



# THE INTERNATIONAL LAWYER

A QUARTERLY PUBLICATION OF THE ABA/SECTION OF INTERNATIONAL LAW

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## Global Whistleblower Hotline Toolkit

### How to Launch and Operate a Legally-Compliant International Workplace Report Channel

DONALD C. DOWLING, JR.\*

As corporate social responsibility and business ethics continue to grab our attention, evermore-sophisticated “best practices” and compliance strategies emerge. A key practice that anchors many corporate social responsibility programs and compliance initiatives is launching and publicizing an internal whistleblower procedure, report channel, or “hotline”<sup>1</sup> that entices insiders to denounce colleagues’ misdeeds so management can root out corporate crimes, corruption, and cover-ups.

Within the United States, workplace whistleblower hotlines are a largely uncontroversial “best practice” to which few ever object. But tensions rise when a multinational organization extends report channels abroad. Overseas, whistleblower hotlines can spark blowback from staff, employee representatives, and government enforcers and can trigger confounding legal issues that do not appear in the United States. To a socially responsible American, the hurdles impeding foreign whistleblower hotlines look higher than they should have any right to get.

Workplace whistleblower hotlines take many forms. Some stand on their own while others comprise part of a broader corporate code of conduct, code of ethics, or compliance or social responsibility program. Some run in-house while others are outsourced. There are single global hotlines and there are aligned but separate report channels across local affiliates. Some hotlines are closed to staff in certain countries. Whatever the form or reach, the idea behind a workplace hotline is simple: empower insiders who hear about

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1. This article uses “hotline” to mean any report channel or other internal system or procedure designed to collect whistleblower complaints, regardless of the structure and the medium (media might include, for example, telephone, email, interactive website, postal mail, social networking, or a combination). *See infra* note 21.

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white-collar crime, policy breaches, or other wrongdoing to come forward with allegations so management can investigate, right wrongs, and punish the guilty.

Prison, gangster, and schoolyard cultures revile “snitches,” “stool pigeons,” and “tattle-tales, and what Melville’s Billy Budd reviled as “the dirty work of a telltale.”<sup>2</sup> But corporate culture in America and many other modern societies reveres company and political whistleblowers as do-gooders who expose corruption for the benefit of all. Look at all the Hollywood movies championing real-life informants. What was a trickle of based-on-a-true-story whistleblower-themed film dramas—*Serpico*, *All the President’s Men*, *The Insider*, *Erin Brockovich*—is now, in our post-Enron/post-Madoff age of “Occupy Wall Street,” a steady stream—*The Whistleblower*, *The Informant!*, *Fair Game*, *Puncture*, *Enron: The Smartest Guys in the Room*, and *Chasing Madoff*. Americans who watch these movies root for whistleblowers standing up to white-collar criminals and fighting for corporate accountability. In the workplace, too, rank-and-file Americans tend to welcome whistleblowing (and hence company whistleblower hotlines) as a check against abuses of management. American executives, meanwhile, champion whistleblowing (and hotlines) to support compliance and avert scandals and bet-the-company litigation. Everybody wins—except criminals brought to justice.

But this accommodating view of corporate whistleblowing (and hotlines) is not universal. A cultural component divides some places from the rest. Whistleblowing-averse societies from Russia and Latin America to the Middle East and India to parts of Asia and much of Africa fear reprisals and retaliation so much that they suspect workplace whistleblower hotlines as tools for entrapment. In jurisdictions such as Korea, corporate whistleblowing is taboo,<sup>3</sup> and parts of Continental Europe resist anonymous whistleblowing (and hence anonymous hotlines) surprisingly vehemently.<sup>4</sup> European workers may see hotlines as a threat to privacy—their own and that of powerful wrongdoers. An article in the *New York Times* says that in “much of Continental Europe” a “less swashbuckling attitude toward matters of privacy offer[s] the powerful,” such as corporate officers, “a degree of protection that would be unthinkable in Britain or the United States.”<sup>5</sup> The *Times* article points out that “French politicians have been able to hide behind some of Europe’s tightest privacy laws, protected by what amounted to a code of silence about the transgressions of the mighty.”<sup>6</sup> An article in the *Yale Law Journal* explores why Continental Europeans approach workplace privacy (and, by extension, workplace whistleblowing) so very differently from our outlook stateside:

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2. HERMAN MELVILLE, *BILLY BUDD, SAILOR: (AN INSIDE NARRATIVE)* ch. 15, ¶ 5 (1962).

3. See Choe Sang-Hun, *Help Wanted: Korean Busybodies With Cameras*, N.Y. TIMES, Sept. 29, 2011, at A6, A11 (Korea is “a country where corporate whistle-blowing is virtually unheard of—such actions are seen as a betrayal of the company [and] carry a social stigma”).

4. To Americans, facilitating anonymous whistleblowing encourages candid reports from otherwise-reluctant sources. According to Stephen M. Kohn, Executive Director of the National Whistleblowers Center, “[a]nonymity gets people to file [denunciations] and gets people with a lot to lose to file. The ability to be anonymous is a real game changer in terms of [enhancing potential whistleblowers’] willingness to file.” Stephen Joyce, *SEC Officials: Dodd-Frank Whistleblower Program Has Resulted in Higher Quality Tips*, 215 Daily Rep. for Executives (BNA), at EE-13 (Nov. 7, 2011). Europe stands in sharp contrast. See Donald C. Dowling, Jr., *Sarbanes-Oxley Whistleblower Hotlines Across Europe: Directions Through the Maze*, 42 INT’L LAW. 1, 11-16, 21-28 (2008) [hereinafter Dowling SOX]. As to this article’s operative definition of “workplace whistleblower hotline,” see *supra* note 1 and *infra* note 21.

5. Alan Cowell, *Scandals Redefine Rules for the Press in Europe*, N.Y. TIMES, July 10, 2011, at A13.

6. *Id.*

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GLOBAL WHISTLEBLOWER HOTLINE TOOLKIT 905

[W]e are in the midst of significant privacy conflicts between the United States and the countries of Western Europe—conflicts that reflect unmistakable differences in sensibilities about what ought to be kept “private.”

....

. . . To people accustomed to the continental way of doing things, American law seems to tolerate relentless and brutal violations of privacy in [many] areas of law . . . .

....

. . . American privacy law seems, from the European point of view, simply to have “failed.”

....

. . . Americans and Europeans are, as the Americans would put it, coming from different places. At least as far as the law goes, we do not seem to possess general “human” intuitions about the “horror” of privacy violations. We possess something more complicated than that: We possess American intuitions—or, as the case may be, Dutch, Italian, French, or German intuitions . . . .

....

. . . Maybe Europeans feel that their personhood is confirmed by the fact that their bosses are obliged to respect their privacy in the workplace . . . .

. . . Everybody [in Continental Europe] is protected against disrespect, through the continental law of “insult,” a very old body of law that protects the individual right to “personal honor.” Nor does it end there. Continental law protects the right of workers to respectful treatment by their bosses and coworkers, through what is called the law of “mobbing” or “moral harassment.” This is law that protects employees against being addressed disrespectfully, shunned, or even assigned humiliating tasks like xeroxing.<sup>7</sup>

In societies that value personal privacy above corporate compliance, rank-and-file employees tend to fear workplace whistleblowing, particularly anonymous whistleblowing, as ruthless worker-on-worker espionage.<sup>8</sup> A confidential hotline makes every colleague and co-worker a potential spy, and facilitates unscrupulous rivals lodging false accusations. European workforces get especially queasy when an employer accompanies an anonymous hotline with a mandatory reporting rule—a common provision in multinational codes of conduct that forces employee witnesses to denounce misconduct or else get fired.<sup>9</sup> Conti-

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7. James Q. Whitman, *The Two Western Cultures of Privacy: Dignity Versus Liberty*, 113 YALE L.J. 1151, 1155-57, 1159-60, 1163-65 (2000) (emphasis added, footnotes omitted).

8. Some countries outside the common law tradition, such as European regimes that suffered under Nazis, fascists, and Communists, fear anonymous whistleblowing as potentially treacherous and see anonymous whistleblowers as untrustworthy and dangerous sneaks who escape accountability for their denunciations. These cultures fear anonymous hotlines as lures that might tempt a jealous or vindictive grudge holder to accuse rivals of exaggerated or fabricated misdeeds. These cultures even seem to distrust corporations' skill in conducting unbiased internal investigations into whistleblower allegations. This is, however, a generalization. Not every Continental European fears whistleblowers and elevates personal privacy above corporate compliance. Indeed, corporate governance mavens in parts of Continental Europe may be coming over to the Anglo view that values even anonymous whistleblowing (and hence corporate whistleblower hotlines) as a powerful weapon in the fight against corporate wrongdoing. See Dowling SOX, *supra* note 4, at 11-16.

9. Americans see mandatory reporting rules as a clear best practice. See Holly J. Gregory, *Whistleblower Bounty Rules: Impact on Corporate Compliance Programs*, 2011 PRAC. L. J. 20, 20 (“Corporate codes of conduct typically provide that employees have an obligation to come forward with information about potential wrong-

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mental Europeans are quick to draw analogies here to anonymous neighbor-on-neighbor betrayals under the Stasi and Nazis that sparked torture and murder<sup>10</sup>—a period when the “sea of denunciations and human meanness” swelled to overwhelm even Adolf Hitler.<sup>11</sup> Beyond Europe, many societies fear whistleblowing reprisals, loathe mandatory reporting rules, and see an employer non-retaliation guarantee as a trap.

Laws exist to resolve conflicts in society.<sup>12</sup> In American society, corporate fraud sparks passionate conflict, so Americans tend to embrace corporate whistleblowing and hotlines

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doing . . . Without [this] direct reporting from employees, the company is hindered in its ability to identify potential problems, investigate and take timely corrective action.”). Mandatory reporting rules support employers’ internal investigations, such the scenario where an internal investigation does not uncover quite enough evidence to prove all implicated parties actively committed wrongdoing, but where the investigation confirms that some peripheral conspirators helped cover up malfeasance they demonstrably knew about. Mandatory reporting rules in international codes of conduct raise delicate issues of international and foreign-local employment law, issues beyond the scope of this article (which addresses international whistleblower hotlines). For a discussion by this author of mandatory reporting rules, see Dowling SOX, *supra* note 4, at 6, 17, 44-45. For a discussion by this author of multinationals’ cross-border internal investigations, see Donald C. Dowling, Jr., *Conducting Internal Employee Investigations Outside the United States*, in 2010 EMPLOYMENT LAW UPDATE ch. 2 (Henry H. Perritt ed., 2010), reprinted in 35 N.Y. ST. B.A. LAB. & EMP. L.J. 4 (2010) [hereinafter Dowling Investigations].

10. For examples of Europeans drawing this analogy, see Dowling SOX, *supra* note 4, at 12. Compare, as one example of an anonymous denunciation under the Nazis leading to torture, the case of Joseph Schachno, a U.S.-citizen expatriate doctor practicing medicine in a Berlin suburb during Hitler’s rise to power:

On the night of June 21 [1933], Schachno [was] visited at his home by a squad of uniformed men responding to an anonymous denunciation of him as a potential enemy of the state. The men searched his place, and although they found nothing, they took him to their headquarters. Schachno was ordered to undress and immediately subjected to a severe and prolonged beating by two men with a whip. Afterward, he was released . . . He lay in bed for a week. As soon as he felt able, he went to the [U.S.] consulate [which] ordered him taken to a hospital . . .

ERIK LARSON, IN THE GARDEN OF BEASTS: LOVE, TERROR, AND AN AMERICAN FAMILY IN HITLER’S BERLIN 4 (2011). Describing the beating, Larson adds, “From the neck down to the heels he was a mass of raw flesh,” as “he had been beaten with whips and in every possible way until his flesh was literally raw and bleeding.” *Id.* at 3.

Larson adds:

[In 1930’s Germany,] petty jealousies flared into *denunciations* made to the . . . Storm Troopers—or to the . . . Gestapo . . . The Gestapo’s reputation for omniscience and malevolence arose from . . . the existence of a populace eager . . . to use Nazi sensitivities to satisfy individual needs and salve jealousies . . . [O]f a sample of 213 *denunciations*, 37 percent arose not from heartfelt political belief but from private conflicts, with the trigger often breathtakingly trivial. In October 1933, for example, the clerk at a grocery store turned in a cranky customer who had stubbornly insisted on receiving three pfennigs in change. The clerk accused her of failure to pay taxes. *Germans denounced one another with such gusto that senior Nazi officials urged the populace to be more discriminating as to what circumstances might justify a report to the police. Hitler himself acknowledged . . . ‘we are living at present in a sea of denunciations and human meanness.’*

*Id.* at 57 (emphasis added). *But cf.* Whitman, *supra* note 7, at 1165 (arguing that the “Nazism” explanation for the Continental Europeans conception of personal privacy generally—but *outside* the whistleblowing context—is too facile because it ignores pre-Nazi-era history).

11. See LARSON, *supra* note 10, at 57 (“Germans denounced one another with such gusto that . . . Hitler himself acknowledged . . . ‘we are living at present in a sea of denunciations and human meanness.’”).

12. *Cf.* JURGEN HABERMAS, BETWEEN FACTS AND NORMS: CONTRIBUTIONS TO A DISCOURSE THEORY OF LAW AND DEMOCRACY 263 (William Rehg, trans., MIT Press 2d ed. 1996) (1992) (arguing that democratic laws are “procedures according to which citizens can, in the exercise of their right to self-determina-

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that encourage it.<sup>13</sup> U.S. law tends to support, even mandate, workplace hotlines, and U.S. corporations embrace hotlines in their push for “full compliance.”<sup>14</sup> By contrast, an employer that promotes whistleblowing in whistleblowing-averse societies like Russia, Latin America, the Middle East, and parts of Asia and Africa, causes conflict. And, because invading personal privacy sparks conflict among Continental Europeans,<sup>15</sup> European legal systems actively block many types of personal data processing<sup>16</sup> and interpret data protection laws to rein in the launch and staffing of hotlines.<sup>17</sup> This frustrates U.S. multinationals that buy into the “best practice” of report channels supporting compliance—especially those multinationals that think U.S. law actively requires offering hotlines overseas.<sup>18</sup> Many see the United States and European positions here as “seemingly contradictory regulatory regimes.”<sup>19</sup> The *Wall Street Journal* once quoted someone saying

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tion, successfully pursue the cooperative project of establishing just (i.e., relatively more just) conditions of life.”)

13. Every modern society rejects corporate misconduct, but modern U.S. society seems to be particularly vigilant in this regard. As just one example, in August 2011 a U.C.L.A. law professor publicly called for the U.C.L.A. School of Law to reject a \$10 million gift donated by Lowell Milken because, over twenty-five years before, Milken’s brother had been convicted in junk-bond scandals. Julie Creswell & Peter Lattman, *Milken Gift Stirs Dispute at U.C.L.A.*, N.Y. TIMES, Aug. 23, 2011, at B1. The donor himself, Lowell, had never been convicted and had never “admit[ted] to any wrongdoing.” *Id.* Protest notwithstanding, U.C.L.A. took the money. *Id.*

14. See *infra* Part II(A)(1). On why the U.S. social concept of privacy and U.S. privacy law are compatible with phenomena like corporate whistleblower hotlines, see generally Whitman, *supra* note 7. As to U.S. corporations’ push for compliance, see generally Donald C. Dowling, Jr., *U.S.-Based Multinational Employers and the “Social Contract” Outside the United States*, 43 INT’L LAW. 1237, as reprinted in 26 ABA J. LAB. & EMP. L. 77 (2010).

15. See generally Whitman, *supra* note 7. For a discussion on “proportionality,” see Dowling SOX, *supra* note 4.

16. See Council Directive 95/46, EU Data Privacy Directive, art. 12, 1995 O.J. (L 281) (EC). For analysis of this directive, see generally Donald C. Dowling & Jeremy M. Mittman, *International Privacy Law*, in PROSKAUER ON PRIVACY: A GUIDE TO PRIVACY AND DATA SECURITY LAW IN THE INFORMATION AGE 14-1 (Kristen Mathews ed., 2006); Whitman, *supra* note 7.

17. See *infra* Part II(C).

18. For discussion of whether U.S. law actually requires hotlines abroad, see *infra* Part II(A)(1). As to U.S. opinion that it does, see, for example, DANIEL P. WESTMAN & NANCY M. MODESITT, WHISTLEBLOWING: THE LAW OF RETALIATORY DISCHARGE 162 (2d ed. 2004) (“it would be prudent to assume [that SOX enforcers will treat SOX as extending abroad] because foreign issuers whose shares are traded on U.S. stock exchanges are not exempt from securities filing requirements”). According to a U.S. law firm newsletter of August 2011, “[r]egulatory decisions in [Europe] cast doubt on the legality of whistleblowing hotlines within the EU, and companies listed on U.S. stock exchanges appear to face a difficult choice between two seemingly contradictory regulatory regimes.” Heather Egan Sussman & Alison Wetherfield, *An Employer’s Guide to Implementing EU-Compliant Whistleblowing Hotlines*, McDermott Newsletter (McDermott Will & Emery) Aug. 23, 2011, available at <http://www.mwe.com/index.cfm/fuseaction/publications.nldetail>. These “two seemingly contradictory regulatory regimes” refer to a widespread interpretation that Sarbanes Oxley § 301 (cited and discussed *infra* at Part II(A)(1)) extends extraterritorially—an interpretation that might be inconsistent with the U.S. Supreme Court decision *Morrison v. Nat’l Austl. Bank Ltd.*, 130 S. Ct. 2869, 2883 (2010).

19. Sussman & Wetherfield, *supra* note 18. As to the SEC position: in April 2003, the SEC issued an early release interpreting SOX and saying the SEC declines to take a “one-size-fits-all” approach to regulating whistleblower hotlines and will not “mandat[e] specific [hotline report] procedures” for a number of reasons including the fact that “large, multi-national [sic] corporations [employ] thousands of employees in many different jurisdictions,” presumably meaning different nations, as opposed to different U.S. jurisdictions. Standards Relating to Listed Company Audit Committees Release, Securities Act Release No. 33-8220, 79 SEC Docket (CCH) 2876 (Apr. 9, 2003) (emphasis added) (SEC release implementing Exchange Act § 10A(m)(1) as amended by Sarbanes-Oxley Act of 2002, Pub.L. No. 107-204, 116 Stat. 772, § 301).

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the conflict here effectively orders multinationals either to “chop off [their] left hand or chop off [their] right hand.”<sup>20</sup> Beyond Europe, those jurisdictions where workers fear hotlines as entrapment also impose hotline restrictions.

This article is a toolkit for a compliance-focused multinational that wants to launch a workplace whistleblower hotline across worldwide operations and therefore needs to comply with hotline restrictions overseas.<sup>21</sup> The discussion splits into halves, one conceptual, and one practical. Part One, the conceptual part, explores why any legal system would restrict whistleblower hotlines when no jurisdiction restricts whistleblowing itself and when few whistleblowers even bother with hotlines. Part Two, the practical part, analyzes the six categories of laws that restrict global whistleblower hotlines, focusing on compliance strategy.<sup>22</sup>

### **I. Part One: Why Restrict Whistleblower Hotlines Without Regulating Whistleblowing Itself, When so Few Whistleblowers even Bother with Hotlines?**

A workplace whistleblower hotline comprises three basic components: (1) a *communication* that (a) encourages (or forces)<sup>23</sup> employees to denounce colleagues suspected of wrongdoing, (b) explains how to submit a denunciation, and (c) (often) guarantees confidentiality or anonymity and non-retaliation; (2) a *medium or media* (channel or channels) for accepting denunciations, such as an email address, web link, postal mail address, telephone number, or some combination; and (3) *protocols/procedures and scripts* by which a hotline responder, often a specialist outsourced company,<sup>24</sup> processes denunciations and passes them onto someone at the hotline-sponsor company to investigate. Internal investigations into whistleblower denunciations raise tough legal issues of their own, particularly in the cross-border context, but investigations into specific denunciations are

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20. David Reilly and Sarah Nassauer, *Tip-line Bind: Follow the Law in U.S. or EU?*, WALL ST. J., Sept. 6, 2005, at C1. For similar analogies in this context, see Dowling SOX, *supra* note 4, at 3, n. 6.

21. This article addresses *workplace-context* whistleblower hotlines because most regulations specific to hotlines are specific to *employee* hotlines. Some corporate hotlines are open to stakeholders like customers, suppliers, contractors, and the general public, in addition to employees. Opening a hotline to informants other than staff raises few, if any, legal issues beyond the ones discuss here. Further, hotlines tend to attract most of their calls from current and former employees, not from outsiders.

22. In 2008 this author published a study of the legal issues the reach whistleblower hotlines launched in Europe. See generally Dowling SOX, *supra* note 4. The present article updates some of the points in the 2008 piece and takes a global focus—beyond Europe.

23. See Gregory, *supra* note 9, for a discussion of employer mandatory reporting rules.

24. Hotline-sponsoring multinationals often contract with specialist outsourcer companies to respond to hotline calls. Indeed, a mini-industry of niche “hotline outsourcers” has emerged, comprising companies that respond to hotline calls purportedly in any language. See, e.g., EthicsPoint.com, Beyond Compliance: Implementing Effective Whistleblower Hotline Reporting Systems, <http://www.ethicspoint.com/articles/whitepapers/beyond-compliance-implementing-effective-whistleblower-hotline-reporting-systems> (last visited Jan. 1, 2012). The ability to outsource a cross-border hotline offers a hotline sponsor some distinct advantages—impartiality, specialized expertise—but also triggers additional legal issues because giving an outsider access to highly-confidential denunciations necessarily discloses sensitive data outside the company (even though, in the hotline context, the sensitive transmissions come from individual whistleblowers, not the employer). Particularly in Europe, using an outsourcer implicates the data protection/privacy law concepts of “onward transfer” and, where the outsourcer is outside the European Economic Area, “data export.” See Dowling SOX, *supra* note 4, at 24-25, 48; cf. chart, *infra* Part II(C).

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completely separate from this topic, the pre-investigatory launch, and the operation of a workplace whistleblower hotline.<sup>25</sup>

In many societies, distrust of or aversion to whistleblowing<sup>26</sup> combines with particularly protective local privacy and labor laws<sup>27</sup> to spawn six distinct legal doctrines<sup>28</sup> that restrict multinational employers' freedom to launch anonymous whistleblower hotlines across international operations.<sup>29</sup> But to Americans, the fact that any jurisdiction resists workplace hotlines seems counterintuitive. A government should encourage, not frustrate, businesses policing themselves to comply with the government's own laws. Yes, social forces and public policy in some places seem hostile to whistleblowing, and yes, some societies aggressively ban hotlines that "disproportionately" invade personal privacy. But legislatively restricting hotlines raises a paradox: even the most privacy-protective legal systems on Earth do not dare restrict whistleblowing itself.<sup>30</sup> Why restrict channels that merely facilitate otherwise legal whistleblowing?

As a practical matter, "free-form" whistleblowing—truthful solo denunciations outside formal report channels—is probably impossible to regulate without prior restraints. Whistleblowing intrinsically links to speech, secrecy, and human interaction. In its most basic form, whistleblowing is ubiquitous—quite literally child's play: every toddler tattling on a sibling's misbehavior to mother and every kindergartner bringing an unruly classmate to the attention of teacher is a whistleblower. No free society can prohibit or materially restrict whistleblowing without imposing intolerable prior restraints on speech. And dictatorial, repressive, and fascist governments do not want to restrict whistleblowing; they encourage denunciations to police lawbreakers. Even the legal systems that are most hostile to hotlines leave free-form whistleblowing—including *anonymous* whistleblowing—completely unrestricted.<sup>31</sup>

With whistleblowing unrestricted, why rein in channels that merely receive otherwise-legal whistleblower reports? The historical (and practical) way that governments, free and authoritarian alike, censor speech is to restrict the speaker, not the listener. No federal communications law would restrict radio receivers but leave radio broadcasts unregulated. Merely crippling hotlines leaves would-be whistleblowers free to denounce colleagues any other way they want, anonymously or not, by telephone, written note, postal mail, e-mail,

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25. Investigating a hotline-received whistleblower denunciation opens its own Pandora's Box of legal issues—issues that follow after the launch of a company whistleblower hotline. Not all whistleblower hotline complaints lead to internal investigations and not all internal investigations are sparked by denunciations received via hotline. For analysis and inventory of international internal investigation issues, see generally Dowling Investigations, *supra* note 9.

26. See *supra* notes 1-4, 7-11 and accompanying text.

27. See, e.g., *supra* notes 4, 7-11 and accompanying text.

28. This article addresses these six doctrines *infra* Part II.

29. On workplace hotlines versus hotlines open to non-employee stakeholders, see *supra* note 21.

30. No known jurisdiction imposes any law that acts as a prior restraint on speech to forbid private citizens from truthfully reporting others' misdeeds to private third parties (or to government/police authorities, for that matter). Yet legal doctrines could conceivably be triggered under certain narrow whistleblower scenarios. For example, a government employee whistleblower could illegally divulge state secrets; a corporate officer whistleblower could breach a fiduciary duty; a lawyer whistleblower could breach the attorney-client privilege; a whistleblower party to a confidentiality/non-disclosure agreement could breach the agreement.

31. This part of the article discusses restrictions *against* free-form whistleblowing, not laws that *promote* or *require* whistleblowing. Part II(B), *infra*, discusses laws that promote denunciations to government authorities.

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text message, on-line chat room, tweet, social media, web post, letter to the editor, spreading rumors, contacting government authorities, tying a note to a rock thrown through a window—whatever. With a smorgasbord of non-hotline channels available, restricting only hotlines seems futile.

Indeed, it *is* futile. Whistleblowers overwhelmingly favor non-hotline channels. Only a tiny minority—three percent—of corporate whistleblowers bother with hotlines; a whopping *ninety-seven percent* of whistleblowing is free form.<sup>32</sup> The study that confirms this ninety-seven percent figure was confined to the United States—abroad, where hotlines are less common and less accepted, the percentage of non-hotline whistleblower reports is likely even greater. Information-age communications make non-hotline whistleblowing easier now than ever before. Put aside old, low-tech whistleblowing channels like mailing a letter, dialing a telephone, slipping a note on someone’s chair or under the door, talking to a news reporter, talking to government authorities, and spreading a rumor. Today’s whistleblower accesses many high-tech channels instantly to transmit denunciations to anyone—anonymous email accounts, interactive websites, social media, tweets, text messages, web chat rooms, disposable cell phones, and web-enabled communications. In today’s technology-enabled world, who needs a hotline? Ninety-seven percent of whistleblowers cannot be wrong.

Historically, hotlines always seem to have been mostly irrelevant. Whistleblowing without a hotline is the time-honored way we denounce our fellows. America’s legendary whistleblowers—the real-life informants immortalized by Hollywood—submitted their history-making denunciations without hotlines: take, for example, environmental whistleblower Erin Brockovich (played by Julia Roberts in *Erin Brockovich*); New York police whistleblower Frank Serpico (played by Al Pacino in *Serpico*); Watergate “Deep Throat” whistleblower Mark Felt (played by Hal Holbrook in *All the President’s Men*); tobacco industry whistleblower Jeffrey Wigand (played by Russell Crow in *The Insider*); Archer-Daniels-Midland whistleblower Mark Whitacre (played by Matt Damon in *The Informant*); Dyncorp/U.N. sex trafficking whistleblower Kathryn Bolkovac (derivative character played by Rachel Weisz in *The Whistleblower*); Nigeria “Yellowcake” whistleblower Joseph Wilson, husband of Valerie Plame (played by Sean Penn in *Fair Game*); Enron whistleblower Sherron Watkins (star of the documentary *Enron: The Smartest Guys in the Room*); Bernie Madoff whistleblower Harry Markopolos (star of the documentary *Chasing Madoff*)—even Oval Office sex-scandal whistleblower Linda Tripp (parodied by John Goodman on *Saturday Night Live*).<sup>33</sup> Trailblazing whistleblowers do not bother with hotlines.

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32. “[T]he Ethics Resource Center survey found that *only three percent of all reports of wrongdoing come through hotlines*—possibly indicating that *employees don’t trust them*. They might be right: A study by the University of New Hampshire concluded that *corporate officials take anonymous complaints less seriously and devote fewer resources to them*.” Dori Meinert, *Whistle-Blower: Threat or Asset?*, 56 SOC’Y HUM. RESOURCE MGMT. 27, 27 (2011) (emphasis added). Of course, though, there is no firm correlation between anonymous whistleblowing and hotline whistleblowing: anonymous denunciations are submitted all the time through channels other than hotlines, and self-identifying whistleblowers often call hotlines.

33. Other famous whistleblowers not yet immortalized by Hollywood also made their well-known denunciations free form, without resort to formal corporate hotlines. Think of Japan nuclear power whistleblower Kei Sugaoka; Glaxo Smith Klein whistleblower Cheryl Eckard; “Weinergate” (Anthony Weiner “sexting” whistleblower scandal) whistleblower Andrew Breitbart; and tobacco industry whistleblower Jeffrey Wigand. Indeed, workplace whistleblowers denounce errant employees every day without resorting to formal company



To Americans, imposing laws to restrict hotlines seems downright quixotic for two reasons. First, hotlines exist to support compliance with the government's own laws. Second, restricting hotline listeners without bothering whistleblower speakers is both counterintuitive and futile when ninety-seven percent of whistleblowers avoid hotlines anyway. But this is just a U.S. perspective. For whatever reason, jurisdictions worldwide do regulate workplace whistleblower hotlines, using six separate categories of laws. Multinationals launching cross-border report channels need to comply.

