> See *Corporations Act 2001* (Cth) sub-reg 436A (Austl.). Instead of a court proceeding, the document of appointment is filed with the Australian Securities Commission and appropriately made public.

<sup>131</sup> The Australian Law Reform Commission contemplated only a supervisory function for courts in the Voluntary Administration process. The Commission recommended "that the court have a broad power to make orders for the effective operation of the procedure. Although provision for extensive involvement of the court has been avoided to simplify and reduce the time and expense of the procedure, the court should have a role to ensure that the procedure operates in accordance with the law." The Law Reform Commission, *supra* note 124, ¶ 62.

<sup>132</sup> See generally K.J. Bennetts, *Voluntary Administration: Shaping the Process Through the Exercise of Judicial Discretion*, 3 *INSOLVENCY L.J.* 135 (1995).

<sup>133</sup> See The Law Reform Commission, *supra* note 124, ¶ 35.

<sup>134</sup> See *Corporations Act 2001* (Cth) sub-reg 440 (Austl.). This is consistent with the automatic stay provisions listed in 11 U.S.C. § 362. Justifications for the Australian moratorium are similar to those for the American automatic stay. For example, they provide for orderly administration of debtors' affairs rather than a race to the courthouse door, and they preserve certain assets for the state that may be necessary for successful reorganization.

<sup>135</sup> See *Corporations Act 2001* (Cth) sub-reg 440A(1) (Austl.).

<sup>136</sup> *Id.* sub-reg 440B.

property as a general matter.<sup>137</sup> The moratorium not only serves the purpose of halting creditor collection efforts, but it also provides leave for the Administrator to investigate the company's affairs and to accordingly prepare a report for use by the creditors.

There is, however, one major exception to the breadth of the § 440(d) moratorium. Upon appointment, an administrator must notify any holder of a charge over all, or substantially all, of the company's property of his or her appointment.<sup>138</sup> That creditor then has the right to enforce its charge within a certain proscribed period.<sup>139</sup> This time period is referred to as the decision period.<sup>140</sup> Since the company cannot stop a majority lien holder from enforcing its interest during the decision period,<sup>141</sup> the effect is that a secured creditor can effectively opt out of an Australian bankruptcy proceeding and foreclose on property following default.<sup>142</sup> While many critics initially feared that secured creditors would routinely exercise their rights pursuant to this exception, this has not transpired as frequently as originally thought.<sup>143</sup>

Unlike the situation with Examinerships, the appointment of an Administrator largely suspends the powers of the officers of the cor-

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<sup>137</sup> *Id.* sub-reg 440B(1).

<sup>138</sup> *See id.* sub-reg 450A(3).

<sup>139</sup> *See id.* sub-reg 441A. While the provision governing secured creditors with a lien over substantially all of the company's assets is by far the most significant exception to the moratorium, two others do exist. First, secured creditors who have acted to enforce their rights prior to the appointment of the administrator may also enforce their lien, as may creditors with a security interest in perishable property. *See id.* §§ 441B, 441C, 441F.

<sup>140</sup> The decision period is typically 10 to 14 days. If the creditor fails to act within that time, he may still give notice pursuant to his security interest that he will enforce his interest when the administration ends. *See Corporations Act 2001* (Cth) sub-reg 441E (Austl.).

<sup>141</sup> *See Corporations Act 2001* (Cth) sub-reg 441A(3) (Austl.).

<sup>142</sup> By contrast, the Chapter 11 approach forces the secured creditor to participate in the bankruptcy process unless one of two primary circumstances has been met, in which case the creditor can lift the automatic stay. The first circumstance is "cause," including the lack of adequate protection. *See* 11 U.S.C. § 362(d)(1) (West 2012). The second circumstance is when the debtor has no equity in the property, and the property is not needed for an effective reorganization. *See* 11 U.S.C. § 362(d)(2).

<sup>143</sup> *See* Ron W. Harmer, *Bankruptcy in the Global Village: Comparison of Trends in National Law: The Pacific Rim*, 23 *BROOK. J. INT'L L.* 139, 148–49 (1997). Perhaps one reason why banks have been reluctant to routinely exercise this right is the fear of negative publicity because their financial best interests may not correlate with the financial well-being of the business community at large.

poration,<sup>144</sup> and the Administrator obtains these powers.<sup>145</sup> If a company's officers violate this provision, however, they may be held personally liable for any debts incurred.<sup>146</sup>

The Administrator handles both company operations and investigations into the company's affairs. Following appointment, proceedings in court or in relation to the company's property can only commence with either the written consent of the Administrator<sup>147</sup> or with leave of court.<sup>148</sup> Additionally, any transfer of shares is void absent court approval.<sup>149</sup> The Administrator further acts as company agent and has a wide range of authority,<sup>150</sup> including bringing and de-

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<sup>144</sup> While directors do remain in office, their powers are greatly truncated. "While a company is under administration, a person (other than the administrator) cannot perform or exercise, and must not purport to perform or exercise, a function or power as an officer . . . of the company," except with the administrator's written approval. *See Corporations Act 2001* (Cth) sub-reg 437C(1) (Austl.). Rather, the director's primary role becomes to assist the administrator. Directors are required to aid the administrator by the delivery of the company books and provide statements about the company's business, property, affairs, and financial circumstances, as well as provide any other information the administrator reasonably requires. *See id.* §§ 438B(1)–(3).

<sup>145</sup> *Compare id.* § 437A(1) ("While a company is under administration, the administrator: (a) has control of the company's business, property and affairs; and (b) may carry on that business and manage that property and those affairs; and (c) may terminate or dispose of all or part of that business, and may dispose of any of that property; and (d) may perform any function, and exercise any power, that the company or any of its officers could perform or exercise if the company were not under administration."), with 11 U.S.C. § 1107(a) (West 2012) ("Subject to any limitations on a trustee serving in a case under this chapter . . . a debtor in possession shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter.").