## II. Part Two: Complying with the Six Categories of Laws that Restrict Whistleblower Hotlines Around the World

The *raison d'être* of any whistleblower hotline is compliance. Because hotlines coax witnesses to reveal otherwise-clandestine wrongdoing so an employer can investigate, right wrongs, and comply with law,<sup>34</sup> no hotline can afford to violate applicable law. *Reductio ad absurdum*: an informant could contact a non-compliant report channel, announce the hotline itself violates some law, and denounce the in-house project team that launched it. So every compliant multinational that launches international hotlines needs to start by checking, in each affected jurisdiction, whether the channel might break the law. Then the multinational must comply. Because U.S. domestic laws tend not to restrict whistleblower hotlines, the issues here seem obscure to U.S. multinationals. The rest of this article analyzes the six categories of laws that can restrict whistleblower hotlines abroad, focusing on compliance.<sup>35</sup>

### A. CATEGORY # 1: LAWS MANDATING WHISTLEBLOWER PROCEDURES

The first category of hotline-regulating laws comprises mandates that require setting up whistleblower hotlines in the first place.<sup>36</sup> These laws even reach an organization already

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hotlines. One random, recent example appears in a 2011 California court opinion, *San Diego Unified Sch. Dist. v. Comm'n on Prof'l Competence*, 194 Cal. App. 4th 1454 (2011). In that case an anonymous whistleblower denounced, to police—not using any in-house hotline—a middle-school public teacher who had posted pornographic photographs of himself, and had solicited sex, on Craigslist. *Id.* The California court upheld the firing of the teacher even though the public-sector employee's Craigslist advertisement had been posted off-hours and was unconnected to his classroom job, and even though the denunciation had been anonymous. *Id.*

34. A hotline is never *necessary* for whistleblowing: any whistleblower can submit even anonymous tips in plenty of ways without a hotline. Indeed, only three percent of whistleblowers bother with hotlines. See, e.g., Meinert, *supra* note 32.

35. These six categories are the categories of laws that regulate the *launch and operation* of a whistleblower hotline itself. As such, they do not reach—and this article does not address—legal issues ancillary to hotline launch and operation. For example, it does not address either laws regulating the launch of a *global code of conduct* or laws regulating a *mandatory reporting rule* that forces employee witnesses to report wrongdoing. This author has addressed both of those issues elsewhere. As to laws regulating the launch of a global code of conduct, see generally Donald C. Dowling, Jr., *Code of Conduct Toolkit: Drafting and Launching a Multinational Employer's Global Code of Conduct*, in *GLOBAL LABOR AND EMPLOYMENT LAW FOR THE PRACTICING LAWYER* 563-77 (Andrew P. Morriss & Samuel Estreicher eds., 2010). For discussion of laws regulating a mandatory reporting rule that forces employee witnesses to report wrongdoing, see Dowling SOX, *supra* note 4, at 6, 17, 44-45.

36. For this article's definition of "hotline," see *supra* notes 1, 21. Hotline-mandating laws promote workplace hotlines and so these laws exist only in whistleblowing-friendly jurisdictions.

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committed to launch a hotline, because any report channel rolled out where the law requires hotlines must comply with the strictures in the hotline-mandating law. This section first addresses the U.S. hotline mandating law, the Sarbanes-Oxley Act of 2002 [SOX],<sup>37</sup> then looks at similar mandates overseas.

1. SOX § 301

For multinationals that raise funds on U.S. stock exchanges, the vital hotline-mandating law is SOX § 301(4), which forces company board audit committees to offer “employees” “procedures” for the “confidential, anonymous” submission of “complaints” and “concerns” of “accounting or auditing matters.”<sup>38</sup> The Dodd-Frank law of 2010, discussed in subsection B(2), amends many parts of SOX but does not tweak this particular mandate.<sup>39</sup> SOX § 301(4) requires audit committees of SOX-regulated corporations, including so-called “foreign private issuers” based outside the United States, to:

*establish procedures for:* (A) the receipt, retention, and treatment of *complaints* received by the issuer regarding accounting, internal accounting controls, or auditing matters; and (B) the *confidential, anonymous* submission by *employees* of the issuer of concerns regarding questionable *accounting or auditing matters*.<sup>40</sup>

Fortunately, any viable hotline likely complies if only because SOX § 301(4) offers significant leeway in structuring “complaints” “procedures.”<sup>41</sup> Congress wanted audit committees to tailor bespoke report “procedures” to fit each company’s own needs, and so the U.S. SEC refuses to “mandat[e] specific [hotline] procedures.”<sup>42</sup> Any robust whistleblower channel that a SOX-regulated employer communicates to its (at least U.S.) employees likely complies with SOX § 301(4)(B) as long as employees know about it and can access it “confidential[ly] and “anonymous[ly].”<sup>43</sup> Structuring a SOX-compliant hotline is so easy that no one ever seems to have gotten it wrong: as of mid-2011, no SOX § 301(4) prosecution had ever been reported. Compliance may be so simple that most “complaints” “procedures” comply with SOX § 301(4).

But the concern here is the global context: *how can a multinational launch a compliant hotline for whistleblowers overseas?* The international dimension slams the otherwise-

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37. Sarbanes-Oxley Act of 2002, Pub.L. No. 107-204, 116 Stat. 745, § 301 (codified at 15 USC 78j-1) [hereinafter SOX]. SOX reaches all entities, be they U.S.-based or foreign private issuers, that raise funds on U.S. stock exchanges such as the NYSE and NASDAQ.

38. *Id.* § 301(4). This part of the article addresses the SOX hotline mandate that audit committees make “procedures” available to “employees.” Separate provisions in SOX impose additional rules as to “reasonably” “promoting” whistleblowing reports by “senior financial officers” and “attorneys.” *See id.* §§ 307, 406, 407; 17 C.F.R. § 205.3. This article does not address those mandates because here the focus is on broad-based whistleblower hotline procedures available to all employees (and even to non-employee stakeholders).

39. Dodd-Frank Wall Street Reform and Consumer Protection Act (whistleblower bounty provision), Pub. L. No. 111-203, § 922(a), 124 Stat. 1841 (2010) (codified at 15 U.S.C. § 78u-6 *et seq.*).

40. SOX, *supra* note 37, § 301(4) (emphasis added).

41. SOX § 301 does not use the word “hotline.” *See id.* § 301. This article’s definition of “hotline” includes any “complaints” “procedure” that complies with SOX § 301(4). *See supra* notes 1, 21.

42. Standards Relating to Listed Company Audit Committees, *supra* note 19. *See also* Dowling SOX, *supra* note 4, at 6, n. 17.

43. SOX, *supra* note 37, § 301(4). SOX § 301(4) offers almost no guidance as to what hotline “procedures” must be, except that the text of § 301(4) requires a report channel be “confidential” and “anonymous.” *Id.*

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straightforward § 301(4) “procedures” mandate into hotline-restrictive barriers, erected overseas to hold hotlines back.<sup>44</sup> The question might therefore become: *to what extent can a SOX-regulated audit committee modify a § 301(4) hotline protocol to conform to overseas laws restricting hotlines?* But that question assumes SOX § 301(4) steps beyond U.S. soil and confronts hotline-restrictive laws abroad. Notwithstanding a widespread belief and a 2003 statement by the U.S. SEC to the contrary,<sup>45</sup> SOX § 301(4) might be a shut-in. If SOX § 301 does not travel overseas, then a hotline launched abroad is free to conform to any local hotline rules that foreign law might impose. And so our actual question is: *does the SOX § 301(4) “complaints” “procedures” mandate reach extraterritorially?*

Perhaps it does not. U.S. statutes apply only domestically unless they specify otherwise.<sup>46</sup> Nothing in SOX, nor in any SOX regulation or reported case,<sup>47</sup> addresses whether § 301(4)(B) reaches “employees” based outside the United States. This statutory silence may anchor § 301(4) to U.S. soil.<sup>48</sup> In *Carnero v. Boston Scientific*, the U.S. First Circuit Court of Appeals (later confirmed with a U.S. Supreme Court denial of certiorari) confined a different SOX whistleblowing provision—SOX § 806, which prohibits whistleblower retaliation—to the United States, reasoning that the text is silent as to overseas reach.<sup>49</sup> SOX § 301(4) is also silent on that issue, so the *Carnero* analysis might compel a similar result and confine § 301(4) to the United States. Fresh support lies in the 2010 U.S. Supreme Court decision *Morrison v. Nat’l Aust. Bank Ltd.*,<sup>50</sup> which is eight years newer than SOX. *Morrison* anchors § 10(b) of the U.S. Securities Exchange Act of 1934—like SOX, also a securities law—to the United States:

It is a “longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.” . . . When a statute gives no clear indication of an extraterritorial application, it has none . . . . On its face, § 10(b) [U.S. securities law] contains noth-

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44. See Chart, *infra* Part II(C) (summarizing European hotline laws).

45. See Standards Relating to Listed Company Audit Committees, *supra* note 19.

46. The general, long-standing canon of statutory construction, upheld by a number of U.S. Supreme Court decisions, is that U.S. statutes do not apply extraterritorially unless they expressly say they reach abroad.

47. As of mid-2011, a search revealed no case law or other authority on this point.

48. See Dowling SOX, *supra* note 4, at 7-11.

49. *Carnero v. Boston Sci. Corp.*, 433 F.3d 1, 10 (1st Cir. 2006). *Accord Villanueva v. Core Labs.*, Docket No. 09-108 (Dep’t of Labor Dec. 22, 2011). *But cf. O’Mahoney v. Accenture*, 2008 U.S. Dist. LEXIS 10600 (S.D.N.Y. 2008) (distinguishing the facts of *Carnero*). As to the factual distinction between *Carnero* and *O’Mahoney*, see Dowling SOX, *supra* note 4, at 8-9, n.29. After *Carnero*, Dodd-Frank § 929A amended SOX § 806 to expand the definition of entity to include “any subsidiary or affiliate whose financial information is included in the consolidated financial statement.” Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929A, 124 Stat. 1841 (2010). This would seem to include foreign-incorporated affiliates. But the Dodd-Frank amendments to SOX § 806 do not say anything about overseas-based whistleblowers or whistleblowing incidents that occur abroad. And so the Dodd-Frank § 929A amendments probably do not affect the rule in *Carnero*. But if the Dodd-Frank § 929A amendment is somehow held to overrule *Carnero* and extend SOX § 806 abroad, the fact that Dodd-Frank did not similarly amend SOX § 301 buttresses the analysis that § 301 does not extend abroad: Congress could have made a Dodd-Frank § 929A-like amendment to SOX § 301, but chose not to. On the Dodd-Frank § 929A amendment, see generally OSHA Docket Number OSHA-2011-0126, RIN 1218-AC53, Procedures for the Handling of Retaliation Complaints under Section 806 of the Sarbanes-Oxley Act of 2002, as Amended, Interim Final Rule, Request for Comments, at 5-6.

50. See generally *Morrison v. Nat’l Austl. Bank Ltd.*, 130 S. Ct. 2869 (2010).

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ing to suggest it applies abroad . . . In short, there is no affirmative indication in the [Securities] Exchange Act that § 10(b) applies extraterritorially, and we therefore conclude that it does not.<sup>51</sup>

But *Morrison* is merely the U.S. Supreme Court's view. Multinationals reflexively presume, following an aging 2003 SEC comment with a fleeting reference to § 301 hotlines in "different jurisdictions,"<sup>52</sup> that the SOX hotline "procedures" mandate extends worldwide. SOX-regulated multinationals may not even care whether SOX § 301 reaches abroad—even if it does not, they aspire to the "gold standard" of a SOX-compliant confidential, anonymous hotline across operations worldwide, regardless of whether it sparks a conflict with hotline-restricting laws abroad.

2. *Beyond SOX § 301*

Abroad, whistleblower hotlines must comply with strictures in foreign laws that, like SOX § 301, require employee report channels.<sup>53</sup> But these laws are rare. As of 2011, very few laws beyond SOX force employers to offer hotlines. "Whistleblower laws" have popped up worldwide, but they tend to be mere *retaliation* prohibitions, stopping employers from punishing whistleblowers whether they use hotlines or not.<sup>54</sup> For example, the UK Public Interest Disclosure Act 1998,<sup>55</sup> India's Limited Liability Partnership Act 2008,<sup>56</sup> Japan's Whistleblower Protection Act,<sup>57</sup> and South Africa's Protected Disclosures Act 2000 contain whistleblower retaliation prohibitions without affirmatively requiring report channels.<sup>58</sup> Anti-fraud securities laws tend not to require hotlines either. Japan's Financial Instruments and Exchange Law (J-SOX) does not require them,<sup>59</sup> nor do UK financial accountability laws or the UK Bribery Act.<sup>60</sup> Legislatures in a few jurisdictions *recommend* whistleblower hotlines—India's clause 49 of the Listing Agreement<sup>61</sup> and Spain's Recom-

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51. *Id.* at 2877-78, 2881, 2883 (emphasis added). After *Morrison*, Dodd-Frank § 929P, amended part of the securities law at issue (§ 17 (a) of the U.S. Securities Act of 1933) so that that law now expressly reaches abroad. See Dodd-Frank Wall Street Reform and Consumer Protection Act § 929P. But nothing in Dodd-Frank or elsewhere extends SOX § 301(4) abroad, and the § 929P amendment does not affect the jurisprudence of *Morrison*.

52. Standards Relating to Listed Company Audit Committees, *supra* note 19.

53. Just as, for example, SOX § 301 imposes the stricture that report "procedures" be "confidential [and] anonymous." See SOX, *supra* note 37, § 301(4).

54. See *infra* Part II(E) for discussion of whistleblower retaliation laws.

55. See *generally* Public Interest Disclosure Act, 1998, c. 23 (Eng.).

56. Limited Liability Partner Act, 2008, No. 6, Acts of Parliament, 2009 (India), *available at* <http://www.llp.gov.in/>.

57. Act No. 122 of 2004 (Japan).

58. Protected Disclosures Act 26 of 2000 (Cape Town) (S. Afr.). Section 6(2) addresses, but does not mandate, voluntarily-adopted "procedure[s] authorised by [an] employer." *Id.* § 6(2).

59. Financial Instruments and Exchange Act, Acts No. 65, 66 of 2006 (Japan).

60. Bribery Act, 2010, c. 23 (Eng.).

61. Limited Liability Partner Act, 2008, No. 6, Acts of Parliament, 2009 (India); Press Release, Sec. & Exch. Bd. of India, Extension of Date of Ensuring Compliance with Revised Clause 49 of the Listing Agreement (Mar. 29, 2005) (establishing an effective date of Dec. 31, 2005 for compliance with clause 49 of the Limited Liability Partner Act).

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mentation 50.1(d), part II of *Codigo Unificado de Buen Gobierno* 19 May 2006.<sup>62</sup> But companies can and do ignore these.<sup>63</sup>

A few isolated laws in a handful of places require or have required employers to sponsor report channels. Liberia Executive Order # 22 of 2009,<sup>64</sup> issued by Liberia's Nobel Peace Prize-winning president, required "private entities" to launch procedures for "receiving and processing" "public interest disclosures" about private company "malpractices."<sup>65</sup> But that order has now lapsed. Norway's Working Environment Act<sup>66</sup> grants Norwegians a right to report "censurable conditions" and urges employers to "establish" some "routin[e] . . . or . . . other measures" for employee whistleblower reports.<sup>67</sup> But this is qualified and little more than a strong recommendation. Multinationals launching cross-border whistleblower hotlines must adapt report channels to strictures in local hotline mandates like the now-lapsed Liberia order and Norway's Working Environment Act. But beyond U.S. SOX, few laws yet require hotlines, although this might be an emerging trend.

**B. CATEGORY # 2: LAWS PROMOTING DENUNCIATIONS TO GOVERNMENT  
AUTHORITIES**

Requirements of whistleblower procedures aside, our next category of hotline regulation is laws like U.S. Dodd-Frank<sup>68</sup> that promote employee/stakeholder denunciations to *government authorities*. These laws do not regulate company hotlines per se, but they steer employer hotline strategy for two reasons: first, encouraging whistleblowing to government competes with employer hotlines by enticing internal whistleblowers to divert denunciations from company compliance experts and over to outside law enforcers who indict white-collar criminals. Second, laws that require (as opposed merely to encourage) government denunciations rarely except corporate hotline sponsors. These laws therefore force hotline sponsors to divulge hotline allegations to law enforcement. For both reasons, hotline sponsors need strategies accounting for these laws. We address U.S. Dodd-Frank first, then similar laws elsewhere.

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62. CODIGO UNIFICADO DE BUEN GOBIERNO [REPORT OF THE SPECIAL WORKING GROUP ON THE GOOD GOVERNANCE OF LISTED COMPANIES] recommendation 50.1(d), part II, CNMV (2006), *available at* [http://objetivo15.net/doc/CNMV\\_CodigoBuenGobiernoDeLasSociedadesCotizadas.pdf](http://objetivo15.net/doc/CNMV_CodigoBuenGobiernoDeLasSociedadesCotizadas.pdf) (Spanish version) (Spain); *see also* Dowling SOX, *supra* note 4, at 15, n.48.

63. This part addresses laws mandating *general* denunciations to government authorities. In the specific area of sexual harassment, there are some other laws in some jurisdictions like Costa Rica that require employers to offer a report channel specifically for *sex harassment* complaints. Other countries affirmatively require employers to investigate specific allegations of sex harassment; those countries include Chile, India, Japan, South Africa, and Venezuela. Colombia requires some report channel for "labor" harassment.

64. Exec. Order 22 of 2009 (signed by Liberia President (2011 Nobel Peace Prize winner) Ellen Johnson Sirleaf in Dec. 2009; order now lapsed) (Liber.).

65. *Id.*

66. Working Environment Act, No. 10 (2007) (Nor.), *available at* <http://www.arbeidstilsynet.no/binfil/download2.php?tid=92156>; *see also* Dowling SOX, *supra* note 4, at 15, n.48 (discussing the Working Environment Act).

67. Norwegian Act, *supra* note 66.

68. Dodd-Frank Wall Street Reform and Consumer Protection Act (whistleblower bounty provision), Pub. L. No. 111-203, § 922(a), 124 Stat. 1841 (2010) (codified at 15 U.S.C. § 78u-6 *et seq.*).

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1. *U.S. Dodd-Frank*

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 amended Sarbanes-Oxley in many key respects, but did not touch SOX § 301(4)'s mandate for hotline/"complaints" "procedures."<sup>69</sup> Rather, Dodd-Frank took a radically different approach to whistleblowing that ultimately promotes robust internal company hotlines for a completely different reason. Under Dodd-Frank § 922<sup>70</sup> and U.S. Securities and Exchange Commission [SEC] implementing rules of May 2011,<sup>71</sup> a U.S. government "bounty" pays cash awards of ten percent to thirty percent of SEC-recovered sanctions over \$1 million to eligible whistleblowers—whether living stateside or abroad<sup>72</sup>—who told the SEC "original information" about securities violations leading to an actual money recovery.<sup>73</sup> Even whistleblowers that bypass internal SOX § 301 hotlines are eligible. Dodd-Frank's lure of a huge payday may tempt whistleblowers more than even the warm feeling of doing the right thing by calling an in-house SOX hotline.<sup>74</sup> *The Wall Street*

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69. *See id.*

70. *Id.*

71. Adopting Release, Implementation of Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Rel. No. 34-64545 (May 25, 2011) (codified as amended at 17 C.F.R. pt. 240).

72. *Cf.* Tammy Marzigliano & Jordan A. Thomas, *Advocacy & Counsel for the SEC Whistleblower: A Primer for Employment Lawyers*, 196 DLR I-1, 1-2 (2011):

Any violation of the federal securities laws qualifies for protection under Dodd-Frank. The reported violation may have occurred *anywhere in the world*, involving public or private organizations and domestic or international violators. In most cases, securities fraud occurs when manipulative and deceptive practices are employed in connection with the purchase and sale of a security. Beyond stocks and bonds, the federal securities laws have interpreted "security" broadly to include investment contracts, notes, and other nontraditional investments.

(emphasis added).

73. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, *supra* note 68, at § 922(a); *see also* Adopting Release, *supra* note 71. SEC Enforcement Division Associate Director Stephen L. Cohen, speaking at a conference in November 2011, said that critics of the bounty program "warned," "individuals [would] see[k] financial awards under the program, which by statute will be *no less than \$100,000 and could reach into the millions of dollars.*" Joyce, *supra* note 4, at 1 (emphasis added). The Dodd-Frank bounty is payable only for disclosing a violation of U.S. securities laws—not, for example, for disclosing bribery that violates the U.S. Foreign Corrupt Practices Act. Dodd-Frank Wall Street Reform and Consumer Protection Act, *supra* note 68, at §§ 21F(a)(1), (b)(1). That said, though, "[s]ome whistleblowers may not distinguish between the securities laws and [other laws like] the FCPA . . . and once the SEC has received a tip, it can be expected to pass it on to other law enforcement authorities." Larry P. Ellsworth, *Blowing the Whistle on Private Cos.?*, Employment Law 360, LAW360.COM (Oct. 26, 2011). Whistleblowers resident outside the United States who suspect a violation of U.S. securities laws (such as related to accounting fraud occurring overseas) appear to be fully eligible for the bounty.

74. *Cf.* Marzigliano & Thomas, *supra* note 72:

Dodd-Frank not only provides robust whistleblower protection, but it has revived pre-existing whistleblower claims. The False Claims Act (FCA), once limited to individuals who were "original sources" with "direct and independent knowledge," has been expanded to cover individuals with either information or analysis . . . . Similarly, the Sarbanes-Oxley Act (SOX) now appears to have the teeth it was intended to have. Dodd-Frank expanded SOX by extending coverage beyond just public companies to employees of affiliates and subsidiaries of publicly traded companies "whose financial information is included in the consolidated financial statements of such publicly traded company."

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*Journal* and many others lament the discordant policy message here to would-be whistleblowers.<sup>75</sup>

Former Deputy U.S. Attorney General George Terwilliger, now a partner practicing white-collar criminal law at White & Case LLP in Washington D.C., analyzes the conflict here in detail and offers strategic advice to corporations caught between SOX and Dodd-Frank. Terwilliger's analysis merits setting out in detail:

Notably *omitted* from the [SEC Dodd-Frank whistleblower bounty] Final Rules are requirements that were suggested and designed to preserve the effectiveness of [SOX § 301-style] corporate internal reporting systems. The Final Rules provide what the SEC posits are a number of incentives to encourage potential whistleblowers to utilize existing internal reporting systems. However, *an individual with access to a well-structured, staffed, and responsive internal reporting system can nonetheless forgo reporting internally, provide information directly to the SEC, and remain eligible for [a bounty] award.*

The SEC has downplayed the likelihood that individuals seeking awards will bypass internal systems, but *the program's first-to-report requirement, enormous potential financial awards, and lack of an internal reporting requirement represent a significant challenge to maintaining effective compliance programs [including an effective internal hotline].* Companies have implemented these very compliance programs, often at great expense, at the behest of federal authorities and the dictates of Sarbanes-Oxley requirements to effectively monitor corporate operations for compliance with law.

*Companies now need to assess the effect of the whistleblower reward provision of Dodd-Frank and the SEC's implementing rules on their compliance programs and consider such programmatic adjustments and changes as that assessment may suggest.*<sup>76</sup>

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75. According to a Wall St. Journal blog article:

Compliance lawyers and general counsel argue that they've spent much of the past decade putting compliance programs into place to deal with whistleblowing complaints; *letting every disgruntled employee run to the SEC would provide huge headaches and little benefit . . .* David Becker, the SEC's general counsel, recently told a group . . . that *whistleblowers should not have to approach their companies' management before they run to the SEC . . .* Becker said the reason is because some compliance programs "no matter how elaborately conceived and extensively documented, exist only on paper. Some small number are shams."

Ashby Jones, *Sympathy for the Whistleblower? SEC GC's Comments Pique Interest*, WALL ST. J.L. BLOG (Feb. 1, 2011), <http://blogs.wsj.com/law/2011/02/01/sympathy-for-the-whistleblower-sec-gcs-comments-pique-interest/>.

Many later commentators offered similar views during 2011. See, e.g., BNA Daily Labor Report, *Lawyers Stress Whistleblower Protections in Dodd-Frank Act and SOX Amendments*, 112 DLR C-1 (June 10, 2011); Corpedia Ask the Experts, *What Should a Company's Response Be to the Dodd-Frank Whistleblower Provisions Which Encourage Employees to Report Wrong-Doing to the SEC?*, CORNPEDIA ONLINE, Aug. 2, 2011; Ellsworth, *supra* note 73; Gregory, *supra* note 9; Meinert, *supra* note 32; David Schwartz & Kathiana Aurelien, *Whistleblowing: Dodd-Frank Whistleblower Bounties and Their Impact on Employers*, BLOOMBERG LAW REPORTS: LABOR & EMPLOYMENT, vol. 5 no. 42, at 14 (Oct. 24, 2011); Sutherland Whistleblower Response Team, <http://www.regulatoryreformtaskforce.com/whistleblowerresponseteam/> (last visited Dec. 30, 2011); George J. Terwilliger III, *SEC Adopts Final Rules to Implement New Whistleblower Program*, METROPOLITAN CORP. COUNS., July 1, 2011. For the opposite point of view—Dodd-Frank's whistleblowing scheme as it looks to counsel for *employee whistleblowers*—see Marzigliano & Thomas, *supra* note 72.

76. Terwilliger, *supra* note 75 (emphasis added, footnotes omitted). Terwilliger adds:

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The final SEC rules implementing the bounty attempted, at least ostensibly, to accommodate the critics. According to Terwilliger:

The SEC's release accompanying its Final Rules identifies three incentives in the Final Rules to encourage individuals to report potential misconduct to internal [hotline] systems, or at least minimize the incentive for individuals to bypass internal reporting systems in the hope of qualifying for an award. First, a whistleblower's voluntary participation or interference with a corporate compliance program may increase or decrease the award for that whistleblower. Second, if an individual reports information internally that . . . leads to a successful enforcement action, the SEC will give the whistleblower "full credit" for information disclosed by the corporation for purposes of determining the individual's eligibility for and amount of an award. Third, if a whistleblower reports information internally and within 120 days, reports that same information to the SEC, the SEC will consider the initial date of internal disclosure as the effective date for purposes of determining the whistleblower's eligibility for an award.<sup>77</sup>

But to Terwilliger, these three would-be "incentives . . . fall short of the rule-making options available to the SEC that would ensure internal [hotlines] continue to help companies identify misconduct and provide opportunities to investigate and take appropriate remedial actions:"

It seems apparent that the SEC made a policy choice that places greater importance on its enforcement interests than on maximizing the continued effectiveness of internal reporting systems and the compliance programs they support. For its part, the SEC "expects that in appropriate cases . . . it will, upon receiving a [bounty-eligible] whistleblower complaint, contact a company . . . and give the company an opportunity to investigate the matter and report back." While one can hope this positive

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[SEC] Commissioner Paredes stated: "singular attention has centered on the extent to which the [Dodd-Frank] whistleblower [bounty] program, depending on how it is structured, could unduly erode the value of internal compliance programs in rooting out and preventing wrongdoing." Despite the advocacy for an internal reporting requirement as a condition of award eligibility, the SEC declined to incorporate such a requirement in the final rules.

77. *Id.* (footnotes omitted). According to David Schwartz and Kathiana Aurelien of the law firm Skadden, Arps, Slate, Meagher & Flom LLP:

Even though employers do not pay bounties directly to whistleblowers, many employers are rightly concerned that they will now be subject to unnecessary SEC investigations as employees start to view bounties as personal "lottery tickets." If a few employees "bit it big," more complaints to the SEC will follow, whether or not they are well-founded.

Schwartz & Aurelien, *supra* note 75, at 14 (emphasis added); see also Gregory, *supra* note 9, at 20-22:

The [Dodd-Frank] rules pose a potential risk to the effectiveness of corporate compliance programs, which by their nature depend on reports from employees about potential wrongdoing. The split 3-2 SEC vote adopting the rules underscores the controversy about the potential impact of the rules on [company compliance] programs . . . A new Office of the Whistleblower has been established within the SEC's Division of Enforcement to administer the rules. . . . [The rules] address concerns that compliance programs will be undermined if employees go directly to the SEC with information about potential wrongdoing . . . . The new rules may have a detrimental effect on existing internal reporting systems.

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policy statement will describe a normative practice excepted only in outlier cases where the business . . . in question bears hallmarks of a criminal enterprise, the SEC's actual practice under its whistleblower rules merits continued attention, including through congressional oversight.

The new whistleblower program provides good cause for corporations to *evaluate their compliance efforts* and *take steps to encourage employees* to use internal reporting systems and ensure that companies are made aware of compliance issues as soon as possible.

The objectives of such reevaluation should include (a) maximizing the effectiveness of internal reporting systems; (b) ensuring that internal reports are thoroughly evaluated by a person or group with sufficiently comprehensive knowledge to recognize potential compliance issues in reports that are misdirected or incomplete; and (c) re-examining policies and practices concerning the dissemination of information regarding potential compliance issues within a corporation . . . .

Corporations may also want to consider renewed efforts to inform or remind employees about the existence and use of internal [hotline] reporting systems and provide additional training concerning such use. Employees must believe that reporting internally *will not negatively impact their job status*. Where appropriate, examples of successful internal reporting offer the best evidence to employees that internal reporting is in the best interest of both the employees and the corporation.

*Corporations should also evaluate, assess, and update compliance programs* to ensure that internal complaints are handled swiftly and, where appropriate, lead to investigations, remediation and disciplinary measures. Such efforts are, of course, necessary to protect shareholder value and mitigate liability if misconduct does occur, as the SEC will continue to consider cooperation efforts by companies in accordance with . . . SEC policies that reward such efforts.<sup>78</sup>

Despite the stark policy clash between SOX § 301 and the Dodd-Frank bounty, at the end of the day both laws push company hotline strategy in the very same direction: SOX *requires* an employer to offer internal hotline "procedures" while Dodd-Frank *motivates*

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78. Terwilliger, *supra* note 75 (emphasis added, footnotes omitted). For other analyses broadly consistent with Terwilliger's, *see* citations *supra* note 75. According to *HR Magazine*:

To reduce the risk of an expensive and embarrassing government investigation [following up on a Dodd Frank whistleblower's call], company leaders must step up internal reporting procedures and management training to encourage employees to report their concerns to the company first, lawyers say. . . . Corporate lawyers argue that the proposed [Dodd-Frank] regulations would entice disgruntled employees to circumvent internal reporting methods with the goal of getting hefty rewards.

Meinert, *supra* note 32, at 28. According to Skadden, Arps commentators:

The final rules do not require employees to report suspected violations using internal compliance mechanism to qualify for a bounty. Although the lack of a requirement to report internally *creates a huge incentive* for employees to go directly to the government, the SEC attempted to encourage compliance with internal reporting systems by counting it as a factor when determining the amount of the bounty.

Schwartz & Aurelien, *supra* note 75, at 15 (emphasis added).

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the very same thing—a conspicuous internal report channel robust enough to attract denunciations that informants might otherwise report to government enforcers.<sup>79</sup>

2. *Beyond Dodd-Frank*

Laws outside the United States also regulate whistleblower denunciations to local government enforcers. Any multinational launching a global hotline needs to account for these if only because they rarely exempt hotline sponsors themselves and require companies to disclose hotline denunciations over to local law enforcement. Yet these laws are rare in the free world. The Malaysian Whistleblower Protection Act of 2010, as one example, encourages whistleblowing with a vague Dodd-Frank-like bounty.<sup>80</sup> Now-lapsed Liberia Executive Order # 22 used to encourage whistleblowing to the government in a few ways.<sup>81</sup> But both these laws and even U.S. Dodd-Frank merely *promote* denouncing wrongdoers to government. They pose no compliance challenge to companies launching and staffing internal hotlines, although they motivate multinationals to promote report channels robust enough to attract denunciations that might otherwise go to law enforcers.

The tougher compliance and hotline administration issue here is laws that *require* divulging evidence of criminal behavior to government enforcers. Because few, if any, mandatory-reporting laws exempt hotline sponsors, these laws require divulging credible hotline reports to law enforcers *even before* a thorough internal investigation. Fortunately, very few free-world jurisdictions impose these laws. Slovakia's Criminal Code, as one example, forces Slovaks (including employers) who reliably learn of illegal behaviour to denounce wrongdoers to the police.<sup>82</sup> Liberia's now-lapsed Executive Order # 22 forced employers that received credible criminal allegations through mandatory hotlines to report them to Liberia's "attorney general."<sup>83</sup> These laws cripple hotline strategy both because they require organizations to use their hotlines to incriminate themselves and because they limit organizations' power to investigate denunciations.<sup>84</sup>

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79. See citations *supra* note 75. While to a self-interested whistleblower an internal hotline may not ever look as attractive as the Dodd-Frank cash bounty, employers are in a special position for keeping their hotlines in front of employees worldwide. The U.S. SEC does not communicate directly with U.S. workforces, much less overseas workforces.

80. Act 711, *effective* Dec. 15, 2010, at art. 26 (Malay) (government can pay "rewards" to whistleblowers), available at <http://www.bheuu.gov.my/pdf/Akta/Act%20711.pdf>; cf. *id.* at art. 18(2)(f) (whistleblower can win "pain and suffering" award).

81. Exec. Order 22 of 2009 (signed by Liberia President (2011 Nobel Peace Prize winner) Ellen Johnson Sirleaf in Dec. 2009; order now lapsed) (Liber.).

82. See Dowling SOX, *supra* note 4, at 15 (discussing Law of the National Council of the Slovak Republic No. 300 (2005) Coll. Penal Code (section 340/failure to report a criminal offense)).

83. Liberia Executive Order # 22 of 2009, *supra* note 64.

84. See *generally* Dowling Investigations, *supra* note 9. Hotline communications are usually worded to invite reports of violations of both criminal law and of company policy; laws that require reporting to police obviously affect only whistleblower denunciations of criminals, not denunciations of mere policy violators.

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C. CATEGORY # 3: LAWS RESTRICTING HOTLINES SPECIFICALLY (EU DATA PROTECTION LAWS)

Having discussed laws that both require whistleblower hotlines and promote whistleblowing to government, our next category is hotline mandates that run completely in the opposite direction and *restrict* organizations' freedom to launch and operate report channels.<sup>85</sup> In theory, this category includes all laws that specifically ban or limit whistleblower hotlines, but no such laws are known to exist anywhere. Rather, the only known laws specifically restricting employer whistleblower report procedures are European Union member state guidelines interpreting EU data protection (privacy) laws in the hotline context.<sup>86</sup>

Some Continental Europeans distrust whistleblowers and hotlines.<sup>87</sup> Over a dozen European jurisdictions interpret their local domestic data protection laws (either by regulation or at least by data agency pronouncement) specifically to rein in employer hotlines. In addition, an EU advisory body called the Article 29 Working Party issued a persuasive but non-binding report that recommends all twenty-seven EU states embrace a particularly restrictive interpretation of EU data law to rein in hotlines.<sup>88</sup> Broadly speaking, Europeans see hotlines as threatening privacy rights of denounced targets and witnesses when hotlines are not "proportionate" to other report channels in European workplaces.<sup>89</sup>

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85. We do not include here in "Category #3" whistleblower *retaliation* laws because those laws do not reach the *launch and operation* of whistleblower hotlines. Rather, whistleblower retaliation laws regulate retaliatory acts against whistleblowers who have already denounced suspected wrongdoers, whether or not they had used a hotline to do it. We address whistleblower retaliation laws separately, *infra* at Part Two, "Category #5."

86. See EU Data Privacy Directive, directive 95/46/EC (Oct. 1995) (discussing what EU data protection laws are); see e.g., Dowling & Mittman, *supra* note 16; and see generally Whitman, *supra* note 7.

87. *Supra* notes 5-11 and accompanying text.

88. See Dowling SOX, *supra* note 4, at 18-56 (summarizing (far more thoroughly than the discussion *infra*) these European hotline restrictions); see also Chart, *infra* Part III; Daniel Cooper & Helena Marttila, *Corporate Whistleblowing Hotlines and EU Data Protection Laws*, PLC ONLINE, <http://ipandit.practicallaw.com/1-366-2987>.

89. See Dowling SOX, *supra* note 4, at 41-42 (on "proportionality" in the hotline context); Continental Europeans insist that a hotline is not "proportionate" (is redundant, unnecessary, or at least "overkill") if it threatens to compromise data rights of denounced targets and others but offers little benefit beyond simply duplicating alternate, more privacy-protective report channels already in the European workplace. These so-called "alternate report channels" are not hotlines, of course, but rather are local employee representatives (trade unions, works councils, health and safety committees, ombudsmen), local grievance procedures, and local line managers/chain of command/human resources. To an American, though, these are not adequate "alternates" at all. An American sees local representatives/processors/managers as insiders incompetent to substitute for a hotline for two reasons: (1) reporting to local representatives/processors/managers tends to be neither confidential nor anonymous (although it can be both); and (2) local representatives/processors/managers are rarely both neutral and able to field potentially-explosive denunciations about their own local team or their own local office/plant/operation. An informant making a scandalous accusation to a local representative/processor/manager could step into internal company politics or sensitive personal relationships and the denunciation might go nowhere. Even a local representative/processor/manager not intending to bury an allegation might be too distracted to appreciate its gravity or too busy or untrained to ask the right follow-up questions, or else communication lines might break down. For many reasons, headquarters might never hear about the denunciation or might not get an accurate version. These problems are not just theoretical or hypothetical; denunciations to local interested insiders are mishandled all the time. For example, in October 2011 a California jury awarded a Sears employee \$5.2 million in a race harassment case that emerged from this very scenario. Loretta Kalb, *Sears Employee Wins \$5.2 Million Jury Award for Racial Harassment*, SACRAMENTO (CA.) CITY NEWS, Oct. 26, 2011. The Sears employee had approached his "supervisors" denouncing

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Among the specific hurdles that European jurisdictions erect to frustrate hotlines, perhaps the four biggest are: (1) restrictions against hotlines accepting anonymous denunciations; (2) limits on the universe of “proportionate” infractions on which a hotline accepts denunciations; (3) limits on who can use a hotline and be denounced by hotline; and (4) hotline registration requirements. This article discusses each in turn.

1. *Restrictions Against Hotlines Accepting Anonymous Denunciations*

European hostility toward whistleblowing runs fiercest against anonymous denunciations<sup>90</sup> and hotlines that accept them. Spain and Portugal ban anonymous hotline denunciations entirely and France may prohibit (or at least has prohibited) employers from disclosing that a hotline will accept anonymous calls, even if it does in fact take them.<sup>91</sup> Hotline communications across the rest of Continental Europe should affirmatively discourage anonymous calls and affirmatively encourage informants to self-identify. Multinationals that see SOX § 301(4)’s mandate for “anonymous procedures” as reaching overseas face an impossible conundrum, at least in Spain and Portugal, and possibly in France.<sup>92</sup>

Employers that think they must reconcile U.S.-style SOX hotlines with European anonymity restrictions have four possible choices, not all fully compliant: (1) violate Spanish, Portuguese, and maybe French law by offering and communicating a hotline that accepts anonymous calls; (2) keep hotline communications silent on anonymity but let hotline staff accept denunciations from informants who refuse to self-identify, even where that violates local law; (3) issue a hotline communication that discourages but implicitly accepts anonymous denunciations even where this violates local law; or (4) have hotline staff hang up on anonymous callers where required under local law, taking the position that the SOX § 301 “anonym[ity]” requirement does not reach abroad.

Deciding among these four options forces a multinational to ponder whether to locally tailor hotline communications abroad or to do what every American multinational would likely prefer—issue a single global hotline protocol for affiliate employees worldwide, or at least Europe-wide. This requires tough decisions. How can a global intranet send different messages to employees in different countries? If a hotline sponsor can post

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a racist colleague who happened to be “one of [Sears’s] top sales producers nationally.” *Id.* The “supervisors,” “not want[ing] to take action” against the racist sales star, covered up the denunciation and took “subsequent acts . . . to avoid being exposed for failing to follow the law.” *Id.* A jury awarded \$5.2 million to the victim. *Id.* The Sears case shows that what Europeans call “alternate” internal “report channels” do not really mimic whistleblower hotlines because they are not disinterested. To Americans, the European “proportionality” argument in the report channel context fundamentally misunderstands what workplace whistleblower hotlines are designed to do. A hotline, to an American, gives retaliation-fearing informants a *way around* interested local players who might be less concerned with “making it right” than with “making the numbers”—Americans see a hotline as a detour around, not a duplicate of, local internal “report channels.” See *infra* note 95.

90. See *supra* notes 4-10 and accompanying text. In the United States, by contrast, champions of corporate compliance and social responsibility tend to trust anonymous report channels, reasoning that anonymity encourages reluctant whistleblowers.

91. See Chart *infra* Part III (citing to these laws in Spain, Portugal, and France).

92. See *supra* notes 18, 50-54 (SOX-regulated multinationals widely believe that SOX § 301(4) extends “extraterritorially” to workforces outside the United States even if the 2010 *Morrison* U.S. Supreme Court decision does not support this belief).

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country-tailored hotline protocols on its company intranet, what happens if an employee based in one-country accesses and follows a protocol for staff in a different country? What if an informant from a country where the employer purports not to accept anonymous calls offers up a huge denunciation but refuses to self-identify—must hotline staff cut off his report? At this level of granularity, these are strategy questions; answers depend on circumstances, risk analysis, and HR communication systems specific to each organization.<sup>93</sup>

2. *Limits on the Universe of “Proportionate” Infractions on Which a Hotline Accepts Denunciations*

Even the most hotline-skeptical jurisdictions in Europe recognize, grudgingly, that U.S. multinationals feel compelled to offer employee hotlines to collect reports of financial/audit/accounting fraud and bribery/improper payments, to comply at least with the spirit of U.S. SOX and the U.S. Foreign Corrupt Practices Act.<sup>94</sup> Hotline-skeptical jurisdictions in Europe interpret data protection laws to allow only “proportionate” workplace hotlines closed off to all but these few infractions.<sup>95</sup> But U.S. multinationals see no reason to restrict hotlines this way. They prefer to throw open hotlines to most any impropriety. After all, Americans reason, if we go through the trouble of launching and staffing a hotline, we might as well use it to find out about any problem out there, be it an environmental spill, workplace harassment and bullying, vandalism, corporate espionage, breach of HR policy, breach of expense reimbursement protocols—even theft of office supplies, and unsanitary use of toilets. But to list hotline-reportable infractions is illusory and deceptive if hotline operators will actually take all calls. Yet an employer faces logistical problems confining a hotline to only a few topics. How does hotline-answering staff field an off-point call? Can they even listen? How does hotline staff divert an off-point denunciation to another channel, without dropping it?

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93. These issues lead to real-world litigation. See *Benoist Girard (subsidiary of Stryker) v. CHSCT, Cour d'Appel Caen 3rd Chamber* (23 Sept. 11, released 4 Oct. 11) (Fr.) (Holding illegal the France hotline of Michigan-based medical technology multinational Stryker, even though the French Data Protection Authority had previously approved it. A French whistleblower had gotten past the approved France-specific communications and accessed a different on-line hotline communication meant for Stryker U.S. employees.); see also Dowling SOX, *supra* note 4, at 51-56 (for a deeper discussion of the strategy issues in play here).

94. FCPA, 15 U.S.C. §§ 78dd-1 *et seq.* (The FCPA does not expressly mandate in-house hotlines, but FCPA compliance without a hotline presents tough challenges. Even EU jurisdictions seem open to hotlines that accept denunciations of bribery); see also Dowling SOX, *supra* note 4, at 30.

95. In short, European jurisdictions see workplace hotlines as a threat to data privacy tolerable only where absolutely necessary. By European standards a hotline is somehow less objectionable if it collects only allegations of audit/accounting fraud and bribery but not allegations of, say, theft, physical violence, and sexual harassment. Europeans speak here in terms of “proportionality;” to a European, a hotline that accepts denunciations of thievery, bullying, and sex harassment is not “proportionate” because harassers, bullies, and thieves, unlike fraudsters and bribers, somehow can be denounced more appropriately via other channels. To an American, this “proportionality” analysis in the hotline context seems circular, even bizarre. See *supra* note 89 (on “proportionality”).

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3. *Limits on Who Can Use a Hotline and be Denounced by It*

Some jurisdictions such as Austria, Hungary, Netherlands, and Sweden<sup>96</sup> seem oddly classist and undemocratic because they force employers to reserve hotlines for executives denouncing misdeeds of upper-level colleagues. These jurisdictions steer low-level staff to report channels more “proportionate” for their low rank.<sup>97</sup> An employer communication closing off a hotline to low-ranking whistleblowers and targets must be explicit. Hotline staff must be ready to cut off any low-ranking would-be whistleblower who offers a compelling denunciation.

4. *Hotline Registration Requirements*

Many European jurisdictions require hotline sponsors to register hotlines with local government data-privacy bureaucracies (data protection authorities). These tend to be general mandates that in effect require data “processors” to declare to data authorities many various types of “data processing systems”—including Human Resources Information Systems from payroll and attendance to performance evaluation, pension/benefits, expense reimbursement, travel tracking, milestone anniversary gift programs, and hotlines, too. A few European jurisdictions, such as France,<sup>98</sup> go farther and require complex *hotline-specific* data agency registrations. France imposes both a hotline “declaration” procedure and an alternate hotline “authorization” mandate.<sup>99</sup>

Beyond these four main types of EU data-law hotline restrictions, Europe’s hotline-skeptical jurisdictions regulate other aspects of report channels. Other regulated issues include: (5) alignment with “proportionate” alternate report channels in the workplace;<sup>100</sup> (6) notices to employees, targets, and witnesses explaining their rights; (7) restrictions against outsourcing hotlines; (8) communications to targets/witnesses disclosing specific whistleblower denunciations; (9) complying with “sensitive” (EU Data Directive article 8) data restrictions as to criminal data received by hotline; (10) rights to access, rectify, block, or eliminate personal data processed via hotline; (11) restrictions against transferring hotline data outside of Europe; and (12) deleting/purging of data in hotline call files.<sup>101</sup> The chart below summarizes hotline laws in Europe on key topics.

### III. Whistleblower Hotlines and Data Protection Laws in Europe

This chart summarizes data-protection law pronouncements in those EU member states that issued data-law mandates or interpretations specific to employee whistleblower hotlines as of mid-2011. “Whistleblower hotline” means any channel/system for employees/stakeholders to submit complaints/concerns/allegations of wrongdoing to management.

96. See “Sweden” row on Chart and citations therein.

97. See *supra* notes 89 and 95 (on “proportionality”).

98. See Dowling SOX, *supra* note 4, at 18-56 (summarizing European hotline restriction laws); see also Chart, *infra* pp. 141-61; Cooper & Marttila, *supra* note 88.

99. See “France” row on Chart and citations therein.

100. See *supra* notes 89, 95 (on “proportionality”).

101. These twelve issues are discussed at Dowling SOX, *supra* note 4, at 41-51.

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| Jurisdiction                    | Is the authority binding law?   | Must confine hotline to certain topics only?  | Are anonymous whistleblower calls ever ok?  | Is outsourced (vs. in-house) hotline favored?   | Must disclose hotline to data agency?   |
|---------------------------------|---|---|---|---|---|
| <b>EU Art. 29 Working Party</b> | No: opinion of 1 Feb. 06 is persuasive, a collective view of local Data Protection Agency [DPA] representatives from the EU member states   | Hotline OK if limited to accounting, internal accounting controls, audit, anti-bribery, banking and financial crimes; no opinion on hotlines that reach other topics  | Yes, but do “not advertise” anonymity feature: “The Working Party considers that whistleblowing schemes should . . . not encourage anonymous reporting as the usual way to make a complaint . . . [c]ompanies should not advertise the fact that anonymous reports may be made through the scheme. If, despite this information [being assured of confidentiality], the person reporting . . . still wants to remain anonymous, the report will be accepted.” | In-house hotline is favored; trained in-house team should oversee   | Art. 29 Working Party has no opinion; disclosure depends on local EU member state law   |
| <b>Austria</b>                  | Largely yes: Four hotline-specific decisions are binding as to their specific facts and parties only but otherwise are persuasive:<br>K178.274/0010-DSK/2008 of 5 Dec. 08<br>K178.301/0003-DSK/2009 of 25 Feb. 09<br>K178.305/0004-DSK/2009 of 24 July 09<br>K600.074/0002-DVR/2010 of 20 Jan. 10 | Yes. A hotline must be for a legitimate purpose, therefore must be limited to complaints on topics of “substantial importance;” specifically, Austrian authority interprets this to reach: accounting/ internal accounting controls; audit; severe misconduct/ severe violations of internal code of conduct; | Yes, but employers are not supposed to encourage anonymous calls  | Third-party hotline outsourcer is favored; in any event (whether hotline is answered internally or outsourced), an independent specially-trained team should handle reports | Yes, whistleblowing systems must be <i>notified</i> to the DPA; affirmative DPA <i>authorization</i> is required if the hotline will process sensitive data and/or other special categories of data such as criminal offences |

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| Jurisdiction   | Is the authority binding law?  | Must confine hotline to certain topics only?   | Are anonymous whistleblower calls ever ok?   | Is outsourced (vs. in-house) hotline favored?   | Must disclose hotline to data agency? |
|----------------|--|--|--|---|---------------------------------------|
|                |  | money laundering and anti-terrorism might also be considered legitimate<br>Only reports of misconduct regarding executive managers can be processed and transferred to the US  |  |   |                                       |
| <b>Belgium</b> | No, but persuasive: DPA recommendation of 29 Nov. 06   | Yes, to: criminal offenses and violations of company written rules and legal regulations (particularly related to finance and accounting)  | Yes, but discouraged; only for exceptional cases   | Outsourcing is disfavored and maybe not allowed; need in-house independent point person                     | Yes                                   |
| <b>Denmark</b> | Yes, binding as to notification process with the DPA: Local DPA Whistleblower Guidelines: Procedure for Notification of Whistleblower Systems (updated Apr. 10)<br>There are also two DPA decisions: 2006-42-1061 (Vestas) 2010-42-1941 (Euprin)<br>DPA decisions are not directly binding on non-parties, but have persuasive authority; DPA must treat similar cases similarly | Yes, to: criminal offenses; issues under US SOX; serious offenses important to group/company or relevant to life/wellbeing; economic crimes (e.g., bribery, fraud, forgery); accounting, auditing, bank/finance; corruption/crimes; environmental issues; serious work safety issues, serious employee issues (e.g., assault or sexual abuse)<br>Hotline should not accept reports about "less serious offences," expressly including: harassment, "cooperative difficulties," | Not addressed by guidelines; Danish lawyers understand anonymous calls are OK but should not be encouraged | Neither is favored; third-party hotline outsourcers must be listed in notification to the DPA as processors | Yes                                   |



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|----------------|--|--|--|---|--|
|                |  | incompetence, absence, violation of HR policies  |  |   |  |
| <b>Finland</b> | No (local DPA guidelines of 27 July 10)  | Yes, to: accounting, financial matters, banking, and bribery<br>Under the Finnish data protection law “necessity” requirement, only information directly necessary for an employee’s employment relationship should be collected through a hotline   | Apparently yes, but discouraged; hotline sponsor should discourage anonymous calls; targets have a right to know the source of reports about them unless specifically restricted by law  | Neither is favored; hotline needs to be notified to DPA if outsourced                     | No, <i>unless</i> data transferred outside EU/EEA (without using model contractual clauses, safe harbor or binding corporate rules) <i>or</i> hotline is outsourced to third party |
| <b>France</b>  | Yes: local DPA (CNIL) guidelines of 10 Nov. 05 and 8 Dec. 05 (modified by Resolution no. 2010-369 of 14 Oct. 2010 as a result of <i>Dassault Systèmes</i> decision [ <i>Cour de Cassation</i> 8 Dec. 09]), and clarified by CNIL <i>Fiche pratique</i> of 14 Mar. 11; <i>see generally</i> Benoist Girard (subsidiary of Stryker) v. CHSCT, <i>Cour d’Appel Caen</i> 3rd Chamber (23 Sept. 11, released 4 Oct. 11) | Yes, to: financial, accounting, audit and banking issues; antitrust/ competition practices; and bribery/ corruption; per <i>Fiche pratique</i> of 3/11, if serious issues <i>outside the scope</i> (e.g., environmental violations; trade secret disclosure; data breach risks; discrimination, harassment and other “risks” to employee “integrity”) are reported via hotline, the report needs to be redirected to the responsible person (e.g., financial | Yes, but not encouraged; DPA orally said on 2 Mar. 07 that anonymity feature cannot be communicated to employees, but as of 2011 DPA’s position on this seems to have softened; per <i>Fiche pratique</i> of 3/11, “in principle, whistleblower systems are not anonymous” and whistleblower “must” be “invited” to self-identify; <i>Benoist Girard</i> decision ( <i>supra</i> ) says anonymous denunciations cannot be “accepted except by exception and surrounded | Neither is favored; if in-house, a trained team should oversee and retain confidentiality | Affirmative permission required under 10 Nov. 05 hotline guidelines; self-certify disclosure necessary under 8 Dec. 05 hotline guidelines  |

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| Jurisdiction   | Is the authority binding law?   | Must confine hotline to certain topics only?   | Are anonymous whistleblower calls ever ok?            | Is outsourced (vs. in-house) hotline favored?  | Must disclose hotline to data agency?  |
|----------------|---|--|---|--|--|
|                |   | director, HR director)   | by certain precautions”                               |  |  |
| <b>Germany</b> | No (opinion of 20 Apr. 07 of <i>Düsseldorfer Kreis</i> , a national data agency collective/working group consisting of local German <i>Länder</i> [states] data agency representatives)                               | Hotline OK if limited to: criminal offenses (in particular, fraud, accounting and auditing matters, corruption, banking and financial crime, and insider trading), human rights (e.g., child labor), and environmental violations; other topics may be OK, but hotline may not focus on “conduct which adversely affects company ethics” (e.g., vague mandates such as “to be friendly when dealing with customers”) | Yes, but discouraged; only for exceptional cases      | Not clear; third-party hotline outsourcers appear favored  | Yes, but disclosure mandate is general, applying to many data processing systems (no hotline-specific disclosure mandate), and subject to exceptions such as where there is a company data protection officer  |
| <b>Hungary</b> | No<br>Local DPA guidance to individual parties (like letter ruling): No. 652/K/2007 and No. 295/K/2007<br>Fair Process Act includes some limited references restrictively authorizing employer whistleblowing systems | Limit hotline to “matters that may cause harm to or jeopardize public interest” (e.g., abuse of public resources, corruption, bribery, health and safety, criminal conduct, environmental issues); if hotline covers other matters (not of public concern), employees’ consent is needed<br>Only senior employees can be targets   | Yes; Hungary tracks the Art. 29 Working Party opinion | In-house is favored; if outsourced, employees’ consent is needed and hotline must be registered with DPA; in both cases, access to data must be restricted to limited group authorized to handle reports | If hotline involves transferring data beyond the direct employer (e.g., intra-group transfers or transfer to third-party hotline provider), registration (and perhaps also consent) is required; if not, no explicit registration obligation, but registration is advisable; processing personal data from a whistleblowing call must be registered with the DPA |

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| Jurisdiction       | Is the authority binding law?  | Must confine hotline to certain topics only?  | Are anonymous whistleblower calls ever ok?   | Is outsourced (vs. in-house) hotline favored?   | Must disclose hotline to data agency?   |
|--------------------|--|---|--|---|---|
| <b>Ireland</b>     | No (guidance posted on local DPA webpage, 6 Mar. 06)   | No; hotline can cover whatever violations company specifically designated in advance  | Yes, but “not encouraged”  | Neither is favored  | No, certain data controllers are required to register with DPA, but hotlines do not trigger the registration obligation |
| <b>Italy</b>       | <i>Segnalazione al Parlamento e al Governo sull'individuazione, mediante sistemi di segnalazione, degli illeciti commessi da soggetti operanti a vario titolo nell'organizzazione aziendale</i> , 10 Dec. 09 (Italian DPA) issued per art. 154,1f of 30 June 03, no.196) (DPA referral of hotline questions to Parliament taking no substantive positions) | No position   | No position  | No position   | No position   |
| <b>Luxembourg</b>  | No (guidance of 30 June 06, updated 10 Nov. 07 and 11 May 09, posted on DPA webpage and affirmed in 2009 Annual Report of Activities at § 2.2.1.2)   | Yes, to: accounting, audit, banking and bribery issues  | Yes, but anonymity must be discouraged; whistleblowers must identify where possible  | Neither is favored; trained hotline-answering team with a confidentiality obligation to handle reports is recommended | Yes   |
| <b>Netherlands</b> | No, but persuasive: local DPA recommendation to individual party of 16 Jan. 06   | Yes, “limi[t]” scope to “substantial abuses;” any forwarding of reports to “parent company” can only involve “substantial abuses” above “subsidiary level” (mostly reports of serious abuses by upper management) | Yes, but organizations may not encourage anonymous reports and in theory must use a system by which identity of the informant is established | Third-party hotline outsourcer is favored   | Yes   |

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| Jurisdiction    | Is the authority binding law?   | Must confine hotline to certain topics only?  | Are anonymous whistleblower calls ever ok?   | Is outsourced (vs. in-house) hotline favored?   | Must disclose hotline to data agency?   |
|-----------------|---|---|--|---|---|
| <b>Portugal</b> | No, but persuasive (“The [whistleblowing hotline] authorizations granted shall make direct reference to the legal principles included herein”); DPA’s deliberation n° 765/2009 of 21 Sept. 09   | Yes, to: accounting, internal accounting controls, audit, fight against corruption, banking and financial crimes; targets must be individuals exercising management activities in these fields            | Likely no; anonymous calls appear to be forbidden: DPA “deliberation” “repudiates” anonymous hotlines; Portuguese practitioners differ on whether this “repudiation” amounts to a complete ban on accepting anonymous calls                | Third-party hotline outsourcers are preferred; if in-house, only a small trained team with a confidentiality obligation (contractual) should handle reports | Yes: hotline must be authorized by DPA  |
| <b>Slovenia</b> | No, Slovenia Information Commissioner Opinion on Registration of Whistleblowing Systems, 26 June 07   | No position   | Yes. No restrictions   | Neither is favored; no position   | No; disclose and register investigation files only<br>A hotline itself is not deemed to process “personal data;” uninvestigated third party allegations are too speculative to be deemed Slovenian “personal data;” investigation files are subject to Slovenian data law art. 27(3) registration as HR records |
| <b>Spain</b>    | No, but very persuasive: report 0128/2007 of 28 May 07 issued by DPA legal department sets out DPA’s opinion; later cited in: several DPA international data transfer authorizations (files n°: TI/00035/2007; TI/00022/2009; TI/00026/2009; TI/00088/2010; TI/00089/2010, etc.), | Yes, to: violations of internal or external regulations that could subject target to discipline; must specify: what offenses can be denounced; what internal or external regulations the offenses violate | No; “[m]echanisms guaranteeing only the acceptance of reports in which the whistleblower is clearly identified should be established to guarantee the information’s accuracy; not being adequate to establish systems permitting anonymous | Neither is favored; whistleblowers and targets must be duly informed if data is sent to a third party to investigate the reports                            | Yes, “it will be necessary to notify” to get “inscription” in DPA “Register” and obtain authorization to send data outside of EU/EEA: this is a general (not hotline-specific) mandate  |