<sup>146</sup> *See Corporations Act 2001* (Cth) sub-reg 437E.

<sup>147</sup> As a general matter, any action on behalf of the company neither taken nor approved by the administrator is void. *See generally id.* § 437D. There are, however, some exceptions relating to certain payments by banks. *See id.* § 437D(3).

<sup>148</sup> *See id.* § 440D(1). Circumstances where a court will do so are rare. *See, e.g., Foxcraft v. Ink Group Pty Ltd.* [1994] 15 A.C.S.R. 203, 205 ("It may be that where the company is insured against the liability the subject of the proceedings, the administrator will ordinarily consent or the court will give conditional leave, but outside this field it is hard to see situations where it would be proper to grant leave, though doubtless there are such situations.").

<sup>149</sup> *See Corporations Act 2001* (Cth) sub-reg 437F(1)(c) ("A transfer of shares in a company that is made during the administration of the company is void except if: . . . (c) the Court makes an order under subsection (4) authorizing the transfer."). *See id.* § 437F(8)(c) ("An alternation in the status of members of a company that is made during the administration of the company is void except if: (c) the Court makes an order under subsection (12) authorizing the alteration.").

<sup>150</sup> *See id.* § 437B.

fending legal actions and executing documents.<sup>151</sup> There are two noteworthy exceptions to the Administrator's power to bring legal action. First, once a company is under administration, any guarantee of the company's liabilities, which has been given by a director of the firm or a relative of a firm's director, is not enforceable except by court order.<sup>152</sup> Second, potentially voidable transactions may not be challenged by an Administrator.<sup>153</sup> Like his Examiner counterpart, an Administrator may be personally liable for debts incurred under his or her administration, including for goods bought and for property leased, used, or occupied,<sup>154</sup> though in both the Irish and Australian instances, the Administrator is entitled to indemnification for such liability from the company's assets.<sup>155</sup>

A primary power of the Administrator is to investigate. Shortly following appointment, the Administrator is charged with calling two meetings of creditors. The first meeting must be called within eight business days of the commencement of the administration; its purpose is to first, determine whether a committee of creditors should be appointed to aid the administration,<sup>156</sup> and second, to determine who are to be the committee's members, with their primary functions to be consultation regarding administrative matters and consideration of administrative reports.<sup>157</sup> A second meeting of creditors must be held within 5 days of the convening period,<sup>158</sup> generally within twenty days of the commencement of the administration.<sup>159</sup>

Thus, within a month – by the time of the second meeting – the Administrator will have examined the financial status of the ailing company and will have reported to the firm's creditors on both the fi-

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<sup>151</sup> See *id.* § 442A(c)-(d).

<sup>152</sup> See *id.* § 440J(1).

<sup>153</sup> However, such transactions may be challenged by a liquidator. Thus, the presence of such transactions may encourage creditors to vote for a liquidation rather than for a deed of arrangement so that such transactions may be legally challenged. See *Uncommercial Transactions*, WORRELLS (Feb. 6, 2011), <http://www.worrells.net.au/Content/InsolvencyResources/InsolvencyResourceArticle.aspx?ArticleId=71>.

<sup>154</sup> *Corporations Act 2001* (Cth) sub-reg 443A(1) (“The administrator of a company under administration is liable for debts he or she incurs, in the performance or exercise, or purported performance or exercise, of any of his or her functions and powers as administrator, for: (a) services rendered; or (b) goods bought; or (c) property hired, leased, used, or occupied . . .”).

<sup>155</sup> See *id.* § 443D.

<sup>156</sup> See *id.* § 436E(1)–(2). It is worth noting that creditors cannot vote to end the administration at this point.

<sup>157</sup> See *id.* §§ 436E(1)(b), 436F(1).

<sup>158</sup> See *id.* § 439A(2).

<sup>159</sup> See *id.* § 439A(5)–(7). This period of time may be extended if the Court finds it to be in the best interest of the creditors.

nancial condition of the company<sup>160</sup> and on the company's potential long-term viability.<sup>161</sup> If he or she deems the company viable, the Administrator will present the creditors with a deed of company arrangement, on which the creditors will then vote.

The reorganization decision is made via a vote of the creditors on the deed of company arrangement. A simple majority of creditors voting is required based both on the number of creditors and on the total dollar amount owed.<sup>162</sup> Creditors are held to the task of convening a commission whereby they may undertake the decision as whether to execute a deed of company arrangement, to end administration, or to wind up the company.<sup>163</sup> The deed binds virtually all parties, including unsecured creditors, the company itself,<sup>164</sup> the company's officers and members,<sup>165</sup> and the deed's Administrator.<sup>166</sup> Secured creditors who have voted affirmatively are also bound by the deed.<sup>167</sup> Secured creditors who have voted to reject a deed which is nonetheless confirmed by the majority are generally not bound by the deed, however, and may generally enforce their rights in their collateral as long as doing so will not result in a "materially adverse" impact

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<sup>160</sup> This includes investigating any past or present officer who may have committed misconduct or who may be otherwise accountable to the business. *See id.* § 439A.

<sup>161</sup> In giving notice of this meeting, the administrator must accompany the notice with the following:

- (a) a report by the administrator about—
  - (i) the company's business, property, affairs, and financial circumstances; and
  - (ii) any other matter material to the creditors' decisions to be considered at the meeting; and
- (b) a statement setting out the administrator's opinion, about each of the following matters:
  - (i) whether it would be in the creditors' interests for the company to execute a deed of company arrangement;
  - (ii) whether it would be in the creditors' interests for the administration to end;
  - (iii) whether it would be in the creditors' interests for the company to be placed in liquidation; and
- (c) if a deed of company arrangement is proposed, a statement setting out details of the proposed deed. Corporations Act 2001 (Cth) sub-reg 439A(4) (Austl.).

<sup>162</sup> *See Corporations Regulations 2001* (Cth) reg 5.6.21(2) (Austl.).

<sup>163</sup> *See Corporations Act 2001* (Cth) sub-reg 439A-C (Austl.).

<sup>164</sup> *See id.* § 444G(a).

<sup>165</sup> *See id.* § 444G(b).

<sup>166</sup> *See id.* § 444G(c).

<sup>167</sup> *See id.* § 444D(1)–(2).

on the purpose of the deed, and as long as the secured creditor is adequately protected.<sup>168</sup>

Creditors may choose any of three options for the deed of company arrangement. First, the company may execute the deed of company arrangement specified in the resolution. As the deed is deemed to be largely a vehicle for creditor satisfaction, there is wide latitude as to what the deed may contain.<sup>169</sup> Deeds of arrangement, however, must meet certain proscribed conditions necessary to assure the ongoing operation of the company.<sup>170</sup> They must bind the company, its officers, members,<sup>171</sup> the deed's administrator,<sup>172</sup> and most of the company's creditors,<sup>173</sup> and they must be implemented within 15 days, unless an extension is obtained through a court.<sup>174</sup> Second, the administration

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<sup>168</sup> See *id.* § 444F(3)(a).

<sup>169</sup> Paul B. Lewis, *Trouble Down Under: Some Thoughts on the Australian-American Corporate Bankruptcy Divide*, 2001 UTAH L. REV. 189, n.69 (citing Phillip Lipton, *Voluntary Administration: Is there Life After Insolvency for the Unsecured Creditor?*, 1 INSOLVENCY L.J. 87, 92 (1993)) ("As one commentator put it: "It is hoped that the procedure will allow for considerable flexibility in order to enable the contents of the deed to meet the needs and circumstances of the company and its various creditors. The deed may provide for debts to be compromised or repayments delayed or paid in installments.").

<sup>170</sup> See *Corporations Act 2001* (Cth) sub-reg 444A(4) (Austl.).

("The [deed] must specify the following:

- (a) the administrator of the deed;
- (b) the property of the company (whether or not already owned by the company when it executes the deed) that is to be available to pay creditors' claims;
- (c) the nature and duration of any moratorium period for which the deed provides;
- (d) to what extent the company is to be released from its debts;
- (e) the conditions (if any) for the deed to come into operation;
- (f) the conditions (if any) for the deed to continue in operation;
- (g) the circumstances in which the deed terminates;
- (h) the order in which proceeds of realising the property referred to in paragraph (b) are to be distributed among creditors bound by the deed;
- (i) the day (not later than the day when the administration began) on or before which claims must have arisen if they are to be admissible under the deed.")

<sup>171</sup> See *id.* § 444G.

<sup>172</sup> See *id.*

<sup>173</sup> See *id.* §§ 444D(1)–(2). It is however, possible to terminate the deed. An administrator may do so when it is no longer practicable to carry on the business. Under such circumstances, a creditors' meeting may be called to decide whether the company should be voluntarily wound up. See *id.* § 445C-F.

<sup>174</sup> See *id.* § 444B(2).

may end. If the administration is terminated,<sup>175</sup> the company reverts to its former position, subjecting the company once again to the prospect of receivership or liquidation. The third and final option is for the company to wind up.<sup>176</sup> In this case, the company is deemed to have wound up voluntarily.<sup>177</sup>

### *B. American Chapter 11*

American insolvency law is designed with an emphasis on rescuing troubled firms to preserve the social and economic benefits that attend the existence of a successful business. A balancing of the competing interests is a distinctly lower level priority than in Ireland.<sup>178</sup> Under Chapter 11, it is the norm for the debtor to remain controlled by the existing management post-bankruptcy filing.<sup>179</sup> The existing management then operates as the “debtor in possession.”<sup>180</sup> With the debtor in possession in charge – rather than an independent party, as is the case in Ireland and Australia – an incentive is created to seek Chapter 11 relief early when the company’s prospects of ongoing viability may be greater. The debtor in possession can operate both without the constraints of a trustee and largely unfettered by creditors, so long as it is functioning within the boundaries of the ordinary course of business.<sup>181</sup>

A few general aspects of Chapter 11 are worth briefly noting. First, there is no insolvency requirement – either on a balance sheet or an equity basis – to file for Chapter 11.<sup>182</sup> Second, as is the case in

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<sup>175</sup> See *id.* §§ 435C(3)(a)-(h) (The administration typically ends for one of these three reasons; however, procedural matters, such as failure to hold the meeting, may bring about an end to the administration as well.).

<sup>176</sup> See Corporations Act 2001 (Cth) sub-reg 439C(c) (Austl.).

<sup>177</sup> See *id.* § 491(1).

<sup>178</sup> Reorganization is seen as preferable to liquidation in the United States. See *e.g.*, *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983) (quoting H.R. REP. NO. 95-595, at 220 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787) (“By permitting reorganization, Congress anticipated that the business would continue to provide jobs, to satisfy creditors’ claims, and to produce a return for its owners. Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if ‘sold for scrap.’”) (internal citations omitted).

<sup>179</sup> *Id.*; see also 11 U.S.C. § 1108 (West 2012).

<sup>180</sup> Sometimes abbreviated as DIP. It is possible in unusual cases in Chapter 11 to have a trustee or examiner appointed. See 11 U.S.C. § 1104 (West 2012). However, the debtor operating as debtor in possession is the norm.

<sup>181</sup> As long as the debtor is operating within the ordinary course of its business, the debtor in possession fully operates the business during the time the company is in Chapter 11. It has the right, subject to certain restrictions, to use, sell, or lease the property of the estate. 11 U.S.C. § 363 (West 2012).

<sup>182</sup> See 11 U.S.C. § 109 (West 2012).