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| Jurisdiction       | Is the authority binding law?   | Must confine hotline to certain topics only?  | Are anonymous whistleblower calls ever ok?   | Is outsourced (vs. in-house) hotline favored?  | Must disclose hotline to data agency?  |
|--------------------|---|---|--|--|--|
|                    | 2007 and 2008 DPA Annual Report, and DPA Guide to Data Protection in Labor Relations  |   | reports” ; Spain’s DPA says (orally) that anonymous calls are not acceptable( <i>bence head-on conflict with SOX § 301, if § 301 extend extraterritorially</i> ) |  |  |
| <b>Sweden</b>      | Yes: Swedish Data Inspection Board general regulations DIFS 2010:1 decided 22 Sept. 10 and subsequent Guidelines for companies: <i>Responsibility for personal data processed in whistleblowing systems</i> of Oct. 2010 partially affirming previous holdings in cases: <i>Tyco</i> Decision of 6 Mar. 08; <i>AON</i> Decision of 26 Mar. 08; <i>Telef</i> Decision of 6 Mar. 08 | Yes, to serious irregularities concerning: accounting, internal accounting controls, audit, fight against bribery, banking and financial crimes, other serious irregularities concerning vital interests of the company or group or individuals’ life and health (e.g., serious environmental crimes, major workplace safety issues, serious discrimination or harassment issues). Processing personal data concerning crimes may only involve those in leading positions in the co. or group | Yet, but cf. <i>Sbell</i> case of 29 Mar. 2007: proportionality required   | Neither is favored; Tyco hotline outsourced to US held OK; there must be a written contract with the outsourcer  | No, if hotline complies with DIFS 2010:1; if not, an affirmative § 21 exemption is required (this article prohibits processing data about crimes)            |
| <b>Switzerland</b> | No: 11th Annual Report of Activities 2003/2004 (of Swiss DPA), at § 7.1 (This report is very early, 2003/04, and may not reflect current Swiss DPA thinking)  | No restriction  | Unclear; hotline must collect at least whistleblower’s untraceable contact information (such as anonymous email address or drop-box address) and, if necessary,  | Neither is favored as neither is seen as a perfect solution; a proposed “compromise” would be to name a person responsible to answer the hotline in each subsidiary; | Yes, but notification mandate is general, applying to many data processing systems (no hotline-specific notification mandate), and there are exceptions such |

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| Jurisdiction | Is the authority binding law?                | Must confine hotline to certain topics only?               | Are anonymous whistleblower calls ever ok?   | Is outsourced (vs. in-house) hotline favored?  | Must disclose hotline to data agency?   |
|--------------|--|--|--|--|---|
|              |  |  | complete identity; a complaint should not, in principle, be processed if the whistleblower does not provide this contact information | reports made by a given employee of one subsidiary would be answered by the person responsible in a different subsidiary, to assure impartiality | as where there is a company data protection officer; if data are sent abroad, the local DPA might also need to be notified. |
| UK           | No (local DPA conference paper of 6 Apr. 06) | No, but there "should be" a "clear" list of topics covered | Yes, but "confidential reporting" is preferred   | DPA position unclear: legal advice in UK recommends third-party hotline outsourcers to reduce likelihood of conflicts of interest                | Likely yes, as part of general mandate to disclose data processing activities annually (no hotline-specific mandate)        |

In discussing laws that expressly restrict workplace whistleblower hotlines, this article discussed only the data protection laws of Europe because those are the only known laws anywhere that specifically speak to, and restrict, employer whistleblower hotlines. Those laws present the toughest single compliance challenge to a multinational launching a cross-border hotline. In particular, France continues to issue cases, regulations, pronouncements, and private letter rulings that regulate hotlines increasingly minutely. Spain aggressively prohibits anonymous hotlines, and Portugal seems to as well.<sup>102</sup> Germany imposes multi-faceted rules that can differ by *Lander* (state).<sup>103</sup> So many differing hotline-specific restrictions across Europe both impose compliance challenges and they create logistical problems of hotline alignment. Having to tailor disparate local hotlines frustrates multinationals that invariably would prefer just one single global (or at least one single European) hotline protocol.<sup>104</sup>

**D. CATEGORY # 4: LAWS PROHIBITING WHISTLEBLOWER RETALIATION**

Having addressed laws that mandate workplace whistleblower hotlines, which regulate denunciations to government authorities and restrict hotlines specifically, this article now turns to a fourth category of whistleblowing law: prohibitions against whistleblower retaliation. These are increasingly common. U.S. SOX<sup>105</sup> and Dodd-Frank<sup>106</sup> as well as U.S.

102. See "France," "Spain," and "Portugal" rows on Chart and citations therein.

103. See "Germany" row on Chart.

104. Cf. Dowling SOX, *supra* note 4, at 53-54 (exploring alternatives of eschewing hotlines altogether or implementing one global hotline).

105. SOX § 806 offers whistleblowers an administrative, and ultimately a court, claim for retaliation—cf. the § 806 claim in the *Carnero* case (cited and discussed *supra* note 49 and accompanying text). The U.S. Occupational Safety and Health Administration handles whistleblower claims in the first instance that allege SOX

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state whistleblower retaliation laws<sup>107</sup> grant causes of action to stateside whistleblowers punished for whistleblowing. Now, more and more overseas jurisdictions, from the United Kingdom and South Africa to Malaysia, Japan, and beyond have climbed aboard this bandwagon and prohibited whistleblower retaliation.<sup>108</sup> Indeed, freedom from workplace whistleblower retaliation has actually been declared a human right, at least in Europe. In a decision of July 2011 involving Germany, the European Court of Human Rights allowed all employees to denounce wrongdoing free from the spectre of retaliation.<sup>109</sup>

Whistleblower retaliation laws are sometimes colloquially called “whistleblower laws,” and so they might seem to play a role in the launch of a legally-compliant hotline. But for the most part they do not. These laws are specific to workplace-context whistleblowing, but in practical effect they have almost nothing to say about hotlines because retaliation is impossible until after a whistleblower call ends and a follow-up investigatory stage begins.<sup>110</sup> Retaliation can become an issue only after an employer responds to a would-be whistleblower.<sup>111</sup>

That said there is a big hotline communication issue here. In whistleblowing-averse jurisdictions around the world, from Russia to Latin America and the Middle East to India and parts of Asia and Africa, an employer needs to overcome worker fear of reprisal for whistleblowing. This means guaranteeing that no one using the report channel in good

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§ 806 violations. OSHA whistleblower-retaliation-handling rules appear at 29 CFR Part 1980. These rules were being revised in 2011 to accommodate the changes of Dodd-Frank, and a draft revision issued November 3, 2011. OSHA “Procedures for the Handling of Retaliation Complaints under Section 806 of the Sarbanes-Oxley Act of 2002, as Amended, Interim Final Rule, Request for Comments,” *supra* note 49.

106. Dodd-Frank, *supra* note 37 (codified as 15 U.S.C. § 78u-6(h)(1)(A),(B)); *cf.* Final Rule § 240.21F-2(b)(2). Dodd-Frank whistleblower retaliation provisions appear at Dodd-Frank § 929, which amends SOX § 806 by expanding the statute of limitations significantly, exempting SOX whistleblower claims from mandatory arbitration, and allowing state court SOX whistleblower retaliation claims to be removed to federal court and tried before a jury. Dodd-Frank’s whistleblower retaliation protections are available to employees who provide information to the SEC in the manner described in the Final Rules and with a “reasonable belief that the information being provided relates to a possible securities law violation that has occurred, is ongoing, or is about to occur.” Dodd-Frank affords individuals a cause in federal district court to enforce the new provisions. *See also* Terwilliger, *supra* note 75; *see* SOX § 806, *supra* note 105.

107. National Conference of State Legislatures, <http://www.ncsl.org/?tabid=13390> (last visited Nov. 21, 2011) (summarizing U.S. state whistleblower retaliation laws).

108. *See, e.g.*, UK Public Interest Disclosure Act 1998; South Africa Protected Disclosures Act 2000, art. 6, no. 785; Malaysian Whistleblower Protection Act of 2010; Japan Whistleblower Protection Act (Act No. 122 of 2004); *see supra* notes 55-63 and accompanying text.

109. *Heinisch v. Germany*, Eur. Ct. Hum. Rts. (5th Sec.), app. no. 28274/08 (7/21/11) (citing, at ¶ 37, Assembly for the Council of Europe, Res. 1729 [2010] on “The Protection of Whistleblowers”), *available at* <http://cmiskp.echr.coe.int/tkp197/view.asp?action=html&documentId=888505&portal=hbkm&source=externallybydocnumber&table=F69A27FD8FB86142BF01C1166DEA398649>.

110. To the extent that some jurisdictions’ whistleblower retaliation laws separately contains a provision mandating the launch of a whistleblower hotline, for our purposes that would be a “category #1” law, discussed *supra* (Part Two, “Category #1”). Liberia’s now-lapsed whistleblower executive order (*supra* note 64) is an example—a hybrid retaliation/hotline mandate law. Laws of this type may be emerging, but as of 2011 were extremely rare.

111. An employer that merely structures, communicates, launches, and operates a whistleblower hotline has not yet arrived at a stage where whistleblower retaliation can possibly come into play. An act alleged to be retaliatory can happen only after a would-be whistleblower purports to have made (by hotline or otherwise) a specific denunciation, and after the employer responds in some way that the whistleblower deems victimization.

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faith will suffer retaliation. But globally communicating a non-retaliation commitment almost surely extends, quasi-contractually, otherwise non-existent anti-retaliation rights to whistleblowers in jurisdictions without retaliation laws.<sup>112</sup> Consider carefully the strategic and legal implications before making an anti-retaliation commitment across borders.

E. CATEGORY # 5: LAWS REGULATING INTERNAL INVESTIGATIONS

Probably every jurisdiction imposes some legal doctrines that reach employer investigations into allegations of employee wrongdoing. Depending on the country and the allegation investigated, an internal investigation might trigger, for example, local laws on labor/employment, data privacy/protection, tort, crimes, criminal procedure, private-party due process, and prohibitions against exporting state secrets.<sup>113</sup> But these doctrines only kick in after an investigation starts. They have almost no bearing on the launch and staffing of a global whistleblower hotline because a hotline is a *pre-investigatory* tool.<sup>114</sup>

This said there is a hotline communication issue here. Heavy-handed communications about a hotline might later support claimants who allege the employer rigged its investigation process. For example, imagine a hotline communication that says something to the effect of “we investigate every report exhaustively, leaving no stone unturned to verify the truth of reports received.” Few organizations are likely to convey so blunt a message, but if one did the statement might turn up later as evidence supporting a victimization claim. Ensure communications about report channels do not convey an overzealous approach to complaint-processing and investigations. Where necessary, such as in Europe, be sure hotline communications spell out the private due process rights of whistleblowers, witnesses, and targets.

F. CATEGORY # 6: LAWS SILENT ON, BUT POSSIBLY TRIGGERED BY,  
WHISTLEBLOWER HOTLINES

Having addressed five types of laws that in at least some contexts regulate hotline whistleblowing specifically, our sixth and final category is broader: legal doctrines that neither explicitly address hotline whistleblowing nor have yet been interpreted in the hotline whistleblowing context, but that a hotline might theoretically trigger. This category is necessarily vague, and determining which laws fall into it is difficult. Our two most likely candidates are data protection laws silent on hotlines and labor laws imposing negotiation duties and work rules obligations.

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112. A common, perhaps “best,” practice is for international hotline communications expressly to guarantee that the employer will not retaliate against those using the hotline in good faith. Making a no-retaliation commitment in a global hotline communication almost surely extends non-retaliation rights quasi-contractually into jurisdictions where local jurisprudence does not specifically protect whistleblowers. And so an employer voluntarily issuing a non-retaliation promise across all a company’s global operations has about the same effect as if each jurisdiction passed a whistleblower retaliation law.

113. This author has analyzed and inventoried international investigation legal issues elsewhere. Dowling Investigations, *supra* note 9.

114. Further, to the extent that ninety-seven percent of whistleblower denunciations come to organizations outside whistleblowing channels (*see supra* note 32), most internal company investigations arise outside the hotline context entirely.



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1. *Data Protection Laws Silent on Hotlines*

This article already discussed, as “category #3,” data protection law doctrines in Europe that explicitly address whistleblower hotlines. Beyond Europe, more and more jurisdictions around the world now impose European-style omnibus data privacy/protection laws. Argentina, Canada, Costa Rica, Hong Kong, India, Israel, Japan, Malaysia, Mexico, Peru, South Korea, Taiwan, Uruguay, and others as of 2011 had passed or were implementing comprehensive (as opposed to sectoral) data protection laws. Some of these are almost as tough as data laws in Europe. In the future these laws might be argued to reach whistleblower hotlines, paralleling the analysis in Continental Europe.<sup>115</sup> But as of 2011 none of these data laws was known ever to have been interpreted to reach hotlines.

The way Europeans stretch their data laws to reach hotlines may be exceptional.<sup>116</sup> Data privacy/protection laws regulate information about identifiable humans, but the launch and staffing of an employer whistleblower hotline—before it receives a whistleblower call that might or might not later morph into an internal investigation—does not implicate any personal data whatsoever, about anybody. A hotline standing alone does not contain or process personal data about any whistleblower, target, or witness. A hotline is a mere channel, not a database, and is more analogous to a telephone, computer, or communications device than to a human resources database warehousing information about, for example, payroll, attendance, performance management, expense reimbursements, business travel, or benefits/pension/insurance administration. For that matter, even when a real-life whistleblower contacts a company hotline to denounce an identified colleague, the personal data transmitted get sent *by the whistleblower*, not the company hotline sponsor. So even an actual hotline denunciation would not seem to implicate a hotline sponsor company in processing personal data until the moment the denunciation ends and hotline staff further processes data received by writing up a report and perhaps launching an investigation.<sup>117</sup> Of course, many but not all<sup>118</sup> *European* jurisdictions reject this analysis and regulate report channels as if they somehow were databases. We have no way yet to know whether *non-European* jurisdictions with comprehensive data laws will be so aggressive.

2. *Labor Laws Imposing Negotiation Duties and Work Rules Obligations*

Labor laws—specifically mandates imposing labor negotiation duties and obligations regarding work rules—are another type of law that, although silent on and not yet construed as to stand-alone whistleblower hotlines, could reach workplace report channels.<sup>119</sup>

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115. See *supra* Part Two, “Category #3.” This interpretation is most likely to emerge in those European states (like, for example, Italy) that have not yet interpreted their data laws in the hotline context but that might accept the Article 29 Working Party analysis. See “Article 29 Working Party” row on Chart.

116. Of course, we are speaking here specifically about hotlines/report channels, not about whistleblowing generally, whistleblower retaliation, or internal investigations.

117. Of course, a hotline operator report and an investigation about a specific incident/allegation differ from a whistleblower hotline. Hotline operator reports and internal company investigations are subject to data laws.

118. Slovenia does not accept the otherwise-common European interpretation on this point. See “Slovenia” row on Chart.

119. We are speaking here of an employer’s launch and operation of a hotline/report channel, not about whistleblowing generally, whistleblower retaliation, or internal investigations.

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Labor laws in most every jurisdiction require at least some employers to bargain with trade unions over certain changes in the workplace. Some jurisdictions also require informing and consulting about new workplace practices with other employee representatives such as works councils, health and safety committees, and ombudsmen.<sup>120</sup> But the texts of collective labor statutes never address hotlines specifically. As of 2011, few if any regulations, court decisions, or administrative rulings had construed bargaining obligations as to launching a stand-alone whistleblower hotline.<sup>121</sup>

An employer subject to labor consultation obligations might take the position that merely offering a new stand-alone hotline does not change anyone's work conditions and so is not subject to labor discussions. Employee representatives might counter that having to work under a hotline regime poisons the work environment because it turns every co-worker and colleague into a possible spy.<sup>122</sup> In the United States, unionized employers have to bargain with their unions before implementing new workplace surveillance technology like email and video monitoring.<sup>123</sup> A U.S. labor union inclined to resist a whistleblower hotline could characterize it as a sort of monitoring/surveillance tool that triggers this same bargaining obligation.<sup>124</sup> This same analysis could apply abroad, as well. Whether launching a stand-alone hotline falls under existing bargaining obligations is rarely settled law. The answer can depend on the comprehensiveness of the local bargaining obligation, the applicable collective agreement, the workplace bargaining history, and the local society's receptivity or aversion to whistleblowing. Consulting over a stand-alone hotline will much more likely be held mandatory in Continental Europe and Hong Kong than in the Middle East, the Americas, much of Asia, Latin America, or Africa.

In launching a stand-alone whistleblower channel outside the United States, check whether local worker representatives in each jurisdiction could plausibly argue that new report procedures trigger mandatory bargaining/consultation. Look into whether existing collective arrangements address reporting and grievance procedures, whether the society is whistleblowing-averse, and whether the company's own worker representatives tend to obstruct most changes to the workplace. Where the employer can convince its worker representatives why the proposed hotline benefits everyone and is not a material adverse change, bargaining/consultation should present no hurdle.

But resisting worker consultation over a stand-alone hotline is not always a sound strategy. In whistleblowing-averse societies that suspect hotlines as a form of entrapment, consultations may make sense to make the hotline effective. And in certain jurisdictions an affirmative agreement with worker representatives about a hotline can help surmount

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120. A discussion of this topic in the whistleblower hotline context appears at Dowling SOX, *supra* note 4, at 16-18.

121. We are addressing stand-alone hotlines. Of course, plenty of labor cases around the world address the launch of work rules, codes of conduct, and mandatory reporting rules (*see supra* note 9), and plenty of cases adjudicate disputes arising out of specific whistleblower denunciations.

122. Dowling SOX, *supra* note 4, at 17.

123. *See, e.g.*, National Labor Relations Act, 29 U.S.C. § 158(d) (2006); Cal. Newspapers P'ship & N. Cal. Media Workers' Guild, 350 N.L.R.B. No. 89 (2007) (email monitoring mandatory subject of bargaining); *Brewers & Maltsters, Local Union No. 6*, 414 F.3d 36 (D.C. Cir. 2005), *aff'g* *Anheuser-Busch, Inc.* 342 N.L.R.B. No. 49 (2004) (surveillance cameras mandatory subject of bargaining). *See generally* Dowling SOX, *supra* note 4, at 16-18.

124. Fighting hotlines, though, seems to rank low on U.S. unions' agenda. Indeed, a U.S. union might be expected to welcome a hotline as a watchdog over abuses of management.

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challenges on grounds beyond labor law. For example, a labor/management works agreement (*Betriebsvereinbarung*) in Germany and a “plant bargaining agreement” in Austria that accept a workplace hotline can rebut claims that report procedures violate data protection laws. Bargaining is also necessary where a hotline does not stand alone but comprises a piece of a more extensive compliance program inarguably subject to consultation, such as a new global code of conduct with a mandatory reporting rule that requires whistleblowing.<sup>125</sup>

A workplace hotline can also implicate a separate labor law issue: *mandatory work rules*. France, Japan, Korea, and other countries require that employers post written work rules that list prohibited workplace infractions. A stand-alone whistleblower hotline, as distinct from a mandatory reporting rule,<sup>126</sup> is not a work rule and so should not require changing already-posted lists of infractions. But a hotline launch that includes a new mandatory reporting rule likely requires tweaks to extant rules.

#### **IV. Conclusion**

Domestically within the United States, launching new work rules, employee handbooks, and codes of conduct can trigger legal issues, especially in unionized workplaces. And in the United States, a whistleblower’s call to a workplace hotline triggers a cluster of legal issues, such as internal investigations, employee discipline, and whistleblower retaliation. But U.S. employers, even unionized ones that make a stand-alone workplace whistleblower hotline available to U.S. staff, rarely get blowback.<sup>127</sup> Indeed, offering employee report “procedures” stateside affirmatively complies with a mandate in Sarbanes-Oxley and is a recommended “best practice” response to the Dodd-Frank whistleblower bounty.<sup>128</sup>

But the U.S. *laissez faire* approach here can lull multinationals into overlooking or minimizing the surprisingly steep compliance hurdles to launching whistleblower procedures across worldwide affiliates. Six distinct legal doctrines can restrict hotline whistleblowing abroad. Our U.S. point of view sees hotlines as a best practice for nurturing compliance by rooting out crimes and corruption. So to us these six restrictions look like technicalities grown bigger and more complex than they should have any right to get. For that matter, Americans have a hard time understanding why laws anywhere would restrict whistleblower hotlines when no jurisdiction bothers to restrict whistleblowing itself and when the vast majority of whistleblowers—ninety-seven percent—tend to avoid hotlines, anyway.<sup>129</sup>

But this policy analysis takes us only so far when legal restrictions already in place around the world actively restrict employers’ freedom to launch a workplace

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125. See *supra* note 9 and accompanying text (on mandatory reporting rules). See, e.g., Wal-Mart, Wuppertal Labour Court, 5th Div., 5 BV 20/05, June 15, 2005 (Germany), discussed at Dowling SOX, *supra* note 4, at 17 (code of conduct with mandatory reporting rule held subject to mandatory information, consultation, and co-determination with works council in Germany).

126. *Supra* note 125.

127. *But cf. supra* note 121 and accompanying text (hotline launch as possible mandatory subject of U.S. labor union bargaining).

128. *Supra* Part II, “Category #1” and “Category #2.”

129. Ethics Resource Center, *supra* note 32.

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whistleblower hotline. Employees in whistleblowing-averse societies like Russia, Latin America, the Middle East, India, much of Asia, and Africa can fear hotlines as entrapment. Meanwhile, data protection laws in Europe actively block hotlines, and violations can spark passionate resistance from European workforces and can trigger punitive sanctions. So launching an international report channel has become a global compliance project of its own. Before making a hotline available to employees worldwide, check which of the six legal topics arise in each relevant jurisdiction. Isolate, in each affected country, those issues the hotline will trigger under local law. Then take steps to make reporting protocols and employee communications packages comply.

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## The Reorganization Process Under China's Corporate Bankruptcy System

EMILY LEE\*

### Abstract

*The number of enterprises plunging into bankruptcy starting in 2008,<sup>1</sup> during which time China was affected by the global financial crisis, tested the efficacy of the Enterprise Bankruptcy Law (EBL), which established a statutory-based reorganization process to be followed and which was seemingly designed for the resurrection of corporate entities caught in financial malaises. During the global financial crisis, the EBL served its intended purpose—the prevention of a greater number of small-and medium-sized enterprises in temporary financial difficulties from premature corporate bankruptcy; but the implementation of the EBL and, by extension, China's corporate bankruptcy system was less than ideal. One of the main tenets of the EBL is the requirement for any reorganization plan to be approved dually—i.e., sanctioned by both the creditors and the court; but the EBL fails to prescribe clearly the circumstances under which the court's discretionary power in granting its approval should be exercised and, if so done, to what extent those powers should be kept in check.*

*The deficiencies of the EBL might impact adversely China's securities markets because there is a strong linkage between an effective corporate bankruptcy reorganization system and increased securities trading. A listed company facing bankruptcy but whose shares remain tradable in China's securities market would normally be labeled as an \*ST corporation<sup>2</sup> first, before being delisted eventually. While reorganization can theoretically, if not practically, provide reprieve for a bankrupt company by saving it from premature corporate bankruptcy, recent research has indicated that the number of successful reorganization cases are few and far between. The paucity of successful bankruptcy reorganization cases in China suggests the EBL, as it was implemented, may have inadvertently put restraints in its own application, in contrast to the more efficacious corporate bankruptcy laws in jurisdictions such as Australia, the United Kingdom, and the United States,*

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1. Shuguang Li & Zuofa Wang, *China's Bankruptcy Law After Three Years: The Gaps Between Legislation Expectancy and Practice and the Future Road—Part One*, 7(5) Int'l Corp. Rescue 303, 304 (2010).

2. ST means 'special treatment.' Special treatment connotes a distinctive 'warning system' that was formulated by the securities exchanges in China to warn investors of listed companies suffering severe losses and that are at risk of being delisted from the stock exchange(s). For more details, please refer to *infra* Part IV concerning the issue of “\*ST” prefixed corporations. See *id.* at 307.

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*each of which provided a model for reorganization legislation. There are both internal and external factors attributive to such lackluster results following the EBL's implementation. The internal factors consist of some judges' preference in applying the old law (which contains no reorganization provisions whatsoever) over the newer EBL, as the new law is less familiar to them. The external factors comprise local protectionism of preferred enterprises and a lack of qualified bankruptcy professionals in China. This article aims to examine the implementation and practice of China's corporate reorganization process, formed and shaped by Chapter 8 of the EBL, immediately before and throughout the global financial crisis. Relevant issues in regards to the administrator system and the expenses associated with the reorganization process will also be addressed. It is hoped that this article, if construed properly, may inform of future amendments to China's EBL.*

### **I. Introduction**

China's corporate bankruptcy<sup>3</sup> system is comprised mainly of two parts: (1) the Enterprise Bankruptcy Law of 2006 (the EBL or new law), passed into law by the National People's Congress and (2) judicial interpretations,<sup>4</sup> made by the Supreme People's Court of the People's Republic of China (the SPC), the highest court of law in China. The EBL, consisting of twelve chapters with 136 articles, was promulgated on August 27, 2006 and came into effect on June 1, 2007. The five judicial interpretations to date have been issued at various times in order to facilitate the implementation of the EBL.

At the heart of China's corporate reorganization process is the independent administrator system. The EBL distinguishes itself from its predecessor law, the 1986 Enterprise Bankruptcy Law Trial Implementation (the 1986 Law or old law), with some distinctive features. First, the EBL has broader application as it applies to all enterprise legal persons, inclusive of SOEs, non-SOEs, private enterprises, and foreign-invested enterprises (not just state-owned enterprises (SOEs) as in the old law<sup>5</sup>). Second, the EBL replaced the liquidation group system with the independent administrator system. Inspired by both the U.S. and the U.K. models, the EBL also provides for a reorganization system by drawing upon Chapter 11 of the U.S. Bankruptcy Code<sup>6</sup> (U.S. Chapter 11) and introduces an independent administrator system by borrowing from the concept of administrator in the U.K.'s Insolvency Act 1986.<sup>7</sup>

'Reorganization' (*i.e.*, '[corporate] bankruptcy reorganization,' also known as 'corporate rescue' in some jurisdictions) encapsulates a legal procedure that aids the revival of a com-

3. The words 'insolvency' and 'bankruptcy' are used interchangeably throughout this article, and refer to bankruptcy of a corporate nature and not a personal one.

4. With a view to facilitating the implementation the EBL, the Supreme People's Court has in 2007-2008 issued five judicial interpretations, namely: (1) Supreme People's Court Regulation on Law Application of Cases Still Pending upon the Enterprise Bankruptcy Law of People's Republic of China Coming into Effect (Fashi (2007) 10, Apr. 23, 2004); (2) Supreme People's Court Regulation on the Appointment of Administrators (Fashi (2007) 8, Apr. 4, 2007); (3) Supreme People's Court Regulation on the Compensations of Administrators (Fashi (2007) 9, Apr. 4, 2007); (4) Supreme People's Court Regulation on Bankruptcy Cases in which the Whereabouts of the Debtor or Its Assets are Unclear (Fashi (2008) 10, Aug. 4, 2008); and (5) Supreme People's Court Regulation on Time Limits for Hearing Civil Cases (Fashi (2008) 11, Aug. 11, 2008. *See* Li & Wang, *supra* note 1, at 303.

5. Compared to the EBL, the 1986 Law has a narrower scope of application as it concerned merely, and thus applied only to, the bankruptcy of SOEs.

6. 11 U.S.C.A. §§ 1101-74 (1978).