Ireland and Australia, the filing of a Chapter 11 petition creates a moratorium – known as the automatic stay – on all collection efforts on pre-bankruptcy filing obligations.<sup>183</sup> Unlike the situation in Australia, however, the automatic stay generally binds secured creditors subject to certain exceptions.<sup>184</sup> Third, the debtor in possession is given the exclusive right to propose a plan<sup>185</sup> for the first 120 days following the filing of a petition,<sup>186</sup> a period which may be extended further for cause.<sup>187</sup> This “exclusivity period” provides certain leverage to the debtor in possession in negotiating a Chapter 11 reorganization plan.<sup>188</sup> If neither the debtor’s plan nor any other plan can be successfully confirmed, the firm’s assets will likely be liquidated.<sup>189</sup>

The Bankruptcy Code imposes multiple requirements for a plan to be confirmed.<sup>190</sup> All are mandatory, except one – that the plan be consensual.<sup>191</sup> Creditors vote on a plan by class.<sup>192</sup> A favorable vote can be obtained in either of two ways. Any class of claimants whose interests are unimpaired<sup>193</sup> under the plan is automatically deemed to accept the plan.<sup>194</sup> Alternatively, an impaired class may vote in favor of a plan. To do so, both the majority of creditors in the class must vote in favor of the plan, and the claims of those voting for the plan must

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<sup>183</sup> *Id.* § 362; *accord Corporations Act 2001* (Cth) sub-reg 440 (Austl.).

<sup>184</sup> The primary exceptions are that the creditor may have the stay lifted or modified if there is no equity in the property and the property is not needed for an effective reorganization, or if there is an absence of adequate protection of the secured creditor’s secured claim. *See* 11 U.S.C. §§ 361, 362(d)(1)-(2) (West 2012).

<sup>185</sup> A plan proponent must also provide, in addition to the plan, a court approved disclosure statement containing adequate information for a creditor to evaluate the plan. *Id.* § 1125 (West 2012).

<sup>186</sup> *See id.* § 1121(b). This is called the exclusivity period. If the debtor has not filed a plan within 120 days, or if the plan has not been confirmed within 180 days, any party may file its own plan. *Id.* § 1121(c).

<sup>187</sup> *See id.* § 1121(d).

<sup>188</sup> The desire to give the debtor leverage to negotiate is made clear in the legislative history of the Code. *See* S. REP. NO. 95-989, at 64 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5850.

<sup>189</sup> *See generally* 11 U.S.C. § 1112 (West 2012) (providing for conversion of a case from Chapter 11 to one under Chapter 7 of the Code).

<sup>190</sup> *See id.* § 1129(a).

<sup>191</sup> *See id.* § 1129(a)(8).

<sup>192</sup> All holders of claims and interests may vote on the plan. *See id.* § 1126(a) (“The holder of a claim or interest allowed under section 502 of this title may accept or reject a plan.”). *See generally id.* § 1122.

<sup>193</sup> A class is said to be impaired unless certain specified requirements are met which essentially leave unaltered the rights of the party in question. *See* 11 U.S.C. § 1124.

<sup>194</sup> *See id.* § 1124, 1126(f).

have a dollar value equal to at least 2/3 of the dollar value of all of the claims in the class.<sup>195</sup>

As long as the plan is consensual, the debtor's ability to retain ownership is determined contractually based upon the agreement of the parties rather than the rule of law. If the plan is not consensual, however, and an impaired class rejects the plan, the court can still confirm the plan in what is known as a "cram down" if certain requirements are met.<sup>196</sup> These requirements include, among other things, that at least one class of impaired creditors who are not insiders has accepted the plan,<sup>197</sup> that the plan does not discriminate unfairly,<sup>198</sup> that the "best interests test" is satisfied,<sup>199</sup> and that the plan is deemed "fair and equitable."<sup>200</sup>

The "fair and equitable" requirement may be satisfied in different ways depending upon the status of the creditor. For dissenting secured creditors, a plan is fair and equitable and can be crammed down if the secured creditor effectively receives the full economic equivalent of its secured claim.<sup>201</sup> The U.S. Code provides three alternative methods of accomplishing this. First, a dissenting secured creditor may keep its lien and receive payments on the plan's effective date equal to the amount of the secured claim.<sup>202</sup> Second, the creditor may receive the indubitable equivalent of its claim.<sup>203</sup> Third, the property can be sold free and clear of the lien, with the creditor's security interest attaching to the proceeds of the sale; this lien on proceeds may then be treated under either of the other two options.<sup>204</sup>

For impaired, dissenting unsecured creditors, a plan is deemed fair and equitable if it satisfies the terms of the Absolute Priority Rule. The Absolute Priority Rule follows the principle that since creditors have priority over equity in contracts under state law, it is appropriate that, absent an agreement to the contrary, the priority order be maintained in a reorganization.<sup>205</sup> Hence, this signaled the derivation of the Absolute Priority Rule, which holds that no junior class of claimants can receive a penny in a cram down unless all senior classes are

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<sup>195</sup> See *id.* § 1126(c).

<sup>196</sup> See *id.* § 1129(b).

<sup>197</sup> See *id.* § 1129(a)(10).

<sup>198</sup> See 11 U.S.C. § 1129(b)(1)

<sup>199</sup> The best interest test requires the dissenting impaired class of creditors to receive at least as much as it would in a Chapter 7 liquidation. See *id.* § 1129(a)(7).

<sup>200</sup> See *id.* § 1129(b)(1).

<sup>201</sup> See *id.* § 1129(b)(2).

<sup>202</sup> See *id.* § 1129(b)(2)(A).

<sup>203</sup> See *id.*

<sup>204</sup> *Id.*

<sup>205</sup> See *N. Pac. Ry. Co. v. Boyd*, 228 U.S. 482, 502-05 (1913).

paid in full.<sup>206</sup> Thus, a plan is fair and equitable with respect to an impaired class if that class will receive full compensation for its allowed claims before any junior class receives any distributions.

A significant issue in relation to the Absolute Priority Rule is the existence of the so-called “new value exception.” The exception, implicitly recognized by the U.S. Supreme Court in *Bank of America National Trust and Savings Association v. 203 North LaSalle Street Partnership*,<sup>207</sup> has the effect of allowing the existing shareholders of a Chapter 11 debtor to retain ownership notwithstanding their inability to satisfy the Absolute Priority Rule, so long as they contribute new, necessary capital in a full value, market transaction in which they pay top dollar for the right to retain ownership. As will be discussed below, the Irish courts are currently considering a related issue with respect to Examinership. When confirmed, the court will implement a Chapter 11 plan, which will replace old debts with new debts so the company emerges as a reorganized entity not likely to need further economic restructuring.

### C. *Examinership vs. Voluntary Administration and Chapter 11*

The Irish examinership approach to business restructuring appears to be a genuine effort to balance the competing interests of all relevant parties to the restructuring. It reflects a moderate intermediate compromise between the two more extreme approaches to business insolvency considered in this article. This compromise manifests itself in a number of different ways. For example, in Ireland, entry into examinership requires some independent determination of its necessity and its prospect of ultimate success. A report of independent accountant is required, and under section 2(2) of the Companies Act as amended, a Court “shall not make an order . . . unless it is satisfied that there is a reasonable prospect of the survival of the company and

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<sup>206</sup> See 11 U.S.C. § 1129(b)(2)(B), which provides:

— For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(B) With respect to a class of unsecured claims -

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property. . .

<sup>207</sup> *Bank of Am. Nat'l Trust and Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434 (1999).

the whole or any part of its undertaking as a going concern.”<sup>208</sup> In the United States, neither a showing of insolvency nor a showing that Chapter 11 may ultimately be effective is required.<sup>209</sup> As a result, in the United States, any entity, solvent or insolvent, with or without realistic chances of reorganization, may be a debtor in bankruptcy.<sup>210</sup> Not surprisingly, this has given rise in the United States to strategic use of insolvency as something akin to a business-planning device. Insolvency law can be used to obtain otherwise unavailable delays, to reject executory contracts and to get out from under unfavorable labor agreements,<sup>211</sup> as well as for other strategic purposes.

Similarly, voting for an Irish scheme – like an Australian deed of arrangement – is based on a simple majority of creditors both by number and by dollar amount at stake. Claims are not classified. By contrast, the American voting system relies on the classification of a claim,<sup>212</sup> and there is a super-majority component required for a class to consent to a plan. As noted, in the U.S., unless a class is unimpaired, for it to vote in favor of a plan, the majority of creditors in the class must vote in favor of the plan, and their claims must have a value equal to at least two-thirds of the value of all of the claims in the class; yet, a compelling argument exists that super-majority voting is appropriate only where there is a fear that corporate decisions will, by their nature, affect majority and minority shareholders differently, such as is the case with a closely held corporation.<sup>213</sup> This is not true in Chapter 11, since each class member will receive a proportionate share of the distribution. While the benefits of a super-majority scheme in Chapter 11 are nominal, the costs are not. Further, the Irish approach mirrors non-bankruptcy corporate voting which, as a general matter, provides for a one vote per share approach.<sup>214</sup> Such an approach reflects the fact that each vote should correlate with the financial stake of the voter in the firm. Similarly, by employing simple

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<sup>208</sup> Companies (Amendment) (No. 2) Act of 1999, *supra* note 79, § 2(2) (Ir.), available at <http://www.irishstatutebook.ie/1999/en/act/pub/0030/index.html>.

<sup>209</sup> 11 U.S.C. § 301 (West 2012).

<sup>210</sup> *See id.*

<sup>211</sup> For example, the United Airlines bankruptcy.

<sup>212</sup> Note that this is not by the creditor’s classification. A single creditor may have more than one claim. The classic example is an undersecured creditor, who has a secured claim up to the value of the collateral and an unsecured claim for the remainder. This creditor will vote both its secured and its unsecured claim.

<sup>213</sup> *See generally*, David Arthur Skeel, Jr., *The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases*, 78 VA. L. REV. 461, 515–16 (1992).

<sup>214</sup> *E.g.*, 8 DEL. CODE ANN. tit. 8, § 212(a) (2002). However, corporations can generally alter this one vote per share model should they so choose. For an overview of corporate voting rules, *see* Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J. L. & ECON. 395, 399 (1983).

majority voting, Examinership ensures that the vote will necessarily correlate with the financial stake of the voter, and takes into account the rights of small creditors who may be the most adversely affected by the bankruptcy, and whose interests may be contrary to those with the greatest value at stake.

Third, Ireland has no direct counterpart to the American debtor in possession.<sup>215</sup> Instead, an Irish Examiner has substantial, though not complete, control of the debtor entity. Not only does this in part remove management from the decision making process, which may have induced an endogenously caused insolvency,<sup>216</sup> it tends to avoid the moral hazard issues which arise from the debtor in possession law. A debtor in possession may be tempted to opt for high-risk strategies on the basis that it has nothing left to lose by doing so but potentially a substantial amount to gain. This strategy – surely tempting to the debtor in possession of any insolvent company – contains moral hazards analogous to those commonly associated with limited liability. As equity investors lose their investment before debt investors do, the equity holder (in charge as debtor in possession) has nothing left to lose and, thus, does not bear the full burden of its risky behavior. As a result, an incentive is created for the equity holders to direct a firm to behave in an excessively risky fashion. Further, the Irish approach avoids the inherent conflict in fiduciary obligations that exist in the United States. A debtor in possession, with all the rights and powers of a trustee in most instances, is responsible during the bankruptcy for, among other things, operating the business, assuming and rejecting executory contracts, and proposing a plan of re-

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<sup>215</sup> Interestingly, the Commission on the Bankruptcy Laws of the United States, created by Congress in 1970 to examine the existing bankruptcy laws, proposed that a trustee be appointed for any corporate bankruptcy case involving 300 or more security holders and debts of at least \$1,000,000, unless a trustee was found to be unnecessary or the expense would be “disproportionate to the protection afforded.” H.R. Doc. No. 93-137, at 221 (1973). As noted, however, when Chapter 11 was ultimately enacted, the debtor acting as debtor in possession was the established norm, and a trustee could only be appointed “for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management. . . .” 11 U.S.C. § 1104(a)(1) (West 2012).