7. United Kingdom Insolvency Act, 1986, c. 45.

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pany in current and temporary financial difficulty but with viable business prospects and whose business operations may be operated continually as a going concern during the reorganization process. Reorganization gives the financially distressed company a short respite or 'breathing space,' generally referred to as a 'moratorium' (or an 'automatic stay' of corporate bankruptcy proceedings) with which the debtor company (*i.e.*, the financially distressed company) will be free temporarily from its creditors' debt collection or debt enforcement actions. Reorganization cannot be executed effectively without the statutory protection of a moratorium against the company's creditors, whose rights of claims will be suspended temporarily while the company seeks ways to restructure itself and its debts. For each creditor, if he agrees to the company's reorganization initiative, his right of claims under relevant corporate bankruptcy law will be barred temporarily from being exercised or brought to a halt in the course of a bankruptcy proceeding. A moratorium thus works as a major intervention, with the overriding purpose of preserving the debtor company's employees' jobs and averting the unnecessary winding-up of the company. Technically, a reorganization application in China may be commenced by a debtor company itself, a creditor, or an investor whose capital contribution comprises one-tenth (1/10th) or more of the debtor company's registered capital.<sup>8</sup> Initially, a debtor or creditor may apply directly to the People's Court for the reorganization of the debtor company, but in circumstances where there is a liquidation application by a creditor, the debtor company or investor may still apply to the People's Court for reorganization, provided that the said court, after accepting the previous bankruptcy application by the creditor, has not yet declared the debtor company to be bankrupt.<sup>9</sup> Reorganization appears to be a welcome solution for companies listed in stock exchanges in China. Recent study shows that over a period of eight years (from March 2000 to March 2008), there were merely eighteen listed companies that filed for bankruptcy; among which, all but one company had undergone the reorganization process. Each of those seventeen listed companies had been reorganized successfully by reaching a settlement plan with its creditors,<sup>10</sup> while the remaining one company's bankruptcy application was rejected eventually by the court.<sup>11</sup>

The EBL is built on the three pillars of (1) liquidation; (2) reorganization; and (3) settlement, whereof the law offers comprehensive options for a bankrupt company to choose from in order to practically and effectively eliminate its debts and associated liabilities. Reorganization may potentially predominate over liquidation or settlement as viable options, at least when and only if financial difficulty arises at an early enough stage that it is still possible to attempt corporate rescue. Reorganization can also prevent the bankrupt company from premature or unnecessary liquidation and, as a result, the employees' jobs can be saved. Reorganization is oftentimes a precondition for settlement, as reorganization would inevitably involve the preparation of a settlement agreement. Thus one can view that reorganization, if successful, is consummated by reaching a settlement between

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8. Qi Yè Pò Chan Fa (企業破產法) [Enterprise Bankruptcy Law], (promulgated by Standing Comm., Nat'l People's Cong., Aug. 27, 2006, effective June 7, 2007), art. 70, translated in [http://www.fdi.gov.cn/pub/FDI\\_EN/Laws/GeneralLawsandRegulations/BasicLaws/P020070118609950781519.pdf](http://www.fdi.gov.cn/pub/FDI_EN/Laws/GeneralLawsandRegulations/BasicLaws/P020070118609950781519.pdf) (last visited Nov. 18, 2011) (China) [hereinafter The EBL].

9. *Id.* at art. 70, ¶ 2.

10. QIU BO YANG, 上市公司破產選擇行為及其效應研究 [*Choice of Behavior of Listed Companies and its Effects on Bankruptcy*], Southwestern University Finance & Economics Press (2008), at 139-141. (The book is printed in Chinese).

11. *Id.* at 139.

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the debtor company and all its creditors. It would seem to follow that the pinnacle of the EBL is reorganization, to be carried out by a court-appointed independent administrator whose main task is to carry on the debtor company's business operation as a going concern over a statutorily prescribed period called a moratorium. Only when that fails will the debtor company be wound up and liquidated.

China is a country more accepting of legal transplantation. A case in point is that China's corporate rescue system is a hybrid of the systems used in the United States (the U.S.) and the United Kingdom (the U.K.)—the former refers to 'debtor-in-possession' (DIP) and the latter, 'administrator replacement.' Under the U.S. system, the debtor company's management is permitted to stay and continue to run the business as a going concern; under the U.K. system, the management would be replaced by an independent administrator who would run the business during the reorganization process. Under the Chinese system, the administrators must be appointed by the People's Court<sup>12</sup> from the roster system,<sup>13</sup> kept and operated by the said court. The administrators should be diligent and faithful in the performance of their duties<sup>14</sup> and such positions should be held by professional service firms, such as law firms, accounting firms, liquidation firms, and/or persons qualified professionally to manage bankruptcy procedures.<sup>15</sup> During the prescribed period of moratorium, it is the administrator's responsibility to deliver a reorganization plan, essentially a settlement or concession proposal subject to 'dual approval,'—first by creditors of all four voting classes<sup>16</sup> and then by the court.<sup>17</sup> Alternatively, the existing management (represented by directors of the company) may produce a reorganization proposal under the DIP model (like the U.S. system).<sup>18</sup> Once approved at 'meetings of the creditors' by creditors and sanctioned by the court, the reorganization proposal will have a binding effect on the debtor company and all its creditors.<sup>19</sup>

Reorganization is arguably the most innovative feature of the EBL, applicable to all enterprise legal persons. And yet, reorganization in China can possibly take a long time and be expensive. First, reorganization requires the submission of numerous plans: (1) the business plan of the debtor company; (2) the classification of debt claims; (3) the plan for claims adjustment; (4) the plan for claims repayment; (5) the time limit for implementing the reorganization plan; (6) the time limit for supervision over the implementation of the reorganization plan; and (7) other plans favorable to the debtor company's reorganization.<sup>20</sup> Second, the reorganization procedure can spread across a period of almost a year, comprising the original six months set by the EBL as the 'reorganization period,' which is

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12. The EBL, art. 13.

13. 最高人民法院關於法院指定的管理員在審理企業破產案件的規定 [Provisions of the Supreme People's Court on the Designation of Administrators during the Trial of Enterprise Bankruptcy Cases], (promulgated by Standing Comm., Nat'l People's Cong., Apr. 12, 2007, effective June 1, 2007), art. 1 (China) [hereinafter Designation of Administrators].

14. The EBL, art. 27.

15. *Id.* art. 24.

16. *Id.* art. 84, ¶ 2.

17. *Id.* art. 86, ¶ 2.

18. HAIZHENG ZHANG, *Corporate Rescue, in CHINA'S NEW ENTERPRISE BANKRUPTCY LAW—CONTEXT, INTERPRETATION AND APPLICATION* 207, 207 (Rebecca Parry, Yongqian Xu, and Haizheng Zhang eds., 2010).

19. *Id.*

20. The EBL, art. 81.



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extendable for another three months.<sup>21</sup> In connection to that, the People's Court would have to convene the creditors' meeting within thirty days from the date of receipt of the draft reorganization plan to entitle the creditors to vote on the draft reorganization plan.<sup>22</sup> By this time, the procedure would have taken up a maximum of ten months already (6+3+1=10 months). Because it also requires the court's approval, the reorganization plan, once approved, requires a public announcement to be made within thirty days from the date of the court's receipt of the application.<sup>23</sup> This means that it will take a minimum of eleven months (6+3+1+1=11 months) for a reorganization plan to be carried out successfully.

Needless to say, due to the 'dual approval' requirement, where the reorganization plan fails to obtain approval either by the creditors or the court, the undergoing of an entire procedure will most likely exceed one year. It may drag even longer because the EBL does not set a time limit for the court to approve a reorganization plan that has survived initially in the creditors' meeting. There also seems no prescribed time limit for the court to exercise discretion to 'cram-down' an unsuccessful reorganization plan that the dissenting creditors failed to approve.

That said, one should be mindful about the strict time limits set by the EBL for the court to handle expeditiously corporate bankruptcy applications. For example, in a creditor's bankruptcy petition, the court has five days from the date of receipt of the application to notify the debtor, who is given seven days from the date of receipt of the notification from the court to object to the creditor's application. The court shall also make an order whether or not to accept the bankruptcy application within ten days from the date of expiration of the time limit for the debtor to file with the court objections against the creditor's application.<sup>24</sup> Conversely, in a debtor's bankruptcy petition, the court normally would have fifteen days in which to decide whether or not to accept a bankruptcy application, although in special circumstances, it might be necessary for the court to extend the time period, usually for a further fifteen days upon approval by the court at the next higher level.<sup>25</sup> Once an application has been accepted by the court, it has twenty-five days from the date on which it makes an order to accept a bankruptcy application to notify known creditors and to make a public announcement of its decision.<sup>26</sup> In addition to Articles 10-14 of the EBL as aforementioned, the timeliness requirement can also be found in other parts of the EBL, such as in Article 111 of the EBL that involves the timely realization and distribution of the debtor company's assets.

The role, appointment, and remuneration of administrators have been set and provided with some detail as a result of the SPC's issuance and adoption of (1) the "Provisions of the Supreme People's Court on the Designation of Administrators During the Trial of Enterprise Bankruptcy Cases" and (2) the "Provisions of the Supreme People's Court on Determination of the Administrator's Remunerations" (collectively, the SPC Provi-

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21. *Id.* art. 79.

22. *Id.* art. 84. The adoption of the reorganization plan requires the approval of a (simple) majority of creditors in each voting group who are present at the meeting, and that the majority represents claims amounting to at least 2/3rd (two-thirds) of the total amount of the outstanding claims.

23. *Id.* art. 86.

24. *Id.* art. 10.

25. *Id.*

26. *Id.* art. 14.

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sions)—both were issued on April 12, 2007 in supplement to the EBL. A report by The World Bank suggested that in the past fifteen years, some countries have moved towards devising a particular set of rules for regulating administrators, reflecting not only the need for protecting both individual and public economic interests, but also an increased awareness of the complexity involving corporate bankruptcy issues and hence its potentially far-reaching impact.<sup>27</sup> Whether bankruptcy reorganization can be carried out successfully depends a lot on the ability, qualification, and professionalism exhibited by the administrators; hence it has been suggested that the study of administrator systems is conducive to the successful development of a reorganization process within a corporate bankruptcy system.

To this end, the commentator referred to the INSOL International 2005 Global Marketplace Survey,<sup>28</sup> suggesting that bankruptcy services, implied to include bankruptcy reorganization, are executed principally by professional (bankruptcy) administrators, of whose professional qualification can be divided into two categories: licensed and unlicensed. In England, Canada, and Australia, a strict licensing system is adopted for qualifying administrators; whereas, in the United States, where a ‘private trustee’ system is adopted, it does not require strict licensing but is nonetheless guided by a de facto licensing system due to the stringent performance standards required of trustees in the United States.<sup>29</sup> In China, the administrators must be appointed by the court, and such position should be held by either ‘individual administrators’ (e.g., lawyers or accountants) or by ‘institutional administrators’ (i.e., ‘social intermediary institutions,’ which are law firms, accounting firms, and/or liquidation firms).<sup>30</sup> It is suggested that pursuant to the SPC Provisions, jurisdictions in China are authorized and thus have been busy creating ‘Administrators Lists;’ and those that have been placed on the list will be the first to enter into the market of bankruptcy practice following the recent bankruptcy reform.<sup>31</sup>

In preparing the ‘Administrators List,’ the High Court of Chongqing City developed the “Chongqing Model” to limit the court’s unchecked, wide discretionary power and to restrain corruption because most of the information used in the five categories (details will be expounded further below) is both verifiable and available for public scrutiny. As such, it is easier for failed applicants to challenge the court’s selection process if they feel they were unfairly treated. The Chongqing Model is commendable and has been followed by jurisdictions in Beijing and Tianjin, with only small variations.<sup>32</sup> By juxtaposing the Chongqing Model and the SPC Provisions, it is clear that the model was not far from the existing regulations.<sup>33</sup>

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27. Peter Joyce, World Bank Global Forum on Insolvency Risk Management Standards and Strategies, Jan. 28-29, 2003, *The Regulatory Gap: The Cost of Capacity Building*, available at [http://www.insolvencyreg.org/sub\\_publications/docs/Paper%20Gordon%20Johnson%20World%20Bank.doc](http://www.insolvencyreg.org/sub_publications/docs/Paper%20Gordon%20Johnson%20World%20Bank.doc).

28. The Survey was released by INSOL International in 2006. See WEI-GUANG LIU, RESEARCH ON THE DESIGN OF CHINESE INSOLVENCY ADMINISTRATOR SYSTEM—DOCTORAL FORUM OF PROMISING ACCOUNTING STARS (The book is printed in Chinese with an English title) (Dalian: Dalian Publishing House) (2009), at 4.

29. *Id.*

30. The EBL, art. 24.

31. Lawrence (Lixin) Yang, *Administrator in China’s New Bankruptcy Law: Objective Standards to Limit Discretion and Expand Market Controls*, 82 AM. BANKR. L.J. 533, 533 (2008).

32. *Id.* at 540-41.

33. Designation of Administrators, arts. 6-7.

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The court's discretion needs to be guided properly or restrained, or it will likely be subject to abuse or misconstruction. First, the EBL simply uses the 'negative conditions' to disqualify those who wish to be qualified as administrators.<sup>34</sup> Second, the SPC Provisions were designed to keep the door wide open for lawyers/accountants and their associated social intermediaries to apply to be included in the 'Administrators List,' as long as they have 'professional knowledge and adequate practicing qualifications.'<sup>35</sup> The selection decisions thus will be left with a court with higher level jurisdiction than the People's Court (or the intermediary People's Court within its jurisdiction), "according to the number of law firms, accounting firms, bankruptcy liquidation firms and other social intermediary agencies, number of full-time practitioners, and number of enterprise bankruptcy cases within its jurisdiction," all defined loosely. Therefore, none of these terms should be treated as objective criteria whereby the court can apply easily such vague terms to decide who may be named to the 'Administrators List.'

To address this problem, the Chongqing Model adopts a one hundred point scoring system for evaluating law firms, using five categories:<sup>36</sup> (1) achievement in practice (up to thirty-five points);<sup>37</sup> (2) firm size (up to twenty-five points);<sup>38</sup> (3) experience in handling bankruptcy cases (up to twenty points);<sup>39</sup> (4) competency (up to ten points);<sup>40</sup> and (5) level of specialty (up to ten points).<sup>41</sup> The fourteen law firms with the top overall scores will be named to the Preliminary Administrators List,<sup>42</sup> which must be published on the Court's website to solicit public comment or objection.<sup>43</sup> The list is finalized within ten days if there are no objections.<sup>44</sup>

For evaluating accounting and liquidation firms, the criteria are similar to those for law firms—the above-mentioned five categories are still applicable, but with a higher qualification threshold for annual income, hired employees, number of cases handled, etc. The accounting firms with the top five scores are named to the Preliminary Administrators List for public comment and objection in the same fashion as law firms. In the evaluation of liquidation firms, because they account for a small number of the total number of institutional administrators, their assessment criteria have not attracted much attention.<sup>45</sup>

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34. For example, pursuant to Article 24 of the EBL, "individuals or organizations that have been convicted of intentional crimes, whose license has been revoked, are an interested party in the case, or otherwise deemed unfit by the court are disqualified from serving as an administrator." The EBL, art. 24.

35. Designation of Administrators, arts. 2-4.

36. Yang, *supra* note 31, at 535-40.

37. *Id.* at 536 (the first criterion concerns the firm's annual gross income or the award or praise it received from the tax or other relevant government departments).

38. *Id.* (the second criterion looks at the firm's number of employees and its leased office space).

39. *Id.* (the third criterion refers to the number of full-time lawyers hired to handle for each bankruptcy case).

40. *Id.* (the fourth criterion focuses on the speed at which a certain number of civil cases have been handled annually).

41. *Id.* at 536-37 (the fifth criterion helps prove for the law firm's specialty, based on the number of journal articles that have been published on civil cases).

42. *Id.* at 537.

43. This is according to Article 5 of The Provisions of the Supreme People's Court on the Designation of Administrators during the Trial of Enterprise Bankruptcy Cases, which prescribes that "the people's court shall, through the most influential media within its jurisdiction, make an announcement about the matters relevant to the preparation of roster of administrators . . . ." Designation of Administrators, art. 5.

44. Yang, *supra* note 31, at 537.

45. *Id.* at 538.

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In addition to law firms, accounting firms, and liquidation firms (that can be named to the Administrators List as ‘institutional administrators’), individuals who work for them can be qualified as ‘individual administrators,’ and are kept on a separate Administrators List. It needs to be emphasized that individual administrators will have to be selected from among lawyers and accountants whose firms have been named to the Administrators List.<sup>46</sup> For such individuals, their time in practice, achievements, level of specialty, and experience in handling bankruptcy cases will score points<sup>47</sup> for them;<sup>48</sup> the ten lawyers and ten accountants with the most accumulated points may be named to the first Preliminary Administrators List, which also needs to be published on the court’s website for a period of ten days so the public may provide its comments and objections.<sup>49</sup>

Because corruption and *guanxi* (the latter refers to the favoritism extended to those associated with the network of influence)<sup>50</sup> have played a notorious role in China’s historic and modern politics for government intervention, the objective criteria suggested by the Chongqing Model should limit the broad (and thus potentially flawed) discretionary power accredited to the court in appointing administrators. Despite the improvement, the EBL and SPC Provisions are silent about when, if there is a timeframe at all, the new names can be added to the Administrators List.<sup>51</sup> It is also unclear why an individual administrator must be selected from the institutional administrators that are already on the Administrators List.<sup>52</sup> It is particularly intriguing given the EBL already requires practitioners to have effective malpractice insurance to administer a case as an individual administrator.<sup>53</sup>

As a matter of practice, the administrators are established by the EBL to replace the liquidation group in almost all types of bankruptcy enterprises (所有破產企業, in Chinese), especially special private and non-publicly owned enterprises (特別民營或非公有企業, in Chinese). But the liquidation group is not out of the picture entirely yet, as its main function is to supervise the reorganization of all SOEs or State-owned Holding Companies (國有或國有控股企業, in Chinese) and Collective Enterprises (集體企業, in Chinese).<sup>54</sup> The remuneration of an administrator is likely to be much higher than what the members of the liquidation committee (or liquidation group) can be remunerated. The high level of administrator’s fees explains why, in actual practice, reorganization is adopted mainly by large enterprises, and reconciliation by small-and-medium sized enterprises (SMEs), as is so indicated by the Superior Provincial Court in An Hui Province (安徽省高級人民法院, in Chinese).<sup>55</sup> Theoretically, however, reorganiza-

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46. Designation of Administrators, art. 3.

47. The numbers of points required may vary, as there are different grades (Grade 1-4) of lawyers. Additional points may be gained for those holding a position as a professional committee member of Chongqing Registered Accountants Association.

48. Yang, *supra* note 31, at 535-40.

49. *Id.* at 539.

50. *Id.* at 541.

51. *Id.* at 536.

52. *Id.* at 539.

53. The EBL, art. 24, ¶ 4.

54. MING HUA WANG, 安徽省人民法院適用<<企業破產法>>一年情況述評 [Review of the Application of the Enterprise Bankruptcy Law by the People’s Court in An Hui Province] in POCHANFA LUNTAN (破產法論壇, in Chinese) (2009), vol. 3, at 340.

55. *Id.* at 341-42.

tion can be applied to all types of 'enterprise legal persons,'<sup>56</sup> regardless of the size and scale of the individual enterprise.

## II. Bankruptcy Statistics

Bankruptcy statistics are essential, especially those concerning the numbers of bankruptcy (including reorganization) applications made every quarter or year because they help identify the means by which such debt claims are ultimately resolved, whether it be through liquidation, reorganization, or settlement. Stakeholders, most importantly lawmakers but also including debtors and creditors, will inevitably need to draw upon bankruptcy statistics to make data-informed discussions before attempting any resolution options. As far as legislative proposals or reforms are concerned, statistical data can attest to or, conversely, cast doubts on the efficacy of China's statutory bankruptcy system. For creditors, quantitative and evaluative data may help assuage their concerns, if questions arise as to whether the number of administrators in a local jurisdiction is desirable<sup>57</sup> or whether the court-appointed administrators in China are qualified sufficiently in accordance with internationally accepted guidelines (*i.e.*, the UNCITRAL Legislative Guide on Insolvency Law).<sup>58</sup> While the U.S. courts took pains to publish on a regular basis the bankruptcy statistics,<sup>59</sup> information of a similar nature is not easily accessible in China. The PRC courts have unofficially attributed the scanty information to the need for protecting the interested parties' privacy. There is presumably no subterfuge implied in the courts' (in)action unless it is taken to conceal the EBL's implementation problem under the existing political and legal culture in China. Worse still, recent research has suggested that some government officials have interfered actively with the SOEs' bankruptcy proceedings in an attempt to boost local gross domestic product (GDP) by allowing only a small number of enterprises to declare bankruptcy.<sup>60</sup> By analyzing twenty-five corporate reorganization cases in China, the underlying research led to the conclusion that the current bankruptcy reorganization system, embodied in Chapter 8 of the EBL, has not oper-

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56. The EBL, arts. 2, 7. The term 'enterprise legal persons' refers to both state-owned enterprises (SOEs) and enterprises that are not state-owned. Enterprise legal persons include (1) limited liability companies; (2) companies limited by shares; (3) private enterprises; and (4) foreign-invested enterprises, but exclude partnerships and individual-owned businesses. The reason is because partnerships and individual-owned businesses have unlimited liabilities. See WEIGUO WANG, *THE SUM AND SUBSTANCE OF BANKRUPTCY LAW* (Peking: Law Press China) (2007), at 4 (Chinese book with English title).

57. See Designating the Administrator, art. 2, where it stipulates that "a higher people's court shall, according to the number of law firms, accounting firms, bankruptcy liquidation firms and other social intermediary agencies, number of full-time practitioners, and number of enterprise bankruptcy cases within its jurisdiction, decide to prepare a roster of administrator by itself or by the intermediary people's court within its jurisdiction."

58. In ¶ 39 of the UNCITRAL Legislative Guide, it is stated expressly that the administrator should be qualified appropriately, with knowledge of insolvency, commercial, finance, and business laws, as well as with adequate experience in commercial, financial, and accounting matters. U.N. COMM. ON INTERNATIONAL TRADE LAW (UNCITRAL), LEGISLATIVE GUIDE ON INSOLVENCY LAW, Sales No. E.05.V.1 (2004), available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/2004Guide.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html) [hereinafter The UNCITRAL LEGISLATIVE GUIDE].

59. See *News Releases*, UNITED STATES COURTS, [http://www.uscourts.gov/Press\\_Releases/index.html](http://www.uscourts.gov/Press_Releases/index.html) (last visited Apr. 28, 2011).

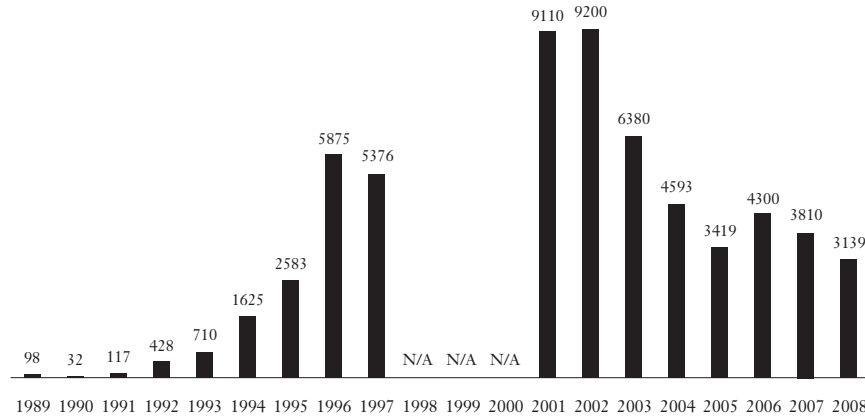
60. Li & Wang, *supra* note 1, at 308-10.

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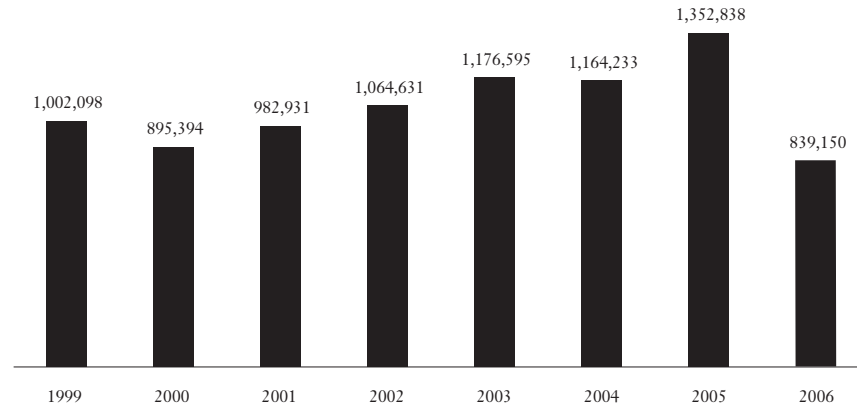
ated fully to the legislative design of preserving the bankrupt company’s going concern value.<sup>61</sup>

**Chart 1 Number of Bankruptcy Cases Accepted to be Heard by the PRC Courts from 1989-2008**



Source: The Supreme People’s Court and the Bankruptcy Law & Restructuring Research Center, The China University of Political Science and Law  
 \*N/A Not available

**Chart 2 Number of Bankruptcy Cases Accepted to be Heard by the U.S. Courts from 1999-2006**



Source: U.S. Courts series of annual reports<sup>62</sup>

61. *Id.* at 309.

62. By the categorization of original U.S. Courts of annual reports, bankruptcy cases in the United States fall into either one of the two sub-categories: liquidation or reorganization, from which either one of the two means bankruptcy cases will be resolved. Hence the total number of bankruptcy cases in the United States

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To better balance the rights of debtors and creditors, the EBL was designed for the administrator to take over the role and function discharged previously by the liquidation group under the old 1986 Law. The liquidation group mainly consisted of government agencies or governmental institutions, among which were the Administration for Industry and Commerce, Public Security Agency, Land Administration Agency, and the management team of the SOE facing bankruptcy.<sup>63</sup> Because so many government departments and agencies were members of the liquidation group, the government therefore orchestrated the direction and decisions. Government intervention was not uncommon, especially for earmarked SOEs whose bankruptcy applications could not be filed with the court without having first obtained the approval from their supervising government department(s). This may explain why the number of bankruptcy cases in China is dwarfed immensely by those in the United States for the same period from 1999-2006, as seen in Charts 1 and 2 above.

Chart 1 shows that the number of bankruptcy cases in China has increased dramatically since 1996 and reached their peaks in 2001 and 2002, nearly fourteen years after the old law was issued in 1986. Since the peak years, the number has since then been reduced significantly—by 2008, only two years after the old law was replaced by the EBL, the number dropped to 3,139, much lower than a year ago at 3,810 when the EBL first came into effect. It is observed that the number of bankruptcy cases recorded was higher in 2006 (at 4,300) than in 2007-2008. The reason is believed to be that a larger number of bankrupt enterprises preferred to file for bankruptcy in 2006 while the old law was still applicable because they were more familiar with that law than the EBL.

Professor Shuguang Li,<sup>64</sup> of The China University of Political Science and Law in his joint article examining the EBL three years after its implementation, suggested that there are gaps between legislation expectancy and actual practice.<sup>65</sup> Since the EBL came into effect on June 1, 2007, immediate revision of the law is suggested to be rather doubtful. Speaking at the annual meeting of China INSOL in 2009, Professor Li, as a member of the drafting group for the EBL, attributed the problem to a couple of what he labeled as “abnormalities.”<sup>66</sup> First, the number of bankruptcy cases heard by the People’s Court has dropped significantly since the enactment of the EBL.<sup>67</sup> Second, over the past two years, hundreds of thousands of enterprises stepped out of the market, not by way of proper bankruptcy procedure but by having their licenses deregistered (*zhubuxiao*, 註銷 in Chinese)

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over the period from 1999-2006 (as shown in Chart 2) have actually combined both numbers for liquidation and reorganization. See also LIU, *supra* note 28, at 6.

63. Emily Lee & Karen Ho, *China's New Enterprise Bankruptcy Law—A Great Leap Forward, but Just How Far?*, 19 INT. INSOLV. REV. 145, 156 (2010).

64. Professor Shuguang Li is the Director of Bankruptcy Law and Restructuring Research Center, housed at The China University of Political Science and Law located in Beijing. He was also a member of the drafting group for the EBL.

65. Li & Wang, *supra* note 1, at 303.

66. China INSOL is the China chapter of INSOL International. INSOL International, headquartered in London, United Kingdom, promotes itself as “a federation of national associations for accountants and lawyers who specialize in turnaround and insolvency.” See INT’L ASS’N OF RESTRUCTURING, INSOLVENCY & BANKR. PROF’LS, <http://www.insol.org/> (last visited Dec. 14, 2011). Currently, there are forty Member Associations in worldwide locations with over 10,000 professionals participating as Members of INSOL International. *Id.*

67. SHUGUANG LI & ZHOFA WANG, REVIEW OF THE PRC BANKRUPTCY LAW IN 2009,” INSOL International Technical Series Issue No. 11, at 1-2 (2010).

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or cancelled (*diaoxiao*, 吊銷 in Chinese).<sup>68</sup> In Li's article, he highlighted the lack of use of the EBL after it was implemented:

There were 3,139 enterprise bankruptcy cases in 2008 while there were 780 thousand [780,000] enterprises stepped out of the market in the same year. Among the 780 thousand [780,000] enterprises 380 thousand [380,000] exited the market through the path of deregistration (*zhuxiao*) and 400 thousand [400,000] through the path of license cancellation (*diaoxiao*)<sup>69</sup>

The statistics above mean that in 2008 alone, the rate for bankruptcy applications (by making use of the EBL) accounted for only 4.02% of all business closures, quite an insignificant ratio compared to deregistration (48.71%) and license cancellation (51.28%). If numbers can talk, the EBL may have been viewed by many corporate debtors as too cumbersome<sup>70</sup> to be acted on; hence they resorted to administrative procedures for a quick fix. This could potentially leave their creditors with little or even no assets for recourse. Worse still, the weak position of the administrators, compared to the strong position enjoyed by the liquidation group in disposing SOEs under the old law, leaves them with few bankruptcy fees.<sup>71</sup> To top it off, unless the creditor, administrator, capital contributor of the debtor company, or any other interested party is willing to make advanced payments,<sup>72</sup> when and where the bankruptcy fees fall short, the bankruptcy procedure will be terminated early, leaving the EBL with no way to be applied and creditors stuck in limbo.

Last but not least, bankruptcy reorganization is reportedly used more frequently by non-listed companies than listed companies. A more recent book publication, of which Professor Li was a co-author, indicated that over a period of three years (since June 1, 2007, when the EBL came into effect, and up until May 31, 2010), there were in total 142 enterprises that entered into reorganization processes, of which 116 were non-listed companies and the remaining twenty-six were listed companies; of these twenty-six listed companies, fifteen of them have been reorganized successfully.<sup>73</sup> In terms of the registered capital or residual company assets before reorganization, it ranges from CN¥218 million to CN¥2.291 billion (equivalent to approximately US\$33.7 million to US\$354.1 million) for listed companies and from US\$40 million to US\$431 million dollars for non-listed companies.<sup>74</sup> This suggests that for reorganization to be successful, either the listed companies or non-listed companies must have maintained a certain level of assets, which shall attest to its viability as a company. Compared to the U.S. bankruptcy statistics, relatively

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68. MEMBER OF CHINA INT'L INSOLVENCY ASS'N ANNUAL MEETING, <http://www.chinainsol.org/show.aspx?id=556&cid=37> (last visited Apr. 27, 2010).

69. LI & WANG, *supra* note 67, at 2.

70. For example, due to the 'dual approval' requirement, as manifested in Article 86 of the EBL, the reorganization plan submitted by the debtor company must be approved by creditors of all four voting classes and by the court. This arguably may render the approval more difficult to obtain.

71. See MEMBER OF CHINA INT'L INSOLVENCY ASS'N ANNUAL MEETING, *supra* note 68.

72. 最高人民法院關於審理企業破產案件確定管理人報酬的規定 [Provisions of the Supreme People's Court on Determination of the Administrator's Remunerations], (promulgated by Sup. People's Ct., Apr. 12, 2007, effective June 1, 2007) art. 12 (China).

73. SHUGUANG LI & ZHI BIN ZHEN, 公司重整法律評論 [LAW REVIEW OF CORPORATE REORGANIZATION & RESTRUCTURING] (Peking: Law Press China) (2011), vol. 1, at 73. (The book is printed in Chinese.)

74. *Id.*



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large companies, indicated by having generated an annual revenue of over US\$100 million, maintain a reorganization rate of sixty-nine percent (by undergoing successfully U.S. Chapter 11 bankruptcy procedures), compared to smaller companies with only US\$25 million in revenue, whose success rate in coming out of bankruptcy proceedings as a viable company has decreased to only thirty percent.<sup>75</sup>

### III. The EBL's Outstanding Issues

Listed below are some outstanding issues that merit a further assessment for considerations of future amendments to the EBL. The list is meant for practical discussions only and cannot be deemed as exhaustive.

#### A. DOMICILE

The reluctance of judges to accept bankruptcy or reorganization applications also poses a threat to the evocation of the EBL—"some judges may not be willing to accept applications until they can find out whose local toes will get trodden on."<sup>76</sup> The problem lies in Article 3 of the EBL, which stipulates that the jurisdiction of a bankruptcy case shall be reserved exclusively for the People's Court of the place where the debtor company is domiciled.<sup>77</sup> Article 3 appears to be overly restrictive, considering that China is a vast country. The creditors and the assets of the debtor may be located throughout the country and the creditors may not be aware where the debtor's principle place of business is, thus the 'domicile' issue can but should not bar the court from accepting bankruptcy petitions. A suggestion might be for the domicile requirement to be tempered so that it will enhance the likelihood for best preservation of the debtor's going concern value. In light of this, Article 3 perhaps should be included in the future amendment of the EBL. Inspiration can possibly be drawn from the domicile regulation in the U.S. Chapter 11, which upholds a multiple-list of possible domiciles from which the creditors and courts can choose in order to determine the debtor company's domicile.

Article 3 excludes the jurisdiction of a bankruptcy case to the People's Court of the place where the debtor is domiciled. Supplementary to that provision, the SPC interpreted that the debtor's domicile refers to its principle place of business.<sup>78</sup> Article 3 apparently supplies little or no choice about where to file a bankruptcy case.<sup>79</sup> In contrast, the law in the United States is very different as "it permits a considerable amount of choice about where an enterprise may file its U.S. Chapter 11 case . . . the case could be filed where the debtor has its principal place of business, where its assets have been located

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75. *Id.*

76. *New Enterprise Bankruptcy Law Faces Severe Test*, CHINA L. & PRAC., Dec. 19, 2008, available at 2008 WLNR 27711718.

77. The EBL applies only to 'enterprise legal persons' and not natural persons; therefore, where 'the debtor' is used in the EBL or mentioned in this article, it refers to 'the debtor company.'

78. See 最高人民法院關於審理企業破產案件若干問題的規定 [Provisions for Several Issues on Trial of Enterprise Bankruptcy Cases (No. 23)], (promulgated by Standing Comm., Nat'l People's Cong., July 30, 2002, effective Sept. 1, 2002), art. 1.

79. William J. Woodward, Jr., *Control in Reorganization Law and Practice in China and the United States: An Essay on the Study of Contrast*, 22 TEMP. INT'L & COMP. L.J. 141, 148 (2008).

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for the 180 days prior to the filing, or where it is domiciled.”<sup>80</sup> Concerning domicile, the U.S. cases have upheld that domicile includes, among other options, the place where the corporation is incorporated.<sup>81</sup> Using various attributes to link jurisdiction, the U.S. law enables the debtors and creditors to choose in which venue and over which asset that bankruptcy proceeding can be filed. Such flexibility is desirable for a vast country like China, especially in circumstances where the creditors and the debtor’s assets may be located throughout the country, so that bankruptcy proceedings may commence sufficiently early and thereby preserving the debtor company’s remaining value. One should also be aware of the problem inherent in making the domicile as the only linkage to the jurisdiction of a bankruptcy case, which can be a serious problem in China where ‘local protectionism’ runs rampant (at least that is still the case in some areas) and thus makes bankruptcy filings against the preferred enterprises difficult to be accepted by the local courts under pressure of the local governments.

On the ground of domicile, some judges might refuse to get the bankruptcy proceedings commenced early for a lack of jurisdiction power. The U.S. law may again provide some inspiration for future amendment of the EBL. It may, however, be likely to create another problem known as ‘venue shopping.’

In the business bankruptcy area, venue shopping in the United States has become a focus of heated debate. In the United States’ largely voluntary business bankruptcy system, it is clear from the empirical data that those who control the corporate debtor are choosing where to file for strategic reasons. The debate concerns why they are doing so and whether this is a good thing.<sup>82</sup>

For now though it is safe to say that venue shopping is possible in the United States in a way that is not in China.<sup>83</sup> A public hearing to instigate the debate of venue shopping is advisable, before the legislators in China decide whether China should follow suit of the United States to expand the jurisdiction of a bankruptcy case beyond the point of the debtor’s domicile.

**B. NON-OBLIGING ATTITUDE BY COURT JUDGES AND ITS IMPACT ON SECURITIES REGULATIONS**

Relevant to the last point, as indicated by a judge working in the People’s Court in An Hui Province, some courts have decided to hold off accepting bankruptcy applications on the grounds that relevant SPC interpretations are still pending. This led to a slip of bankruptcy cases in An Hui Province from 175 to 169 cases, over the one-year period after the EBL was promulgated.<sup>84</sup> The numbers were supposed to have gone up instead in the midst of financial crisis in 2007-2008. Also to be inferred from the judge’s report published in 2009, some judges simply preferred to apply the old law (*i.e.*, the 1986 Law) over the new law (*i.e.*, the EBL), for the sake of their own convenience, even though the new law had already come into effect on June 1, 2007 and thus should be implemented. This

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80. *Id.* at 149; *see also* 28 U.S.C. § 1408.

81. Woodward, *supra* note 79, at 149.

82. *Id.*

83. *Id.*

84. MING HUA WANG, *supra* note 54, at 336.

anomaly in practice may be linked to the paucity of bankruptcy reorganization cases as the old law contains no reorganization provisions whatsoever; in contrast, the new law dedicates an entire chapter (Chapter 8) to that effect. Judges' negation to apply the EBL deprives the creditors or other stakeholders (such as employees of the debtor company) of the benefits and protection of rights, as intended by the new, and thus the more recent or current, law. It also implicates that there may not be enough competent judges capable of handling complex bankruptcy cases that generally require adequate expertise in commercial, financial, and accounting matters. A longer trial period and even delay in bankruptcy proceedings may also arise due to a lack of professional training among concerned judges who either are not familiar with the EBL where time is of great essence or do not possess sufficient knowledge in commercial, financial, and accounting to handle bankruptcy cases. In light of this, the courts should streamline their human resources in order to handle the growing number of bankruptcy liquidation or reorganization cases as can be foreseen reasonably. This is especially true given that the EBL has expanded its scope of application to all 'enterprise legal persons,' compared to the 1986 Law that applied only to SOEs. Moreover, the EBL has also removed previous restrictions for bankruptcy filing—SOEs no longer need to obtain permission/approval from their supervisory government bodies to file for bankruptcy.

Presumably the non-obliging attitudes by some judges who refuse to apply the EBL also make foreign investors in China query "how the bankruptcy process will actually work for them—many are likely to decide to avoid using the [EBL] altogether, as it may not meet their needs."<sup>85</sup> The aversion to the EBL allegedly led more companies to adopt the 'consensual methods,' in lieu of the legislatively-prescribed reorganization procedure, in dealing with their financial problems, so as to avoid a "formal and public process."<sup>86</sup> Consensual methods are often seen by foreign investors as more desirable, even though the legislators' aim was to provide unified legislation (i.e., the EBL) to facilitate the reorganization of both Chinese and foreign enterprises based in China. Needless to say, the EBL's supplementary legislations will not be put to use if the EBL is not invoked. "There is more prospect of foreign companies taking the view [that] the value will come out in consensual discussions, rather than through reorganization proceedings under the EBL or relying on the EBL as an absentee stakeholder."<sup>87</sup> Wherever the EBL fails to be invoked, it would inevitably put relevant securities regulations under pressure for non-compliance, which include:

- (1) "Supplementary Provisions on Pricing Shares Issued in Significant Assets Reorganization of Bankrupt Listed Companies for Restructuring,"<sup>88</sup>  
(關於破產重整上市公司重大資產重組股份發行定價的補充規定, in Chinese), which prescribes that during the bankruptcy restructuring of a listed company, if the company intends to carry out major asset reorganization through the issue of shares for purchasing new assets, the price for the shares to be issued shall, after consultation by each relevant parties, be submitted to the general meeting of shareholders for a reso-

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85. *New Bankruptcy Law Faces Severe Test*, *supra* note 76, at 1.

86. *Id.*

87. *Id.*

88. 關於破產重整上市公司重大資產重組股份發行定價的補充規定 [Supplementary Provision on Pricing Shares Issued in Significant Assets Reorganization of Bankrupt Listed Companies for Restructuring], (promulgated by the China Sec. Regulatory Comm'n, Nov. 11, 2008, effective Nov. 12, 2008) (China).

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lution.<sup>89</sup> The resolution shall be subject to adoption by two-thirds or more of the voting rights of shareholders that are present at the meeting, and shall be subject to adoption by two-thirds or more of the voting rights of public shareholders that are present at the meeting.<sup>90</sup>

(2) “No. 2 Rules on Contents and Format of Information Disclosure by Companies for Publicly Issuing of Securities—Content and Format of Annual Reports”<sup>91</sup> (公開發行證券的公司信息披露內容與格式準則第2號—年度報告的內容與格式, in Chinese), which mandates that companies shall disclose such relevant issues as bankruptcy and reorganization that occurred within the reporting period, including application to courts for reorganization, reconciliation, bankruptcy, or liquidation, any courts’ rulings concerning said reorganization, reconciliation, bankruptcy, or liquidation, and that being handed down during the reorganization of companies, and other material issues.<sup>92</sup> Companies that have implemented reorganization shall state the specific content and implementation of such reorganization plans.<sup>93</sup>

By the name of it, it may be needless to say that the above-mentioned regulations (that are supplementary to the EBL) are applicable only to and thus have a particular focus on listed companies.

The reason for the declining number of bankruptcy cases is not the result only of judges’ shirking their duties to apply the EBL. Another major reason is the cost-prohibitiveness of the EBL. The large amount of expenses associated with undertaking a reorganization process has forced SMEs to reconsider reorganization. Reorganization costs include, among others, (1) general expenses; (2) evaluation costs; (3) administration costs; (4) other professional fees; and (5) administrative costs. All of these costs will be expounded further below. Understandably, these costs all together will likely be too high for the average SMEs to absorb, considering they had come into financial difficulty in the first place.

### C. REORGANIZATION COSTS

Reorganization costs can be immense, within one or several of the following categories.

#### 1. *General Expenses*

The EBL requires that the administrator or debtor company submit a draft reorganization plan within six months (which is extendable for another three months) of the date on which the People’s Court makes an order for the reorganization of the debtor company.<sup>94</sup> To facilitate that requirement, the administrator must call for the holding of the creditors’

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

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

<sup>91.</sup> 公開發行證券的公司信息披露內容與格式準則第2號—年度報告的內容與格式 [No. 2 Rules on Contents and Format of Information Disclosure by Companies for Publicly Issuing of Securities—Content and Format of Annual Reports] (promulgated by the China Sec. Regulatory Comm’n, Dec. 17, 2007, effective Dec. 17, 2007) (China).

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

<sup>93.</sup> *Id.* art 41.

<sup>94.</sup> The EBL, art. 79.

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meeting, which entails not only a thorough investigation and confirmation of debts but also a variety of other expenses for the purposes of producing creditors' lists and printing and mailing said lists to (or calling) the creditors to inform them of the said meeting. Moreover, Article 81 of the EBL provides that the proposed reorganization plan shall contain the following contents, among others:

- (i) the business plan of the debtor company; (ii) the classification of the claims; (iii) the adjustment mechanism of the claims; and (iv) the repayment schedule of the claims; (v) the time limit for implementation of the reorganization plan and (vi) the time limit for supervision (by the administrator) over implementation of the reorganization plan.

All of the content requirements are highly technical and, in the making of a reorganization plan, will require a great deal of secretarial assistance in making and tabling the reorganization plan.

2. *Professional Services Costs*

Professional services in commercial/financial trading will also likely be sought, in order to transform illiquid assets into liquid cash to be distributed fairly to creditors of different classes. Remunerations for these professionals who are service providers will add more charges to the overall expenses towards reorganization.

3. *Evaluation (or Financial Advisory) Costs*

Evaluation costs stem from analyses for both the debtor company's business and assets. The purpose for evaluating the business is for creditors to determine the debtor company's viability to operate as a going concern, while the purpose for evaluating the asset is to "estimate the discount rate implicit in creditors' reorganization plan decisions."<sup>95</sup> Value for the discount rate is essentially an assumption in evaluating the 'best-interests test.' The best-interests test is embodied in paragraph (3) of Article 87 of the EBL, borrowing from § 1129(a)(7)(A) of the U.S. Bankruptcy Code, which states that a U.S. Chapter 11 plan cannot be confirmed unless creditors receive as much under the plan as under liquidation,<sup>96</sup> or put another way, unless the reorganization plan is calculated to benefit the general body of the creditors.<sup>97</sup> In China, the EBL requires that a reorganization plan be approved not only by the creditors, but also the court—this is known as 'double approval.' Influenced by the U.S. practice, whereof court-supervised reorganization procedures typically require judges to apply the best-interests test, the EBL shall require the bankruptcy judges to undertake the same test. A successful reorganization plan entails a discount rate acceptable to the creditors for agreeing to a 'haircut.'<sup>98</sup> Creditors can also agree to ex-

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95. Fabrice Barthélémy et al., *What Discount Rate Should Bankruptcy Judges Use? Estimates from Canadian Reorganization Data*, 29 INT'L REV. L. & ECON. 67, 67 (2009).

96. *Id.*

97. Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, art. 59(2) (Can.).

98. 'Haircut' connotes the creditor's concession to a "certain percentage of the debt owed to them in full, complete, and final satisfaction of their claims against the debtor." See THE UNCITRAL LEGISLATIVE GUIDE, *supra* note 58, at 28, ¶ 27. In doing so, the debtor becomes solvent and may continue to trade, because its debts are reduced. *Id.*

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change debt for equity in the reorganized entity; thereby reorganization entails a change in the debtor company's capital structure. Proper value analysis is material in assessing the feasibility of the debt-credit swap.

4. *Administration Costs*

Administration costs are the fees payable to an independent administrator appointed by the People's Court. The EBL adopts partially from the U.K. model for administrator replacement, which was not seen in its predecessor law (the 1986 EBL) as the latter did not establish an administrator system, but rather provided that the (bankruptcy) liquidation group be responsible and report to the court.<sup>99</sup> Administrators in China must be designated by the People's Court,<sup>100</sup> and once appointed, the EBL allows the administrators to engage in a wide range of activities and responsibilities.<sup>101</sup> The administrator's job consists mainly of checking, investigating, and confirming bankruptcy claims,<sup>102</sup> for which remuneration must be paid. The administrator's remunerations are to be paid out of the debtor company's assets. In this respect, an administrator would "nearly always be an add-on expense, or at least until the ranks of management were trimmed,"<sup>103</sup> said one commentator who proposes "[s]ubstituting the DIP<sup>104</sup> for the [administrator] saves money for the estate [of the debtor company]."<sup>105</sup> This is, strictly speaking, not the practice in China, considering the EBL is essentially a hybrid of both the U.K. and U.S. systems—the role of an administrator in the U.K. system is introduced to the EBL, but instead of assuming 'management replacement' as in the U.K. model, the EBL adopts DIP as in the U.S. model. Last but not the least, the remuneration of administrators in China will be borne from the debtor's unsecured assets, pursuant to the respective percentage charges as

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99. The EBL, art. 24. The same provision was reiterated in (1) Article 201 of the Civil Procedure Law, 中華人民共和國民事訴訟法 [Civil Procedure Law of the People's Republic of China], (promulgated by Nat'l People's Cong., Apr. 9, 1991, effective Apr. 9, 1991) art. 201 (China); (2) Article 249 of the Opinions of the Supreme People's Court on Some Issues Concerning the Application of the Civil Procedure Law of the People's Republic of China,

最高人民法院關於適用《中華人民共和國民事訴訟法》若干問題的意見 [Opinions of the Supreme People's Court on Some Issues Concerning the Application of the Civil Procedure Law of the People's Republic of China], (promulgated by Sup. People's Ct., July 14, 1992, effective July 14, 1992) art. 249 (China); and (3) Article 51 of the 'Regulation on Several Issues Concerning Hearing Enterprise Bankruptcy Cases' 最高人民法院《關於審理企業破產案件若干問題的規定》 [Regulation on Several Issues Concerning Hearing Enterprise Bankruptcy Cases], (promulgated July 30, 2002, effective Sept. 1, 2002) art. 51 (China). See also JIANHUA XIAO, *Bankruptcy Administrator: Status, Powers and Duties*, in CHINA'S NEW ENTERPRISE BANKRUPTCY LAW: CONTEXT, INTERPRETATION AND APPLICATION 89, 99 (2010).

100. The EBL, art. 13.

101. *Id.* art. 25.

102. Bingkun Ye, *Filing of Claims*, in CHINA'S NEW ENTERPRISE BANKRUPTCY LAW: CONTEXT, INTERPRETATION AND APPLICATION 163, 178-82 (2010).

103. Woodward, *supra* note 79, at 147.

104. The debtor-in-possession (DIP) principle is central to the U.S. system, where the incumbent management of the debtor company remains in place to continue to operate its business and manage its assets during the reorganization process.

105. Woodward, *supra* note 79, at 147.

stipulated in the "Provisions of the Supreme People's Court on Determination of the Administrator's Remunerations."<sup>106</sup>

5. *Other Professional Services Fees*

According to Article Two of the "Provisions of the Supreme People's Court on Designating the Administrator during the Trial of Enterprise Bankruptcy Cases," the position of administrator should be held by professional services firms (*e.g.*, law firms, accounting firms, or bankruptcy liquidation firms) or individuals (including lawyers or certified public accountants).<sup>107</sup> Each of them understandably possesses a distinctive set of skills and, as such, it is not uncommon that an administrator would need to engage other professionals to carry out a complex reorganization plan. For example, a lawyer appointed as an administrator would have knowledge in law, but not likely in accounting or finance; thus he would likely have to engage financial services firms for value analysis of the debtor company, especially if such efforts involve the bankruptcy restructuring of a listed company with a major asset reorganization plan. In that case, on top of the administration costs payable to the lawyer, other professional fees will also be incurred for the financial services firms in consideration of their provision of services, inclusive of setting the price for those shares to be issued by the debtor company, which would then form a newly-acquired fund for the debtor company to purchase assets.

Professional fees are likely to be charged to the debtor on either a percentage basis or a time-cost basis; the former refers to the estimation of fees being based on a certain percentage (usually agreed upon beforehand, between parties) of the debtor's estate and the latter, on the actual time spent multiplied by the professional's hourly rate in rendering the services described above. Professional fees could be high, especially for those financial services that are highly technical and strategically complex.

6. *Administrative Costs*

Under the EBL's framework, there is a high degree of court involvement (hence the legal fees payable to the court) throughout the reorganization procedure. For example:

- (i) the debtor company or its creditor shall apply to the People's Court for entering into bankruptcy proceedings;<sup>108</sup>
- (ii) the administrator shall report his work to the People's Court, during the reorganization procedure;<sup>109</sup>
- (iii) the administrator or debtor company shall submit a draft reorganization plan to the People's Court;<sup>110</sup>

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106. 最高人民法院關於審理企業破產案件確定管理人報酬的規定 [Provisions of the Supreme People's Court on Determination of the Administrator's Remunerations], (promulgated by Sup. People's Ct., Apr. 12, 2007, effective June 1, 2007) art. 2 (China).

107. Designation of Administrators, art. 2.

108. The EBL, arts. 2, 7.

109. *Id.* art. 23.

110. *Id.* art. 79.

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- (iv) the People's Court shall convene the creditor's meeting for the creditors (of four voting classes) to vote on the reorganization plan;<sup>111</sup>
- (v) the administrator or debtor company shall submit an application to the People's Court for approval of the reorganization plan;<sup>112</sup>
- (vi) the administrator or debtor company may apply to the People's Court to cram down the objection of the dissenting group(s) of creditors and, in so doing, approve the reorganization plan.<sup>113</sup>

Reorganization cannot commence without petitioning to the People's Court in the location where the debtor is domiciled.<sup>114</sup> Once the bankruptcy petition is approved and filed,<sup>115</sup> the administrator must call for the holding of the creditors' meetings, participate in any lawsuit, arbitration, or other legal proceedings on behalf of the debtor, and report his work to the People's Court.<sup>116</sup> Within six months of the commencement of the reorganization period, the administrator or the debtor company is to prepare a draft reorganization plan.<sup>117</sup> The EBL requires the reorganization plan to be approved by the creditors as well as by the court.<sup>118</sup> To that end, where the reorganization plan is not passed at the creditor's meeting, the administrator or the debtor company may negotiate with the dissenting groups and a second vote may be convened after negotiation.<sup>119</sup> Where the draft plan is still not adopted by the second vote after negotiation, the administrator or the debtor company may apply to the court for approval of the reorganization plan over the objection of the dissident group(s).<sup>120</sup> For any stage of work required under the EBL, a potentially substantial amount of fees will be borne due to this complicated reorganization procedure.<sup>121</sup>

While the legal fees are most likely to be paid only to the People's Court, if the debtor company is involved with a third party (which is also bankrupt and to which the debtor company is a creditor), then in order to receive the collectable debts, the legal fees will also include those that are payable to a foreign court.<sup>122</sup> More specifically, in instances of cross-border corporate bankruptcy, it is possible that the administrator (of the debtor company in China) will have to file a petition in a foreign court for accessing the assets located outside China that belong to the third party.<sup>123</sup> The administrator has the duty to collect any receivable debts to be included in the debtor company's estate, from which the reorganization expenses will be paid out.

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111. *Id.* arts. 82, 84.

112. *Id.* art. 86.

113. *Id.* art. 87.

114. *Id.* art. 3.

115. The filing can be made either by the debtor, the creditor, or the investor with capital contribution of one-tenth or more of the debtor company's registered capital. *See id.* art. 70.

116. *Id.* art. 25.

117. *Id.* art. 79.

118. *Id.* art. 86.

119. *Id.* art. 87.

120. *Id.*

121. Eu Jin Chua, *China's New Bankruptcy Law: A Legislative Innovation*, 20 CHINA L. & PRAC. 17, 20 (Oct. 2006).

122. *Id.*

123. *Id.* at 23.



#### IV. The EBL's Deficiencies & Remaining Issues

##### A. REORGANIZATION USED RARELY IN CHINA

###### 1. *Low Number of Reorganization Cases*

The low number of reorganization cases has been described in an earlier section titled "Bankruptcy Statistics" above. Despite the EBL's modest success, certain bankruptcy experts in China seem rather optimistic about its achievements so far. In a joint article published by Professor Li and Zhofa Wang in 2009, as noted above, it was indicated that:

[T]he newly introduced reorganization system seems to be working well. There appear to have some reorganization cases since the enactment of the new law [EBL], especially that of some large listed corporations. There have been 16 reorganization cases adopted by the courts of listed corporations [until] June 2009. There are also some reorganization cases of close corporations.<sup>124</sup>

It is necessary to note that the number of cases (sixteen) herein is slightly less than the number of cases (twenty-three) reported at the meeting of China INSOL mentioned above—where Professor Li spoke in his capacity as the Director of Bankruptcy Law and Restructuring Research Centre of China University of Political Science and Law. The discrepancy in the two figures was a result of Professor Li's article being written before the said meeting that took place on November 29, 2009.<sup>125</sup> As mentioned before, a more recent book publication co-authored by Professor Li further indicated that there are twenty-six listed companies that have begun the reorganization process.<sup>126</sup>

Despite these slight discrepancies, reorganization is not used widely in China compared to other jurisdictions. The number of Chinese reorganization cases over a period of three to four years (since the EBL's promulgation in August 2006) is significantly less than those recorded in Australia and the United Kingdom, following the respective promulgation of their reorganization laws,<sup>127</sup> namely the Insolvency Act of 1986 (in the U.K.) and the Corporations Act of 2001 (in Australia).<sup>128</sup> Contrary to China's slow acceptance of its new statutory corporate reorganization system, reorganization under the Australian shelter regime (voluntary administration) was used widely from its genesis. In Australia in 2003, "40.3 per cent of all companies entering formal corporate bankruptcy went into voluntary administration."<sup>129</sup> Although the actual number of companies having been reorganized was not available, the ratio stood at a relatively high level, considering it was then only two years following Australia's Corporations Act of 2001.<sup>130</sup> In the United Kingdom in 1987, one year after the U.K.'s Insolvency Act of 1986, there were 131 companies undergoing

124. LI & WANG, *supra* note 67, at 3.

125. See MEMBER OF CHINA INT'L INSOLVENCY ASS'N ANNUAL MEETING, *supra* note 68.

126. LI & ZHEN, *supra* note 73, at 73.

127. Reorganization in the United States is conducted under Chapter 11 of the U.S. Bankruptcy Code. Correspondingly, the Insolvency Act 1986 is the central piece of U.K. legislation while the central piece of Australian legislation is the Corporations Act 2001.

128. Corporations Act 2001 (Cth) (Aust.); Insolvency Act, 1986 (Eng.).

129. ANDREW KEAY, *A Comparative Analysis of Admin. Regimes in Aus. and the U.K.*, in INT'L INSOLVENCY LAW: THEMES AND PERSPECTIVES, ch. 5 (2008).

130. *Id.*

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administration procedures.<sup>131</sup> Note that reorganization, as the shelter regime, has been introduced in the United Kingdom as simply “administration” and in Australia as “voluntary administration.” China adopted the U.K. system, with the administrator replacing the management of the debtor company in (bankruptcy) reorganization. In terms of actual acceptance and adoption of the reorganization system, the ratio or number in Australia and the United Kingdom, respectively, far exceeded the numbers recorded in China.

In the United States, a recent study by Professor Elizabeth Warren of Harvard University suggested that reorganization is very well received in the United States, as evidenced by nearly all troubled companies having chosen U.S. Chapter 11 restructuring over U.S. Chapter 7 liquidation; among those, seventy percent resulted in confirmed plans of reorganization.<sup>132</sup> Professor Warren’s research was premised on data collected from large samples of U.S. Chapter 11 cases filed in 1994 and 2002, against which she identified that “almost half the unsuccessful cases were jettisoned within six months and almost eighty percent were gone within a year.”<sup>133</sup>

To this end, Professor Warren concluded that the reorganization system under U.S. Chapter 11 serves as a critical screening function to eliminate hopeless cases relatively quickly.<sup>134</sup> As such, she challenged the conventional wisdom that U.S. Chapter 11 is characterized by a relatively low success rate and endless delay.<sup>135</sup> Unfortunately, the same conclusion does not apply in China just yet. It has been known that reorganization can take much longer in China, well over one year or beyond.<sup>136</sup> Although a sufficient period of adjustment may be required before the new reorganization legislation becomes widely accepted, Australia’s “immediately engaging” experience proved that it does not always have to be the case. It thus merits further assessment to determine whether China’s low number of reorganization cases is any indication of its administration process being less efficient and too costly.<sup>137</sup> While it is an important issue, it is beyond the scope of this article.

On the other hand, in terms of the cost of corporate bankruptcy, a World Bank report conducted in 2010<sup>138</sup> indicated that undergoing a bankruptcy process in China is estimated to cost about twenty-two percent of the estate value in each year of the period from 2006-2009, which is about sixty-two percent more than the OECD average.<sup>139</sup> To minimize the cost, commentary in favor of DIP argues that substituting the DIP for the ad-

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131. *Id.* at 108 (Table 5.1 Administrative Procedures).