<sup>216</sup> Perhaps most notably in recent years, Bradley and Rosenzweig have argued that this is a common occurrence. “More fundamentally, fashioning a firm’s capital structure obviously involves certain choices regarding the use of debt financing. To the extent that managers, influenced by the availability of bankruptcy protection, choose to burden their firms with ‘too much’ debt or ‘impossible’ debt-payment obligations, financial distress is hardly an entirely exogenous event. On this view, corporate bankruptcy frequently is significantly *endogenous*, chosen by, rather than imposed upon, corporate managers.” Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1047 (1992).

organization.<sup>217</sup> By doing so, it makes numerous decisions that impact the value and viability of the business. These decisions will harm some parties and benefit others. Yet a debtor in possession simultaneously owes fiduciary obligations to a number of parties including creditors, officers, directors, and equity, whose interests rarely align.<sup>218</sup>

Fourth, there are obvious benefits to quickly resolving the financial issues of the company. In Ireland, the entire process is typically concluded within 70 days, and it must be concluded within 100 days at the most.<sup>219</sup> The speed of these processes results in several key benefits, including lower administrative costs and a smaller delay for investors hoping to reinvest their assets.

The related issues of the existence of creditor control and the presence of cram down provisions are core questions for any corporate rescue scheme. Insolvent firms are effectively owned by their creditors.<sup>220</sup> In situations of insolvency, creditors, who primarily bear the burden of further loss, should be given decision-making discretion. Irish law limits the powers of secured creditors by requiring secured creditor participation in the Examinership. While this binds all relevant parties by the process, it does create issues for secured creditors in that their rights are determined in part by those who bear no direct risk. As noted, however, these risks are ameliorated to a degree by the

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<sup>217</sup> See 11 U.S.C. § 363.

<sup>218</sup> For a thorough discussion of the conflict of interest problem, see Raymond T. Nimmer & Richard B. Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 BANKR. DEV. J. 1, 2 (1989).

<sup>219</sup> Companies (Amendment) (No. 2), *supra* note 79, § 22.

<sup>220</sup> See *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1360 (7th Cir. 1990) ("Creditors effectively own bankrupt firms."). In fact, the fiduciary duty of a firm's directors shifts upon insolvency from the firm's shareholders to its creditors. See *In re Mortgageamerica Corp.*, 714 F.2d 1266, 1269 (5th Cir. 1983) ("Becoming insolvent, the equitable interest of the stockholders in the property, together with their conditional liability to the creditors, places the property in a condition of trust, for the creditors, and then for the stockholders.") (quoting *Hollins v. Brieffield Coal & Iron Co.*, 150 U.S. 371, 383 (1893)); *Clarkson Co., Ltd v. Shaheen*, 660 F.2d 506, 512 (2d Cir. 1981), *cert. denied*, 455 U.S. 990 (1982) ("If the corporation was insolvent at that time it is clear that defendants, as officers and directors thereof, were to be considered as though trustees of the property for the corporate-beneficiaries [creditors].") (quoting *New York Credit Men's Adjustment Bureau, Inc. v. Weiss*, 110 N.E.2d 397, 398 (N.Y., 1953)); *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, No. 12510, 1991 WL 277613, at \*34 (Del. 1991) ("At least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk bearers, but owes its duty to the corporate enterprise."); *FDIC v. Sea Pines Co.*, 692 F.2d 973, 976-77 (4th Cir. 1982), *cert. denied*, 461 U.S. 928 (1983) ("[W]hen the corporation becomes insolvent, the fiduciary duty of the directors shifts from the stockholders to the creditors.").

fact that there is precedent suggesting that secured creditors cannot be forced over their objection to accept less than the value of their security in settlement of a debt.<sup>221</sup> Such a protection should presumably help preserve the availability of credit at an appropriate cost in the future.

The second aspect of creditor control is the existence of cram down, or the allowance of confirmation of non-consensual plans of reorganization. In Ireland, a court can confirm a plan if the court is satisfied that the proposals are fair and equitable in relation to any class of creditors that has not accepted the proposals and whose interests would be impaired by them, and if the court is satisfied that the proposals are not unfairly prejudicial to any interested parties. Therefore, Irish law provides some protections for both dissenting secured and unsecured creditors as a balance to the rights of the equity holders.

#### IV. THE DEBT CRISIS AND EXAMINERSHIP IN IRELAND

The number of Examinership cases that have been filed in Ireland in recent years is stunningly small. There has been some significant increase in filings from boom to bust years by percentage, with the numbers of petitions rising by a factor of five, but this is somewhat misleading given the extremely small numbers involved. From 2006 – 2010, the numbers were as follows:<sup>222</sup>

|                            | 2006 | 2007 | 2008 | 2009 | 2010<br>(@ 31 July) |
|----------------------------|------|------|------|------|---------------------|
| <b>Petitions Presented</b> | 8    | 24   | 41   | 40   | 11                  |
| <b>Interim Examiners</b>   | 4    | 20   | 33   | 33   | 8                   |
| <b>Examiners</b>           | 4    | 22   | 39   | 40   | 9                   |
| <b>Schemes Approved</b>    | 6    | 17   | 27   | 32   | 6                   |

The question for this paper is why such a seemingly moderate, sensible approach to corporate rescue has been virtually ignored through-

<sup>221</sup> *E.g.*, *Re Sharmand Ltd.*, [2008] 514 COS (where the secured creditor argued successfully that there is no precedent for the involuntary writing down of secured debt in an Examinership).