132. Elizabeth Warren & Jay Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603, 603 (2009).

133. *Id.*

134. *Id.*

135. *Id.*

136. See World Bank, Wash. D.C., *Doing Bus. 2007: How to Reform: Comparing Regulation in 175 Econs.*, at 105; World Bank, Wash. D.C., *Doing Bus. 2008: Comparing Regulation in 178 Econs.*, at 113; World Bank, Wash. D.C., *Doing Bus. 2009: Comparing Regulation in 181 Econs.*, at 97 (finding that closing a bankrupted business in China took an average of 2.4 years in 2007, longer than the 1.7 years in 2008 and 2009); for more details, see Lee & Ho, *supra* note 63.

137. For more details, see *id.* at 155-59.

138. World Bank, Wash. D.C., *Doing Bus. 2010: Comparing 183 Econs.*, at 104, available at <http://www.doingbusiness.org/ExploreEconomies/?economyid=42> (last visited Jan. 25, 2010). For more details, see also Lee & Ho, *supra* note 63.

139. OECD stands for the Organization for Economic Cooperation and Development.

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ministrator saves money for the debtor company's estate.<sup>140</sup> In connection to this, Professor Li suggested that even though the DIP mode is embedded in China's EBL, "[a]mong the 16 reorganized listed corporations [as mentioned above], there are only 3 DIP cases."<sup>141</sup>

The deficiencies of the EBL impel one to probe into the many hurdles to this law. In addition to the relatively small number of reorganization cases approved in China,<sup>142</sup> a meeting at China INSOL mentioned above also noted that reorganization is undertaken increasingly by more "Special Treatment" (\*ST) companies than regular companies wanting to restructure themselves.<sup>143</sup> Special treatment connotes a distinctive "warning system" that was formulated by the securities exchanges in China to warn investors of listed companies suffering severe losses and that are at risk of being delisted from the stock exchange(s). If a listed company accumulates losses for some consecutive years, varied slightly from each and every stock exchange in China, that company's shares will be suspended from trading; and during the period of suspension, if the company's finance fails to improve, then its business license will be revoked and the company's shares will be delisted from the stock exchange(s). For example,

[A]ccording to the rules of the Shenzhen and Shanghai stock exchange[s], listed corporations suffering losses for two continuous years shall be [branded with the prefix] \*ST . . . [e.g., a fictitious company known as "ABC Company Limited" prior to the branding thus becomes, after the branding, "\*ST ABC Company Limited"] to warn investors of the potential risk that the corporation may be de-listed if the losses continue. If the \*ST corporation continues to lose money for two years, it will [then be further branded with the prefix] "S\*ST" in the third year. If the company is still unable to recover by the end of the third year, its shares will be de-listed.<sup>144</sup>

It is worthwhile to note that "[s]ince the [listing cost] in China's securities market is quite high, the \*ST corporations still possess considerable 'shell value.' \*ST corporations become attractive targets of acquisition for outside financial or strategic investors."<sup>145</sup> In 2009 alone, there were reportedly at least ten \*ST companies that began the reorganization process, including among others \*ST Xia Xin (\*ST夏新, in Chinese), \*ST Dan Hua (\*ST丹化, in Chinese), and S\*ST Guang Ming (S\*ST光明, in Chinese).<sup>146</sup> Among them, unofficial statistics suggested that following the EBL's coming into effect on June 1, 2007, almost all \*ST companies applying for bankruptcy reorganization have been successfully restructured, after which their share prices have soared.<sup>147</sup> This makes restructuring of \*ST companies a highly profitable investment in China, considering that reorganization will generally only take about seventeen months to complete.<sup>148</sup> For \*ST companies, normally on the twentieth trading day after the People's Court accepted their applications for

140. Details will be further explained in the section titled "Reorganization Cost."

141. LI & WANG, *supra* note 67, at 4.

142. See MEMBER OF CHINA INT'L INSOLVENCY ASS'N ANNUAL MEETING, *supra* note 68.

143. *Id.*

144. LI & WANG, *supra* note 67, at 4.

145. *Id.* at 4.

146. Da Jun Wang, 破產重整“黑馬”還剩多少 [Bankruptcy Reorganization: How Many Black Horses Have Left], 21ST CENTURY BUSINESS HERALD, Jan. 25, 2010. [The news story was printed in Chinese].

147. LI & WANG, *supra* note 67, at 4-8.

148. Lee & Ho, *supra* note 63, at 146.

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entering into a bankruptcy reorganization procedure, the \*ST company will be suspended from trading for a period of six months; then, it will take a further ten months for formulating a reorganization plan, which will then need to be approved by the \*ST company's creditors and the court before its ultimate implementation.<sup>149</sup> Once reorganization becomes successful, the \*ST companies' shares, as the historical track records of such events show, quickly soar and become highly profitable for speculators trading in the stock market.<sup>150</sup>

Restructuring of \*ST companies is arguably the most peculiar side of reorganization business in China. In common cases, the \*ST company has minimal or no value (other than shell value), and even so, reorganization application can surprisingly be accepted by the court.<sup>151</sup> Had the same type of cases been applied in other countries, bankruptcy liquidation would likely be the one and only option to resolve the debtor company's debts, as it lacked a viable business prospect at the time of bankruptcy application, a prerequisite to applying for reorganization in most jurisdictions.<sup>152</sup> An extreme example for this is \*ST Guangxia (\*ST銀廣夏, in Chinese), which was bankrupt with no assets, no operating capital, and even no fixed business premise, and yet with its remaining shell value, CITIC Bank entered into a debt transfer agreement with one of the debtor company's creditors, "Beijing Jiu Zhi Hang" (北京九知行, in Chinese), from which CITIC Bank reportedly took on debt of more than CN¥100 million.<sup>153</sup> It was reported that Beijing Jiu Zhi Hang was preparing to file a bankruptcy reorganization application in court, on the basis that the debtor company's debts exceeded its assets.<sup>154</sup> Beijing Jiu Zhi Hang sought to maximize its gains from the debt buy-out by getting priority claims against other creditors.<sup>155</sup> Had the \*ST Guangxia ended in bankruptcy liquidation (instead of bankruptcy reorganization as the case was proceeding toward), the creditors' financial loss (including that of Beijing Jiu Zhi Hang) would have been enormous.<sup>156</sup> While reorganization is the preferred option for Beijing Jiu Zhi Hang, it remains to be seen whether it can be carried out successfully due to the conflict of interests between the \*ST company's (\*ST Guangxia) original shareholders and creditors.<sup>157</sup> As such, the case has been reported widely as highly skeptical and controversial.<sup>158</sup>

2. *Application of the EBL by the Provincial Court*

As with a majority of PRC legislation, the EBL's effectiveness will depend on how it is implemented and enforced at the provincial level.<sup>159</sup> Despite the difficulty facing the People's Courts in adjusting to the EBL, they have demonstrated good intentions in making the transition from the old system to the new one.<sup>160</sup> As evidence of the courts making

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149. LI & WANG, *supra* note 67, at 4-8.

150. *Id.*

151. *Id.*

152. *Id.*

153. Yuqing Kuang, *Daily Perspective—Reorganization of Listed Companies*, BEIJING DAILY, July 7, 2010, at 6.

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

158. *Id.*

159. Eu Jin Chua, *supra* note 121, at 1.

160. *Id.*

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the transition to the new system, one may witness the recent acts of the Superior Provincial Court in An Hui Province (安徽省高級人民法院, in Chinese). That court maintains and operates a roster of administrators comprised of fifty law firms, twenty-six accounting firms, and two bankruptcy liquidation firms.<sup>161</sup> The administrator is appointed by the People's Court through a transparent process of random methods such as rotation, drawing lots, or machine-controlled lottery (roster system).<sup>162</sup> Alternatively, the court may even hold a competitive bidding process in its selection of an administrator who is to handle a complex case (such as the bankruptcy of a commercial bank, securities company, insurance company, or any other financial institution).<sup>163</sup> By way of legislative design, the 'administrator' under the EBL is to replace the 'liquidation group' under the old law, so as to provide fairness and transparency to the creditors. In that connection, the court's role has become less dominant, shifting from "administrating" the bankruptcy procedure (as in the old law) to mainly "facilitating and supervising" it (as in the EBL). But to facilitate the matter, the People's Court shall first convene the creditors' meeting<sup>164</sup> (so as to take a vote on the draft reorganization plan) and then approve the reorganization plan, if a majority of creditors has passed it.<sup>165</sup> From a legislative viewpoint, the administrator is designed by the EBL to lead the reorganization plan, and with the benefit of the administrator's professional expertise and training, this is a move in the right direction.<sup>166</sup>

As more evidence of the courts making the transition to the new system, one may witness the recent acts of the Supreme People's Court in An Hui Province whereby the court has convened three training sessions for 380 civil and commercial law judges and seventy-eight (bankruptcy) administrators to apply and implement the EBL.<sup>167</sup> Such efforts are also evidenced in its presiding of various symposiums for the discussion of key issues arising from the EBL.<sup>168</sup> This is yet another move in the right direction.

**B. THE EBL'S COMPATIBILITY ISSUES**

While implementing the EBL, some judges expressed the challenges they felt in dealing with 'jurisdiction' and 'responsibility of proof,' highlighting the issue of the EBL's compatibility with pre-existing laws that are still in effect. For example, Article 3 of the EBL sets out that the jurisdiction of a bankruptcy reorganization case lies in the People's Court of the place where the debtor company is domiciled. The very same provision can potentially create a conflict with the civil procedural law wherein certain types of cases (bankruptcy being one of them) may be reserved for jurisdiction by a specific level of court (級別管轄, in Chinese) or special court (專屬管轄, in Chinese).<sup>169</sup> 'Reserved jurisdiction' is arguably a familiar practice for many courts in China, at least before the EBL came into

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161. MING HUA WANG, *supra* note 54, at 336.

162. *See* Designation of Administrators, art. 20.

163. *Id.* art 21.

164. The EBL, art. 84.

165. *Id.* art. 86.

166. DERYCK PALMER, RECENT DEVELOPMENTS IN BANKRUPTCY LAW IN CHINA, 2010 WL 3650157, at \*1 (2010).

167. MING HUA WANG, *supra* note 54, at 336.

168. *Id.*

169. *Id.*

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being, to sort out and further delegate to the specific division of the courts the cases filed with them based on their internal management rules.<sup>170</sup>

Another compatibility issue involves Article 7 of the EBL, which allows the creditors to file for the bankruptcy of the debtor company as long as the latter is generally unable to pay its debt as and when they fall due.<sup>171</sup> To prove the debtor's inability to pay, the court relies on information provided by and accessible usually only to the debtor company and not the creditor; thus, it creates a limitation on ascertaining the true state of the debtor company's financial affairs.<sup>172</sup> Problems may arise where the debtor company does not cooperate or fails to provide true accounts of its financial situation.<sup>173</sup> This problem is further exacerbated as the EBL does not specify whether the onus of responsibility to prove insolvency rests on the debtor company, creditors, or elsewhere.<sup>174</sup> This legal lacuna will need to be filled for better creditors' rights protection.<sup>175</sup> It is applicable equally for instances where the creditors files for reorganization of or bankruptcy against the debtor company.

C. DIP PROCEEDINGS

Under the EBL, a debtor, creditor, or substantial investor is eligible to apply to the court for reorganization of the debtor company.<sup>176</sup> Generally speaking, once the reorganization application is accepted by the court, an administrator will be appointed by the court to take over and manage the debtor's business and assets.<sup>177</sup> Accordingly, once the reorganization application is accepted by the court, the managing power of the existing board will be suspended,<sup>178</sup> unless and until the debtor applies to the court for the administrator proceedings to be converted into DIP proceedings under the supervision of the previously appointed administrator during the reorganization period.<sup>179</sup> From this angle, the EBL offers a hybrid of the U.S. and the U.K. systems, the former being the DIP and the latter being management replacement.<sup>180</sup> What remains unclear by the EBL is that it does not provide instructions as to "who is entitled to make such an application—whether it is the general meeting of shareholders or the board of directors."<sup>181</sup> This legislative lacuna could "impede the implementation and effectiveness of the Chinese-modified DIP" concept, as suggested by one commentator who viewed that given the limited management power of the board of directors accorded to them under Chinese company law, the board of directors, without the authority of the shareholders' meeting, should not be allowed to petition the court for applying to convert the administrator proceedings to DIP

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170. *Id.*

171. The EBL, art. 3.

172. THE UNCITRAL LEGISLATIVE GUIDE, *supra* note 58, at 46, ¶ 25.

173. *Id.* at 46; The EBL, art. 8.

174. *See generally* The EBL.

175. Steven Arsenault, *The Westernization of Chinese Bankruptcy: An Examination of China's New Corporate Bankruptcy Law Through the Lens of the UNCITRAL Legislative Guide to Insolvency Law*, 27 PENN ST. INT'L L. REV. 45, 85 (2008).

176. The EBL, art. 70.

177. *Id.* art. 13.

178. ZHANG, *supra* note 18, at 215.

179. *See id.*; The EBL, art. 73(1).

180. ZHANG, *supra* note 18, at 214-15.

181. *Id.* at 215.

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proceedings.<sup>182</sup> In relation to this, the EBL also failed to account for what considerations the court ought to make before granting a DIP application, which again as suggested by the commentator creates yet another legislative lacuna.<sup>183</sup> Some suggested that the court should investigate the root problem for causing the corporate distress and, if poor management and decision making is responsible for the company's bankruptcy, the court should accordingly dismiss the DIP application.<sup>184</sup> Likewise, the "judges need to assess whether or not the existing directors" are competent "to manage the ailing company" and to continue "trading during the reorganization process."<sup>185</sup> To this end, the judges would be expected to "evaluate the directors' experience and ability to deal with the balance of risk and return, to negotiate and produce a reasonable and practicable rescue proposal during the reorganization."<sup>186</sup> By doing so, it is suggested that the debtor company should submit to the court "the management records and board minutes along with the DIP application for the consideration of the court;" on the other hand, the court should also consult the opinions of the creditors and the representatives of the labor union(s) who are familiar with the management's competence, governance style, and decision-making.<sup>187</sup> While all attempts for eliminating the legislative lacuna are commendable, the questions remain as to whether the judges would be given too much discretionary power in making relevant decisions and whether all the necessary investigations to be carried out by the judges who decide on such matters could be completed within the prescribed reorganization period of six months.<sup>188</sup> If that time period is exceeded the unpaid employees and creditors would suffer from the prolonged reorganization procedure and, which, if unsuccessful, could lead eventually to and end with the corporate bankruptcy procedure for the failing/failed company. Given that the EBL is silent on the amount of time before which judges are required to make DIP decisions, it raises another layer of concern for the law's effectiveness and application.<sup>189</sup> It should be noted that, once the DIP application is accepted by the court, the administrator who has taken over the business affairs and assets of the debtor company shall hand over those back to the debtor company's management, and the administrator's functions and powers provided for in the EBL should be exercised by the debtor company's management.<sup>190</sup>

D. REQUIREMENTS FOR REORGANIZATION APPLICATION—TWO-LIMB OR ONE-LIMB TEST?

The persons eligible for applying for reorganization are set out in Article 70 of the EBL, being the debtor company itself, a creditor, or investors whose capital contribution comprises one-tenth (1/10th) or more of the debtor company's registered capital. Then, the next task is to identify the requirements for commencing a reorganization process.<sup>191</sup>

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182. *Id.*

183. *Id.*

184. *Id.* at 215-16

185. *Id.* at 216.

186. *Id.*

187. *Id.*

188. The EBL, art. 79.

189. ZHANG, *supra* note 18, at 216.

190. The EBL, art. 73.

191. *Id.* art. 71.

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The EBL appears to provide the same requirements for the debtor company to resolve its debt, either through bankruptcy liquidation or reorganization process.<sup>192</sup>

Article 2 of the EBL states that:

“Where an enterprise is unable to pay off a debt that is due and its assets are insufficient to pay off all of its debtors . . . it shall clear off its debts in accordance with the provision of this Law.”<sup>193</sup>

Article 7 of the EBL further states that:

“A debtor who comes under the circumstances described in Article 2 of this Law may submit an application to the people’s court for reorganization . . . or bankruptcy liquidation.”<sup>194</sup>

Considering these two articles together, it can be reasonably construed that, for a debtor company to apply for either liquidation or reorganization, it must satisfy *both* the ‘liquidity test’ and the ‘balance sheet test’ (*i.e.*, the two-limb test).<sup>195</sup> The ‘liquidity test’ (also known as the ‘cash flow test’) assesses the debtor’s ability to pay off a debt that is due, while the ‘balance sheet test’ gauges the debtor’s total assets and total liabilities.<sup>196</sup> In contrast, a creditor can apply for the debtor’s liquidation or reorganization by meeting only the liquidity test.<sup>197</sup>

For a debtor to apply for reorganization, the stricter two-limb test shall apply, but it remains unclear whether a lower threshold test can come into play. That is because Article 2 of the EBL also provides that:

“Where an enterprise with the status of legal entity comes under the circumstances described in the preceding paragraph, *or* [emphasis added] is facing the *possibility* [emphasis added] to lose the ability to pay off a debt *apparently* [emphasis added], the enterprise may be reorganized . . . ”<sup>198</sup>

Whether the legislators had ever intended for it to mitigate the strictness of the two-limb test is unknown. Moreover, the debtor’s burden of proof for the application of reorganization is also unclear. At the risk of mincing words, the very word ‘possibility’ points to a lower standard, but the [paring] word ‘apparently’ points the other way. The issue for consideration is whether the provision, “[the debtor is] facing the possibility to lose the ability to pay off a debt apparently,” constitutes as a separate test, apart from the “two-limb” test.<sup>199</sup> On the one hand, this particular provision may be construed as evidence that the EBL encourages reorganization by toning down the stricter two-limb test—as long as there is “possibility” that the debtor would lose the ability to pay off to debt, the

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192. *See id.* arts. 2, 7.

193. *Id.* art. 2, ¶ 1.

194. *Id.* art. 7, ¶ 1.

195. KIRKLAND & ELLIS LLP, CHINA’S NEW ENTERPRISE BANKRUPTCY LAW 2 (2006). [http://www.kirkland.com/siteFiles/kirkexp/publications/2272/Document1/Chinas\\_New\\_Enterprise\\_Bankruptcy\\_Law.pdf](http://www.kirkland.com/siteFiles/kirkexp/publications/2272/Document1/Chinas_New_Enterprise_Bankruptcy_Law.pdf) (last visited Jan. 24, 2012)

196. THE UNCITRAL LEGISLATIVE GUIDE, *supra* note 58, at 45-46.

197. The EBL, arts. 2, 7.

198. *Id.* art. 2, ¶ 2.

199. *See id.* arts. 2, 7.



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debtor can apply reorganization to the People's Court. On the other hand, as one commentator suggested, this provision is not a separate test but rather an element inherent in the meaning of the general cessation of payment.<sup>200</sup> The commentator goes on to say that this provision is not meant to mitigate the strictness of the two-limb test. The commentator's view is justifiable so as to eliminate potential uncertainties in the application of law. Otherwise, due to the absence of objective standards, in defining the degree of which the "possibility" (of the debtor's inability to pay off a debt) would become so 'apparent' that it would amount to the debtor's inability to pay, the debtor could effectively be disqualified to apply for reorganization under the EBL than it would otherwise be allowed to do so.

To assist effectively debtors with financial difficulties at an early stage, the commencement standard for reorganization must be one that is less onerous than that for liquidation. By extension, the reorganization requirement must not require the debtor to wait until it is actually unable to meet its debt before making an application.

The liquidity test is seen as a preferred measure, as suggested by both the United Nations Commission on International Trade (UNCITRAL) and the World Bank. First, the UNCITRAL Legislative Guide, adopted by the UNCITRAL in 2004, suggests that the liquidity test serves to discover early in the period of the debtor company's financial distress, hence minimizing dissipation of assets and avoiding the 'asset-grab' that would cause the dismemberment of the debtor company to the collective disadvantage of all creditors.<sup>201</sup> Although the UNCITRAL Legislative Guide suggests that the balance sheet test suffers from a number of disadvantages and thus should not be used as the single test, it does not object to a standard that contains both the liquidity and balance sheet tests.<sup>202</sup> It states only that if a single test for assessing corporate bankruptcy is adopted, it should be the liquidity test, as in this case of the cessation of payments test, which provides an effective trigger for access to corporate bankruptcy proceedings.<sup>203</sup> Second, the World Bank's "Principles and Guidelines for Effective Insolvency and Creditor Rights Systems" in 2001 also suggests that "the preferred test for insolvency should be the debtor's inability to pay debts as they come due—known as the liquidity test. A balance sheet test may be used as an alternative secondary test, but should not replace the liquidity test."<sup>204</sup>

E. DUAL APPROVAL FOR REORGANIZATION PLAN

Relevant provisions governing the reorganization system under the EBL are contained in Chapter 8. The EBL dedicates an entire chapter for the initiation of reorganization period and the approval of a reorganization plan. Essentially, reorganization in China is a court-supervised three-stage procedure, namely (1) application to the court; (2) com-

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200. ZHANG HAIYAN, *An Analysis of Cause of Bankruptcy in the New Enterprise Bankruptcy Law*, in ZHENG FA LUN CONG (政法論叢), in Chinese), Issue No. 2, Apr. 10, 2007).

201. THE UNCITRAL LEGISLATIVE GUIDE, *supra* note 58, at 46, ¶ 23.

202. *Id.* The balance sheet test is seen as problematic because it relies on information provided by and accessible usually only to the debtor, not the creditor; this creates a practical limitation on ascertaining the true state of the debtor's financial affairs. In addition, the balance sheet test subjects insolvency determination to accounting principles and standards, whose adoption and interpretation vary across countries or even different subparts of the same country.

203. *Id.* at 48, ¶ 29.

204. The World Bank, *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*, principle 9, at 8, (Apr. 2001).

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mencement of reorganization period; and (3) ‘double approval.’ Double approval alludes to the fact that the reorganization plan has to be approved not only by creditors of the debtor but also by the court.<sup>205</sup> Where the double approval procedure is concerned, the first approval must be obtained from creditors, who will be divided into separate voting classes (such as secured creditors, unsecured creditors, and employment-related creditors) for purposes of approving a reorganization plan.<sup>206</sup> It is important to note that approval from each voting class is necessary for the reorganization plan to be adopted.<sup>207</sup> The second approval must be obtained from the court whereby the debtor or administrator shall, within ten days from the date of first approval, submit an application to the People’s Court for approving the reorganization plan.<sup>208</sup>

To examine whether the dual approval requirement would pose any difficulty to the implementation of the corporate reorganization system in China, it is helpful to see what the international benchmark is. The UNCITRAL Legislative Guide states that, throughout the world, most corporate bankruptcy systems require only the creditors’ approval of the reorganization plan and not the court’s approval; those foreign courts often approve subsequently the plan that has already been approved by the creditors.<sup>209</sup> Where the reorganization system requires only ‘single approval’ by the creditors for adopting the plan, even though there is no court supervision of the plan, the corporate bankruptcy laws usually provide for the plan to be challenged in the court.<sup>210</sup> Common grounds for the court’s challenge include reorganization approval implicated by:

- (1) fraud;
- (2) “irregularity in the voting procedure;”
- (3) “irregularity in the organization or conduct of the meeting at which the vote was taken;”
- (4) inadequate opportunity for voting classes to participate in relevant proceedings;
- (5) no access or lack of access to information necessary for voting classes to make an informed decision to reject or accept the proposed reorganization plan; and
- (6) unfair prejudice against the interest of dissenting classes of creditors.<sup>211</sup>

In contrast, where the corporate bankruptcy law requires the court to confirm a plan, the UNCITRAL Legislative Guide suggests that the court’s duty is to “ensure that the approval of the plan was properly obtained” and the stipulated conditions were satisfied.<sup>212</sup> In relation to ‘stipulated conditions,’ the UNCITRAL Legislative Guide suggests that such conditions shall include: (1) dissenting creditors of the plan would share the economic benefits of the said plan; (2) dissenting creditors would receive “as much under the plan as they would have received in liquidation;” (3) “no creditor would receive more than the full value of its claim;” (4) normal ranking of claims under the corporate bankruptcy law is observed by the plan; (5) “similarly ranked creditors are treated equally;” (6) the

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205. The EBL, arts. 84, 86.

206. *Id.* arts. 82, 84, 86.

207. THE UNCITRAL LEGISLATIVE GUIDE, *supra* note 58, at 226.

208. The EBL, art. 86, ¶ 2.

209. THE UNCITRAL LEGISLATIVE GUIDE, *supra* note 58, at 226.

210. *Id.* at 227.

211. *Id.*

212. *Id.* at 228, ¶ 60.

plan can be considered to be fair in respect of those classes of creditors “whose interests are modified or affected by the plan but which nevertheless have voted to approve the plan;”<sup>213</sup> and (7) the plan is feasible from a practical point of view.<sup>214</sup> Such stipulated provisions, on the surface, are similar to the ‘cram-down’<sup>215</sup> provisions in the EBL except that the EBL does not provide any guidelines for the court’s scrutiny.<sup>216</sup> From one’s viewpoint, where the court’s approval (i.e., second approval of the reorganization plan) is required, the provisions should not be open to the court’s wide discretion so as to prevent undue judicial influence. Essentially, the court’s approval should be constrained only to legal formality. Likewise, the court cannot investigate into the merits of the reorganization plan as it is not up to the court to make commercial decisions. The court should not be expected to examine the economic and commercial basis of the decision of the creditors either.

#### F. FORMS OF REORGANIZATION

The EBL focuses mainly on procedural matters and is silent on the substantial matters such as the forms of transactions that qualify for restructuring.<sup>217</sup> In this regard, lessons may be drawn from the “Circular on Several Issues on Corporate Income Tax Treatment of Corporate Restructuring Transactions,” which is the tax implementation rules for corporate restructuring. Under the rules, the forms of transactions that qualify for restructuring are:

- (1) changes in legal form (such as registered name, address or entity type);
- (2) debt restructuring;
- (3) equity acquisition;
- (4) asset acquisition;
- (5) merger; and
- (6) spin-off (or splitting and transferring an enterprise’s partial or entire assets (spun-off [assets]) to other existing or new enterprises (spin-off enterprise) whereby shareholders of the spun-off enterprise receive equity or non-equity payment of the spin-off enterprise in return).<sup>218</sup>

One needs to be aware of the distinction between the ordinary ‘corporate restructuring’ and ‘bankruptcy reorganization.’ In the former case, the company most likely has not yet entered into the bankruptcy process, but for various business reasons the company has

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213. *Id.* ¶ 61.

214. *Id.* ¶ 62.

215. Generally, a reorganization plan will be approved only if (1) an affirmative vote of two-thirds (2/3rd) of the total amount of claims in each class and a majority of the same group present at the creditor’s meeting and (2) approval is obtained from all voting classes and the court. The EBL, art. 84. But, a court can “cram down” a dissenting class and approve the reorganization plan once these four tests are met: (i) fair and equitable test; (ii) best-interest test; (iii) no unfair discrimination and absolute priority; and (iv) feasibility test. *See id.* art. 87.

216. *Id.*

217. The words “reorganization” and “restructuring” are used almost interchangeably in most bankruptcy literature to refer to the rescue of a company approaching insolvency.

218. CIRCULAR OF THE MINISTRY OF FINANCE AND THE STATE ADMINISTRATION OF TAXATION ON SEVERAL ISSUES ON CORPORATE INCOME TAX TREATMENT OF CORPORATE RESTRUCTURING TRANSACTIONS, n. 59 (Cai Shui 2009).

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sought to augment its revenue; whereas, in the latter case (which the article is focused on), because the bankruptcy proceeding has already commenced, the mainstay of the reorganization will rest on debt-repayment. The UNCITRAL Legislative Guide conveys that reorganization can take a number of different forms, including (i) a ‘composition,’ referring to a simple agreement concerning debts, where the creditor agrees to take a ‘hair-cut;’<sup>219</sup> or (ii) a complex reorganization, where debts are restructured; or (iii) a conversion of debt to equity, together with a reduction or even cancellation of existing equity.<sup>220</sup> The UNCITRAL Legislative Guide sets the international benchmark for corporate bankruptcy law, which is accepted by many countries including China, as the EBL conforms largely to the recommendations of the UNCITRAL Legislative Guide and is therefore on par with international standards of corporate bankruptcy law.<sup>221</sup> Deduced from the different context that provides for China’s tax implementation rules for corporate restructuring, such rules should not be understood to supplement the EBL without proper adjustment. Where the implementation of the rules will impinge on the creditors’ rights, especially those expressly protected under the EBL, they shall cease to apply.

G. DISCLOSURE

For the draft reorganization to be acceptable, Article 84 of the EBL states that the People’s Court shall convene the creditors’ meeting within thirty days from the date of receipt of the draft reorganization plan so as to allow for the creditors to vote on the draft reorganization plan.<sup>222</sup> Then, the draft reorganization plan will have to be adopted by each voting group (or class) of creditors before it can be submitted to the People’s Court for its approval.<sup>223</sup> Because the creditors’ approval is fundamental and prerequisite to the court’s final approval, one might suggest that, for future amendment of the EBL, provisions should be made to give creditors reasonable access to information pertaining to the debtor company’s business operations, financial state of affairs, and assets. Information of truth and reliability is absolutely crucial and indispensable for an ultimately successful implementation of the reorganization plan; without these elements, the creditors would not be able to vote with confidence and may instead decide later to bring individual lawsuits against the company through the corporate bankruptcy system, once the reorganization plan fails to be adopted. In light of this lack of disclosure, the creditors would be deprived of the chance to make an informed decision and may debilitate the voting mechanism provided in Article 84 of the EBL, rendering it a mere formality with little or no substance.