<sup>222</sup> The Honourable Mr. Justice Franke Clarke, *Court Supervised Corporate Recovery in Ireland: Recent Developments in the Use of the Examinership Provisions*, presented at the Annual General Meeting and Conference of the International Association of Insolvency Regulators at Dublin Castle, Ireland (Sept. 22, 2010).

out one of the worst economic periods in the history of the Republic of Ireland.

To begin with, the general economic environment in a country is likely to be a significant element in the success or failure of any corporate rescue scheme. In Ireland, the boom at the end of the twentieth century and into the early part of the twenty-first century was followed by a monumental bust. The problems leading to the need for recovery and the issues facing any possible solution must be considered against that backdrop.

There are several possible explanations for the overall small numbers of Examinership filings. One explanation may be that examinership is not well suited to deal with economic failures related to real property and its construction, industries responsible, along with the banking industry, for much of the economic ills by which Ireland has been bedeviled over the past few years. A second possible explanation is that once the economic environment in a country reaches a certain depressed point, corporate rescue ceases to be a viable option. This may be particularly true when the recession hits the nation's banks as deeply as was the case in Ireland, as the necessary funds for post-Examinership success – either through debt financing or through equity financing – were not available. A third, related possibility is that the restructuring process may create a deterrent to its application if the process leaves companies post-Examinership ill-equipped for long-term success. Unfortunately, there is no data available in Ireland as to the survival rate of companies post-Examinership.<sup>223</sup>

Beginning with property and construction companies – industries at the center of Ireland's economic problems – in reviewing proposals related to the Examinership of companies in such industries, courts have recently either declined to appoint an examiner or have refused to approve the scheme of arrangement proffered.<sup>224</sup> While the Examinership process is applied uniformly irrespective of the nature of the company's business, some critics have argued that aspects of the construction business may make the Examinership process more difficult for companies in that industry as compared to other industries.<sup>225</sup>

The devastation of the real property sector in Ireland during the past few years has been exhaustively documented. The majority of property in Ireland has declined significantly in value during this time, with perhaps the majority of property falling in value by fifty

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<sup>223</sup> *Id.* at 4.3.

<sup>224</sup> *See, e.g.*, *Re Vantive Holdings*, *supra* note 92, at 384; *Re Laragan Dev.* [2009] I.E.H.C. 390; *Re Tivway* [2010] I.E.S.C. 11.

<sup>225</sup> *See Clarke*, *supra* note 222, at 8.1–8.7.

percent or more.<sup>226</sup> The result has been devastating for companies in the business of construction and property development in Ireland. These companies have experienced financial difficulties at a rate exceeding any other sector of the Irish economy.

The Honourable Justice Frank Clarke, in a paper entitled “Court Supervised Corporate Recovery in Ireland: Recent Developments in the Use of the Examinership Provisions,”<sup>227</sup> noted a number of issues that have impacted the effective use of the Examinership provisions in Ireland in recent years. These issues include the following:

- Due to the massive losses suffered in the real estate and construction businesses, companies in those industries are likely to have exceptionally severe financial problems compared to an ordinary company seeking restructuring by Examinership.
- Further complicating the situation for such companies is the fact that virtually all of their property of value is likely to be subject to liens, and the holders of such liens may well prefer to have a Receiver appointed and realize on their security rather than try to salvage the existing company.
- A related issue arises for companies required under their lease agreements to pay rental amounts well above market value. As lease prices have fallen with property value, it would clearly be advantageous for companies in such circumstances to be able to get out from under such leases. As noted previously, Examinership allows for the repudiation of leases, but only under limited circumstances and with court consent.<sup>228</sup> While it has not historically been an uncommon occurrence for landlords to negotiate down the amount of rent in difficult financial times, this has been complicated by the fact that many landlords borrowed heavily themselves to finance the purchases of their properties, and may as a result may not be in an economically viable position to renegotiate a decrease in rent. In addition, if there are guarantees by shareholders or principals of the debtor-lessor, the incentives for the lessee to reduce rental amounts are likely to be substantially lessened.
- In a number of recent cases, the company’s primary lender has opposed Examinership. While in many cases the company does have the support of its lender – perhaps because

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<sup>226</sup> Ronan Lyons, *Taking Stock of Ireland’s Property Market, Five Years into the Crash*, DAFT.IE (2012), available at <http://www.daft.ie/report/Daft-House-Price-Report-Q2-2012.pdf>.

<sup>227</sup> Clarke, *supra* note 222, at 16.

<sup>228</sup> *Re Linen Supply of Ireland Ltd.*, [2009] I.E.H.C. 544 (H. Ct.) (Ir.).

the undersecured lender sees an Examinership as creating the greatest likelihood of recovering lost value – cases dealing with real property tend to involve scenarios where the bank may prefer a Receivership to an Examinership. This leads to a core question in Ireland – namely, whether a debtor requiring ongoing financing can successfully establish a scheme of arrangement without the consent of its banks. Among the possible issues for consideration is whether a scheme can force the lender to accept adjusted and less favorable lending terms than that to which they originally agreed. The second question is whether the prohibition on a scheme being “unfairly prejudicial” precludes forcing a secured lender to accept a decreased payment than that to which they would otherwise be entitled.<sup>229</sup> These remain key issues to resolve under Irish Examinership law.<sup>230</sup>

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<sup>229</sup> Clarke, *supra* note 222, at 11.3.

<sup>230</sup> See 11 U.S.C. §§ 1129(b)(2)(a)(i)-(iii) (West 2012). Recall that in the United States, a plan can be confirmed over the consent of the secured claim in effect so long as the secured creditor receives the economic equivalent of its secured claim, which will equal the value of the collateral – not the value of the entire debt – if the creditor is under-secured. See § 1129(b)(2)(A), which reads in relevant part:

- (2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:
  - (A) With respect to a class of secured claims, the plan provides—
    - (i) (I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
    - (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;
    - (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
    - (iii) for the realization by such holders of the indubitable equivalent of such claims.

- A general question of fairness has arisen in regard to schemes of arrangement where the only investors forthcoming are the existing shareholders of the company. While there is no legal prohibition to this in Ireland, it may create a situation where shareholders are allowed to retain ownership of the company notwithstanding the fact that creditors are not being fully repaid what they are owed. As Justice Clarke puts it: Where the investor is an independent third party, then it is difficult to second-guess that investor's commercial judgment of what the company may be worth when it comes out of examinership. Examiners normally advertise in an appropriate way for investors. Examiners will opt for the best investment package if there be more than one. If there is no other investor willing to put forward a better package, then it is difficult to avoid the conclusion that the package on offer represents a legitimate commercial valuation of the company. However, where the investor is, in substance, already in control of the company, and where that person or those persons will retain such control, then it seems to the courts that a greater degree of scrutiny needs to be applied to ensure that the investors are not simply using examinership as a means of writing off their debts and, possibly, avoiding any additional scrutiny that might arise in the context of liquidation. While no scheme of arrangement has yet been refused on such grounds, it is an issue which has arisen in a number of cases and may well require a definitive court ruling in due course. In such cases, fairness as between shareholders and creditors needs to be considered, in addition to fairness between different categories of creditor."<sup>231</sup>

As noted above, a similar issue was litigated in the United States in regard to the so-called new value exception (or corollary) to the absolute priority rule, and was ultimately resolved by the United States Supreme Court in *Bank of America National Trust and Savings Association v. 203 N. LaSalle Street Partnership*, where the Court implicitly allowed such a restructuring plan so long as the new equity was purchased at top dollar.<sup>232</sup> There are a number of policy justifications for allowing old ownership to bid to purchase the equity of the new company even when creditors are not paid in full, so long as the

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<sup>231</sup> See Clarke, *supra* note 222, at 11.3.

<sup>232</sup> *Bank of Am. Nat'l. Trust and Sav. Ass'n*, *supra* note 207.

old ownership will pay more than any other willing buyer. These policy reasons include the basic concept that more bidders generally results in better auctions.<sup>233</sup> The more interested bidders, the greater the price the auction is likely to return, which in turn means more funds will be available for distribution to creditors.

Further, a rational equity holder may bid more than a rational third party creditor or a third party buyer. This is the case for a number of reasons. First, equity holders are already familiar with the business and are thus less likely to discount their bids for unknown risks.<sup>234</sup> Other motivations may include family name and identity associated with the business or embarrassment over failure to pay creditors. Second, the equity holders may also have personal liability, such as guaranties, linked to the continuation of the business, or personal income opportunities, such as employment compensation or management fees. Finally, an additional justification for desiring the availability of new value plans may be to increase the likelihood that the business may successfully reorganize rather than be liquidated.<sup>235</sup> The reorganization process may be viewed as more than a collective proceeding for the enforcement of rights held by creditors under state law. Rather, liquidations may have a negative impact on jobs, suppliers to businesses, and the economy as a whole. The ability of shareholders to remain in control and rehabilitate the business encourages reorganization instead of liquidation.

So why haven't there been more Examinerships during the Irish debt crisis? Clearly, there is a combination of contributing factors. First, to succeed, reorganizations must generally commence before the distressed entity is financially hopeless. Too many Irish housing and construction companies effectively reached the point of no return before any reorganization had commenced. Second, restructuring requires post-insolvency financing, and the credit crunch made the prospect of obtaining available financing a remote one for many businesses. One of the issues impacting the credit crunch in Ireland has been that restrictions on lending were imposed in order to improve the loan-to-deposit ratios of Irish banks. A second is that bank managers – particularly those whose financial success is dependent upon staying in charge rather than based on an equity share of profits – may have sensed greatly increased incentives to be risk averse in their lending, particularly if their bank's capital is low.

Finally, distressed firms need to be restructured in decisive fashion, not merely kept alive. This has been shown to be particularly

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<sup>233</sup> See generally Nicholas L. Georgakopoulos, *New Value, Fresh Start*, 3 STAN. J. L. BUS. & FIN. 125 (1997).

<sup>234</sup> See *id.* at 148–51.

<sup>235</sup> *Id.* at 130.

true in dealing with property-based companies.<sup>236</sup> Thus, in addition to salvaging the banks by guaranteeing their obligations, more attention should have been paid to ensuring some degree of financial solidity of the building and construction companies most heavily hit during the debt crisis.

## V. CONCLUSION

The Irish economy continues to struggle with the effects of an ongoing debt crisis that crippled its banks, caused the government to undertake massive guarantees of bank obligations, and saw the most vulnerable businesses – those in the housing and construction sector – fail at an alarming rate. The presence of a well-thought-out, but little utilized, corporate restructuring law did virtually nothing to ameliorate the effects on distressed businesses. Successful corporate restructuring is dependent upon more than just a sound law. Overall economic conditions, including the presence of a stable banking system, are a necessary prerequisite to the success of any scheme of distressed company restructuring.

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<sup>236</sup> See, e.g., ALAN AHEARNE & NAOKI SHINADA, ZOMBIE FIRMS AND ECONOMIC STAGNATION IN JAPAN 4, 16–17 (2005), available at <http://hi-stat.ier.hit-u.ac.jp/research/discussion/2005/pdf/D05-95.pdf>; Gerard Caprio & Patrick Honohan, *Starting Over Safely: Rebuilding Banking Systems*, in FINANCIAL CRISES: LESSONS FROM THE PAST, PREPARATION FOR THE FUTURE 217–55 (Gerard Caprio, et al. eds., Brookings Inst. Press 2005).