H. RESEARCH LIMITATIONS

Reorganization has priority over bankruptcy liquidation, as emphasized by Professor Li: “The new law [EBL] encourages insolvent businesses to choose restructuring methods as first choice. Only when there is no business viability should the bankruptcy liquidation

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219. THE UNCITRAL LEGISLATIVE GUIDE, *supra* note 58, at 28, ¶ 27. See also Lee & Ho, *supra* note 63.

220. The methods for debt restructuring are exemplified in THE UNCITRAL LEGISLATIVE GUIDE, *supra* note 58, at 28, ¶ 27. See also Lee & Ho, *supra* note 63.

221. Lee & Ho, *supra* note 63, at 149.

222. The EBL, art. 84.

223. *Id.* art. 86.

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process be adopted as the last resort.”<sup>224</sup> While Professor Li's efforts are commendable in reviewing the EBL in 2009, he seemed to have left unanswered a lot of intriguing questions that could help in assessing the practical application of the EBL, such as:

- (1) What was the scale and size of these sixteen listed corporations (as mentioned by him);
- (2) What was the jurisdiction of these sixteen reorganization cases;
- (3) What was the reorganization cost;
- (4) Whether those petitions were filed by the debtor companies themselves, their creditors, or their investors whose capital contribution comprise one-tenth (1/10th) or more of the debtor company's registered capital; and
- (5) Whether the courts that accepted the bankruptcy petitions have exercised, at their discretion, the cram-down discretionary power to approve the reorganization plan, pursuant to the cram-down provisions embedded in Article 87 of the EBL.

One should consider these questions crucial as they would help in assessing whether reorganization is expensive in China and thus accessible only to sizeable listed corporations. Instinctively, there is a correlation between the reorganization cost and the size and scale of the debtor company, given that reorganization cost will be paid off from the debtor company's assets.

The jurisdiction of the reorganization cases might well be linked to the types of enterprises that are being rescued. In the midst of the global financial crisis of 2008-2009, there were many reports of the successful reorganizations of private enterprises;<sup>225</sup> it is worth noting that there were very few reorganization cases reported for SOEs in China during that same period.<sup>226</sup> This is somewhat perplexing as a review in 2007 suggested that there were 2,100 financially distressed SOEs exempted from the EBL's application until the end of 2008,<sup>227</sup> not to mention that it is a well-known fact that many SOEs have suffered economic loss for a long time and therefore were in need of being liquidated or restructured.<sup>228</sup> Why would there be so little reporting on SOEs' reorganizations? There are several possible reasons to consider. First, recent economic reforms in China have led to a large number of SOEs being converted to corporatized enterprises,<sup>229</sup> stemming from China's transition from a planned economic system to a market economic system. Second, amid the financial crisis in 2008-2009, there were tremendous losses suffered by many SOEs such as Air China, China Eastern Airlines, and China Southern Airlines, “resulting from their entering into (often complicated) financial derivatives transactions;”<sup>230</sup> but because they were experiencing only temporary business downturns, there required no bankruptcy liquidations or bankruptcy reorganizations. Third, for those SOEs earmarked for ‘administrative bankruptcy,’ whose insolvencies are to proceed according to the ‘policy bankruptcy’ framework administered by the government and under State Council regula-

224. Li & WANG, *supra* note 67, at 3.

225. For more details, see Lee & Ho, *supra* note 63, at 167.

226. *Id.* at 156.

227. Steven T. Kargman, *Solving the Insolvency Puzzle*, 30 CHINA BUS. REV. 44, 45 (2007).

228. Lee & Ho, *supra* note 63, at 155.

229. *The State-owned Assets Law is an Imperfect Guardian*, CHINA L. & PRAC. (Nov. 2009).

230. *Tighter Control of SOEs Engaging in Financial Derivative Transactions*, CHINA L. & PRAC. (May 2009).

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tions,<sup>231</sup> the EBL (hence the bankruptcy reorganization) were rendered inapplicable. All such reasons catered to the reduced opportunities for us to examine the reorganization of SOEs. Suffice it to say that if SOEs have any chance of survival, the Chinese government or State Assets Management System (SAMS)<sup>232</sup> is likely to resuscitate them, by either providing them with financial support or entering them into corporate restructuring before the underlying SOEs go into bankruptcy.

Although this article aims to examine the practical application of the EBL from a broader perspective, focusing especially on the reorganizations of all legal enterprises under the EBL, the research result is inevitably restrained by the limited bankruptcy information available for public consumption in China. The article draws its conclusions confined by visible research limits, but ideally the research should be examined on a larger scale and on a more quantitative basis. One can only hope that the research horizon will be significantly broadened so that the assessment may explore the issues in greater depth, if and when more case law is accumulated over time and the bankruptcy statistical data—kept by the People’s Court (at the various levels) as well as by only a handful of bankruptcy research centers in China—can be released for public information in general or for creditor’s protection in particular.

## V. Conclusion

Bankruptcy reorganization is arguably the most cost-effective scheme in restoring a financially distressed company back to a state of financial viability. Because the company was in financial difficulty in the first place, for restructuring purposes it relies not only on rearranging (or adjusting) debts but also, and perhaps more effectively, on acquiring new quality assets in backing up a reorganization plan. Debt rearrangement (債務重組, in Chinese) can be flexible, and includes options such as (1) taking a “haircut” by the creditors; (2) extending the period for repayment; (3) deferring payment of interest by the debtor; (4) changing the identity of the lenders (meaning another lender steps into the shoe of the original lender); and (5) swapping debt for equity.<sup>233</sup> Once the reorganization process begins, the restructuring will rely greatly on the sale of assets to obtain the necessary cash to repay creditors. As such, a true and reliable assets valuation is essential in controlling reorganization cost, which needs to be kept in check at all times. There are other benefits arising from the bankruptcy reorganization. First, all debts of the debtor company can be resolved fully once and for all, as the court will be supervising and presiding over the reorganization case. The EBL requires the creditors who enjoy claims against the debtor company to declare their claims within a period set forth by the court for doing so, which shall not be less than thirty days at least and not more than three months at most, calculated from the date on which the People’s Court makes a public

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231. The EBL, art. 133.

232. In China, a state assets management system (SAMS) was established in 2003 to manage the SOEs being converted to corporatized enterprises. The SAMS, reflecting the state supervision system (on state assets), has resulted in a new regulatory process set out in the PRC Law on State-owned Assets of Enterprises (the SOAE law), which was promulgated by the Standing Committee of the National People’s Congress on Oct. 28, 2008 and became effective on May 1, 2009. *The State-owned Assets Law is an Imperfect Guardian*, *supra* note 229.

233. THE UNCITRAL LEGISLATIVE GUIDE, *supra* note 58, at 28, ¶ 27.

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announcement on the acceptance of the bankruptcy application.<sup>234</sup> It can be inferred that most creditors would oblige to declare their claims within that period, as deliberate non-compliance would likely render their claims unrecoverable. As provided, where a creditor fails to declare its claims in accordance with the provisions of the EBL, it shall not exercise its right in the implementation of the reorganization plan.<sup>235</sup> Second, shall the administrator work at his best in raising the recovery rate, it is often conducive to the creditors' approval of the reorganization plan. And an acceptable plan (by the creditors) is also a workable reorganization plan, likely to be implemented successfully. Third, debts that fail to be recovered will be treated as being foregone by the creditors. This reorganization and especially the restructuring of debt will benefit greatly the debtor company. More often than not, as soon as reorganization is completed, the company's share price in the stock market starts to soar, as a result of having restored investors' confidence in the company. This provides one good reason why many financially distressed companies chose bankruptcy reorganization over bankruptcy liquidation.

Despite the EBL's deliberate design to encourage and facilitate reorganization for companies facing bankruptcy, the number of successful reorganization cases is quite slim. Attributive to this are a number of factors such as local protectionism, lack of qualified bankruptcy professionals in China, and certain judges' inclination to apply the more familiar old bankruptcy law over the EBL. Inadequate knowledge possessed by judges in relevant areas can bring down sufficiently any reorganization attempts or efforts. This is a radical problem in China where judges are sometimes Communist Party members and appointed by the government; hence they often lack the qualifications, professional training, or legal knowledge as well as the required expertise in economic, financial, or accounting matters. Considering that there is only one specialized bankruptcy court in China, established by the Shenzhen Intermediate People's Court (深圳中級人民法院, in Chinese) in December 1993, its undertaking of bankruptcy cases can be rather overwhelming; reportedly, there are only eight to ten specialized bankruptcy judges in this court in recent years.<sup>236</sup> Shenzhen is a pioneer city in China, being one of the first five economic zones in Southern China; until the end of 2000, its bankruptcy court had accepted 486 cases and closed 373 of them, or averaged sixty-nine accepted cases and fifty-three closed cases per year.<sup>237</sup> Professor Weiguo Wang of The China University of Political Science and Law suggests that about 5,000 bankruptcy cases were filed in economic trial courts, accounting for only 0.3% of the total of 1.5 million economic cases per year.<sup>238</sup> In addition to the few number of bankruptcy judges, there is also a lack of experienced bankruptcy professionals in China to implement the EBL in a consistent manner. Various levels of People's Courts in China are aware of this problem and it is commendable that the educational responsibility is carried out not only by the courts but also profes-

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234. The EBL, art. 45.

235. *Id.* art. 92.

236. Weiguo Wang, Forum for Asian Insolvency Reform—An Assessment of the Recent Developments and the Role of Judiciary, *Strengthening Judicial Expertise in Bankruptcy Proceedings in China* 3 (Feb. 7-8, 2001), available at <http://www.oecd.org/dataoecd/8/24/1874188.pdf>. According to an anonymous judge in the Shenzhen Intermediate People's Court, the number of insolvency judges working in this court remains the same today.

237. *Id.* at 3-4.

238. *Id.* at 1.

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sional bodies (e.g., China INSOL) and discussion forums (e.g., Pochanfa Luntan, 破產法論壇, in Chinese).

SOEs are another inherent problem in China's reorganization system. In these cases, government interference is likely to complicate the reorganization plan or process. For example, the debtor company may be an SOE that may not have objectively healthy financial prospects or significant continuing operational purposes, and yet the debtor company, essentially the state because it is both the main stakeholder and managing authority, might subjectively decide to commence a reorganization application. This problem can be exacerbated under the EBL (in Article 87), where the SOE, as DIP, can continue to manage the SOE as a going concern.<sup>239</sup> In light of this, the state will likely to have extensive control of reorganization, notwithstanding the supervision by a court-appointed administrator. Not to mention that at this juncture, the appointment, qualification, compensation, and availability of the court-appointed administrator might appear dubious.<sup>240</sup> On the contrary, for those SOEs that are known to be subject to the pressure of the command economy, they might otherwise find the judiciary predisposed against accepting their reorganization application. From a third-party perspective, threatened by local protectionism, political interference, and rampant corruption, it remains uncertain whether the courts would accept reorganization application from creditors or investors against those enterprises (especially SOEs) that are important locally or politically well connected.<sup>241</sup>

It has been suggested that the Supreme People's Court is drafting "a comprehensive judicial interpretation on the [EBL] based on the problems accumulated and experience gained during the recent four year implementation of the EBL. The existing draft of this judicial interpretation contains about 300 articles, which is far more than the 136 articles contained in the [EBL]. It is expected to be published within three years. A smaller-sized judicial interpretation directing the insolvency of listed companies is expected to be issued before this comprehensive one."<sup>242</sup> In light of this, it is hopeful that all the outstanding issues as discussed in this article can be clarified by upcoming Supreme People's Court's judicial interpretations.

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239. The EBL, art. 87.

240. Lijie Qi, *The Corporate Reorganization Regime under China's New Bankruptcy Law*, 17 INT. INSOLVENCY REV. 13, 28 (2008).

241. Eu Jin Chau, *supra* note 121, at 1.

242. Li & Wang, *supra* note 1, at 303.



## Cartel Regulation in Three Emerging BRICS Economies: Cartel and Competition Policies in South Africa, Brazil, and India— A Comparative Overview

SASHA-LEE AFRIKA AND SASCHA-DOMINIK BACHMANN\*

Antitrust laws in general, and the Sherman Act in particular, are the Magna Charta of free enterprise. They are as important to the preservation of economic freedom and our free-enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms. And the freedom guaranteed each and every business, no matter how small, is the freedom to compete—to assert with vigor, imagination, devotion, and ingenuity whatever economic muscle it can muster.<sup>1</sup>

### Abstract

*This article argues that only increased cross-border cooperation through bilateral agreements between domestic competition authorities in the developed world can regulate anti-competitive cartel activities effectively. To discuss this argument, the competition policies and laws of three emerging economies, namely South Africa, India, and Brazil are compared with the competition law of the European Union. The benefits of bilateral agreements concerning international cartels appear to be clear: only a synchronized and international approach will help developing nations in protecting their markets from unfair competition practices. This article will discuss the state of anti-cartel policies and legislation in the selected jurisdictions, the present state of coordination of competition policies through promotion and cooperation at the bi-national and international level, and highlight some examples of more publicized anti-competition cases. The article also provides an insight into cartel activities in these three emerging economies and poses the question about which of the existing methods of cooperation is the most effective one for addressing cartel activities. It provides a short overview of the existing international institutions and enforcement bodies that promote and*

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1. United States v. Topco Assocs. Inc., 405 U.S. 596, 610 (1972).

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*coordinate international competition policies and anti-cartel initiatives. The cooperation methods identified and utilized by the International Competition Network will be briefly analyzed in order to support the authors' view on the relevance and importance of bilateral cooperation agreements for the conclusion of successful cartel investigations. The article concludes with the observation that more could be done by the developing "Newly Industrialized Nations" (NIC) to increase the collaborative ties of their anti-competition policies and organizations as well as ensure that they fall under the wider umbrella of regional competition regimes such as in the case of South Africa and the European Union. Time will tell whether the emerging economies will be able to balance competition policy and consumer welfare in an effective and progressive way without affecting their trade and investment policies.*

### **I. Introduction**

This 1972 *dictum* of the U.S. Supreme Court, read in conjunction with sections 1 and 2 of the U.S. Sherman Act,<sup>2</sup> stresses the importance<sup>3</sup> of balancing the demands of a free market economy with the necessity to promote consumer welfare by limiting anti-competitive corporate market distortion. In the developing world, many states, including South Africa, have made some measurable progress in enacting competition legislation, or antitrust laws as they are known in the United States. South Africa is a developing country with a very recently established competition regime. The majority of the population is plagued by poverty and lack of services.<sup>4</sup> Consequently, anti-competitive business activities by corporations severely affect the poor of society: it is the poor who bear the heaviest burden of anti-competitive behavior such as price fixing, price discrimination, and market distortion leading to a market without sufficient competition. Cartel activity prevents consumers and other market stakeholders from enjoying the benefits of a free and fair market. Thus, the existence of cartels in an economy such as South Africa can have an overall negative impact on the formation of a competitive and prosperous market economy. South Africa depends on direct foreign investment and thus has an interest in demonstrating to a prospective investor that it takes a proactive stand on fair competition and the "preservation of economic freedom."<sup>5</sup> In general, cartels, the "supreme evil of anti-trust,"<sup>6</sup> whose activities constitute one of the "most egregious offence(s) under competition law,"<sup>7</sup> particularly those involving Multinational Corporations (MNCs), often have a

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2. Section 1 of the Sherman Act states "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." 15 U.S.C. § 1 (2004). Section 2 extends this prohibition on monopolies. *See* § 2.

3. The mission statement of the European Commission stresses the need to align these two interests. *See, e.g., Mission of Directorate General for Competition*, EUROPEAN COMMISSION, <http://ec.europa.eu/dgs/competition/mission/> (last visited Jan. 15, 2012). Part One, Article 2 of the Consolidated Version of the Treaty Establishing the European Community stresses the need for such a balance based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and "a high level of protection and improvement of the quality of the environment."

4. *See South Africa Country Profile*, U.N. DEVELOPMENT PROGRAMME, <http://hdrstats.undp.org/en/countries/profiles/ZAF.html> (last visited Jan. 15, 2012), which ranks South Africa's Human Development Index at 123, compared with the U.K.'s rank of twenty-eight.

5. *Topco Assocs. Inc.*, 405 U.S. at 610.

6. *Verizon Commc'n, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 408 (2004), *cited in* KIRSTY MIDDLETON ET AL., CASES AND MATERIALS ON UK AND EC COMPETITION LAW 325, n.1 (2009).

7. *Mondi Ltd. and Kobler Cores and Tubes* [2002] ZACT (LM) at 27 ¶ 87 (S. Afr.).

particularly negative impact on developing market economies: market dominance, its distortion, and an absence of consumer welfare are just some possible consequences.

This article argues that increased cross-border cooperation through bilateral agreements between domestic competition authorities in the developed world can regulate anti-competitive cartel activities effectively. To discuss this argument, the competition policies and laws of three emerging economies, namely South Africa, India, and Brazil, are compared with the competition law of the European Union. This country selection was made based on their shared category as emerging and developing, as well as Newly Industrialized Countries (NICs)<sup>8</sup> reflecting on their similarities in terms of market nature, economic impact, and potential market challenges. Brazil and India are members of the so-called BRICS group.<sup>9</sup> South Africa is the youngest member of the (former) BRIC group and the strongest single emerging economy on the African continent.<sup>10</sup> Another similarity is the fact that all three states are member parties to the International Competition Network (ICN)<sup>11</sup> but not to the Organization for Economic Cooperation and Development (OECD), whose members are mostly developed nations.<sup>12</sup> These organizations, together with organizations such as the European Union and other regional anti-competition bodies, play an important role to ensure that cartels are identified, investigated, and subsequently regulated in terms of international and domestic competition legislation and policies of the countries affected. Subsequently, the role and functions of these two organizations regarding limiting anti-competitive activities, especially cartels, are scrutinized within the scope of the chosen domestic jurisdictions.

The article also provides an insight into cartel activities in these three emerging economies and poses the question as to which of the existing methods of cooperation is the most effective one for addressing cartel activities. It provides a short overview of the existing international institutions and enforcement bodies, which promote and coordinate international competition policies and anti-cartel initiatives. The cooperation methods identified and utilized by the ICN<sup>13</sup> will be briefly analyzed in order to support the authors' view on

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8. See PAWEŁ BOZYK, GLOBALIZATION AND THE TRANSFORMATION OF FOREIGN ECONOMIC POLICY 164 (2006), for an overview of these newly industrialized countries. Go to *World Economic Outlook FAQ*, INTERNATIONAL MONETARY FUND, <http://www.imf.org/external/pubs/ft/weo/faq.htm#q4b> (last visited Jan. 15, 2012) for an overview of criteria used by the IMF to distinguish different categories of market economies.

9. BRICS, named after its members Brazil, Russia, India, China and since April 2011, South Africa, resemble a group of "countries considered economically significant . . . who view themselves as an emerging centre of gravity in the global economy." Mzukisi Qobo, *The BRIC Pitfalls and South Africa's Place in the World*, SUNDAY INDEPENDENT (Apr. 17, 2010), available at <http://www.saiia.org.za/great-powers-africa-opinion/the-bric-pitfalls-and-south-africa-s-place-in-the-world.html>. See also *BRIC Invite: Sign of China's African Ambitions*, AFRICA MONITOR: SOUTHERN AFRICA (BUSINESS MONITOR INTERNATIONAL), Mar. 1, 2011 [hereinafter *BRIC Invite*], in which the BRIC group was described as "a group of leading emerging markets that will become increasingly important in the global economy over the long term. The nations are broadly characterized by fast economic growth, rapid reforms, and business-friendly environments."

10. South Africa joined the BRIC group in April 2011, see *BRIC Becomes BRICS—South Africa as a Gateway to the Continent*, MONEY WATCH AFRICA, May 12, 2011, <http://www.moneywatchafrica.com/2011/05/bric-becomes-brics-south-africa-as.html>; see also *BRIC Invite*, *supra* note 9.

11. For more information on the ICN, go to <http://www.internationalcompetitionnetwork.org/>.

12. See *List of OECD Member Countries*, OECD, [http://www.oecd.org/document/58/0,3746,en\\_2649\\_2011\\_85\\_1889402\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/58/0,3746,en_2649_2011_85_1889402_1_1_1_1,00.html) (last visited Jan. 15, 2012), for a list of the OECD member states.

13. See INT'L COMPETITION NETWORK, CO-OPERATION BETWEEN COMPETITION AGENCIES IN CARTEL INVESTIGATIONS (2006), available at <http://www.internationalcompetitionnetwork.org/uploads/library/doc348.pdf>, submitted at the ICN annual conference held in Moscow in May 2007.

the relevance and importance of bilateral cooperation agreements for the conclusion of successful cartel investigations.

## II. Competition Law and the Concentration of Market Power in Cartels and Multinational Corporations: A Legislative Overview

### A. CARTELS AND ANTI-CARTEL LEGISLATION

The following four legislative examples stress the common aim of regulating competition law, maximizing consumer welfare, and preventing market distortion by means of anti-trust applications.

Cartels constitute an association of manufacturers or suppliers that aims to maintain high prices and restrict competition: the European Union's competition commission defines cartels as "a group of similar, independent companies which join together to fix prices, to limit production or to share markets or customers between them . . . As a consequence, their clients (consumers or other businesses) end up paying more for less quality."<sup>14</sup>

The OECD regards anti-trust measures as a way of ensuring consumer welfare, the "individual benefit derived from the consumption of goods and services," by maximizing consumer surplus of such consumption while also ensuring the well-being of the producers of such services.<sup>15</sup> The organization explicitly warns of the negative impact that so called "hard core cartels" can have and warns of their negative impact on market equity: "They injure consumers in many countries by raising prices and restricting supply, thus making goods and services completely unavailable to some purchasers and unnecessarily expensive for others."<sup>16</sup>

Under South African competition legislation, cartel activities are prohibited under section 4 of the Competition Act 89 of 1998, as amended<sup>17</sup> (the Act): any involvement in such cartel activities may lead to administrative<sup>18</sup> as well as possible criminal sanctions against the companies and the directors involved.<sup>19</sup> South African competition legislation does not provide a concise definition of the term cartel. Instead, the Act lists examples of corporate activities that could qualify as cartel activity. Section 4(1) stipulates that:

An *agreement* between, or concerted *practice* by, *firms*, or a decision by an association of *firms*, is prohibited if—(a) it is between parties in a horizontal relationship and if it

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14. European Commission's competition overview at *Overview: Cartels*, EUROPEAN COMM'N, [http://ec.europa.eu/competition/cartels/overview/index\\_en.html](http://ec.europa.eu/competition/cartels/overview/index_en.html) (last visited Jan. 15, 2012).

15. See OECD, GLOSSARY OF INDUSTRIAL ORGANIZATION ECONOMICS AND COMPETITION LAW 29, 53, available at <http://www.oecd.org/dataoecd/8/61/2376087.pdf>.

16. OECD, RECOMMENDATION OF THE COUNCIL CONCERNING EFFECTIVE ACTION AGAINST HARD CORE CARTELS 1 (1988), available at <http://www.oecd.org/dataoecd/39/4/2350130.pdf>.

17. See Competition Act No. 89 of 1998, § 3(1-2) (S. Afr.), available at [http://www.saffii.org/za/legis/num\\_act/ca1998149.pdf](http://www.saffii.org/za/legis/num_act/ca1998149.pdf), where the South African legislative framework is discussed in more detail.

18. See *id.* §§ 59-61.

19. Criminal prosecution against directors or management who cause a firm to engage in a prohibited practice will soon be possible in South Africa after this Act comes into effect. Competition Amendment Act No. 1 of 2009, § 12 (S. Afr.), available at <http://www.compcom.co.za/assets/Files/Competition-Amendment-Act.pdf>.

has the effect of substantially preventing or lessening competition in a market [. . .] or  
(b) it involves any of the following *restrictive* horizontal practices.<sup>20</sup>

This definition of collusive anti-competition activity is reiterated in India's anti-cartel legislation, with section 1 of the Indian Competition Act<sup>21</sup> defining a cartel as: "an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit, control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services."<sup>22</sup>

The Brazilian Act<sup>23</sup> (hereinafter Federal Law), like the South African statute, lacks a clear definition of a cartel. Section 20 of the Federal Law only contains a rather wide definition of collusive actions qualifying as anti-competitive in order to include any anti-competitive practices between competitors: "any act in any way intended or otherwise able to produce the effects listed below, even if any such effects are not achieved, shall be deemed an infringement of the economic order."

Section 20 then provides a catalogue of generally infringing "prohibited" activities such as distortion of competition or free enterprise, control of the relevant product market, and profiteering and abusing a company's market dominance.<sup>24</sup> Section 21 of the Federal Law lists certain acts that generally constitute a violation of the "economic order," including price fixing,<sup>25</sup> concerted practices,<sup>26</sup> and the practice of "apportion[ing] markets for finished or semi-finished products or services, or for supply sources of raw materials or intermediary products,"<sup>27</sup> which is of a particular relevance for a state of the developing world due to its economic ramifications.<sup>28</sup>

These three legal definitions and regulations of cartel activities in South Africa, Brazil, and India follow the overall rationale and formula of prohibited cartel activities of the European Union. Article 101 of the Treaty on the Functioning of the European Union (TFEU) (former Article 81 of the EC Treaty) defines anti-competitive cartel activities as, "all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market."<sup>29</sup>

Anti-competitive cartel agreements, decisions, and concerted practices deemed incompatible with the internal market resemble "prohibited" practices listed in Article

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20. Competition Act No. 89 of 1998, § 4(1)(a-b). Section 4(1)(b) concerns anticompetitive practices such as price fixing, market sharing/division, or collusive tendering.

21. Competition Act of 2002, 2003, No. 12, Acts of Parliament, 2002 (India), *available at* [http://www.unctad.org/sections/ditc\\_ccpb/docs/ditc\\_ccpb\\_ncl\\_India\\_en.pdf](http://www.unctad.org/sections/ditc_ccpb/docs/ditc_ccpb_ncl_India_en.pdf).

22. *Id.* § 2.

23. *See* Brazilian Antitrust Law, Decreto No. 8884/94, de 11 de junho de 1994, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 13.6.1994 (Braz.).

24. *Id.* § 20.

25. *Id.* § 21(I).

26. *Id.* § 21(II).

27. *Id.* § 21(III).

28. For more violations of the Federal Law, *see id.* § 21.

29. *See* Consolidated Version of the Treaty on the Functioning of the European Union, art. 101(1) Mar. 20, 2010, 2010 O.J. (C 83/47) [hereinafter TFEU].

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101(1)(a)–(e) TFEU, including “price fixing,” exclusive distribution and purchasing agreements, and selective distribution and franchise agreements.<sup>30</sup>

**B. MULTINATIONAL CORPORATIONS, MARKET DOMINANCE AND ANTI CARTEL COOPERATION**

Globalization has seen the rise of so-called multi-national corporations (MNCs) or multi-national enterprises (MNEs). The OECD defines MNCs as “companies or other entities established in more than one country and so linked that they may co-ordinate their operations in various ways”.<sup>31</sup> The International Labor Organization’s (ILO) Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy defines MNCs as “Multinational enterprises include enterprises, whether they are of public, mixed or private ownership, which own or control production, distribution, services or other facilities outside the country in which they are based.”<sup>32</sup>

The economic impact of MNCs is quite significant and increasing: U.S. scholar Blumberg describes the impact of such MNC/MNEs on global trade and business:

In the modern global economy, the largest corporations conduct worldwide operations. They operate in the form of multinational corporate groups organized in “incredibly complex” multi-tiered corporate structures consisting of a dominant parent corporation, sub holding companies, and scores or hundreds of subservient subsidiaries scattered around the world. The 1999 World Investment Report estimated that there are almost 60,000 multinational corporate groups with more than 500,000 foreign subsidiaries and affiliates.<sup>33</sup>

Business activities of MNCs with their headquarters registered in the developed world are often subject to strict competition or antitrust laws. The spatial dimension of such limitations (which limits such governance to the boundaries of the nations of the developed world) does seldom extend to the many group subsidiaries that carry out the business in the developing world where they are registered for the actual business operation. MNCs operate in different states, including emerging economies through subsidiaries, branches, and alliances. These subsidiaries, branches, or alliances might get involved in cartel activities in the developing host country where standards of competition or antitrust legislation and regulations are often underdeveloped or even absent. The U.S. Department of Justice addresses this absence of corporate accountability: “We observe that firms in some cartels compete in the U.S. while conspiring elsewhere.”<sup>34</sup>

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30. *Id.* art. 101(1)(a–e).

31. OECD, OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES ¶ 3, at 14 (2008), available at <http://www.oecd.org/dataoecd/56/36/1922428.pdf>.

32. INT’L LABOUR ORG., TRIPARTITE DECLARATION OF PRINCIPLES CONCERNING MULTINATIONAL ENTERPRISES AND SOCIAL POLICY 6 (2006), available at [http://www.ilo.org/wcmsp5/groups/public/—ed\\_emp/—emp\\_ent/—multi/documents/publication/wcms\\_094386.pdf](http://www.ilo.org/wcmsp5/groups/public/—ed_emp/—emp_ent/—multi/documents/publication/wcms_094386.pdf).

33. Phillip I. Blumberg, *Asserting Human Rights Against Multinational Corporations Under United States Law: Conceptual and Procedural Problems*, 50 AM. J. COMP. L. 493, 493 (2002).

34. J. Bruce McDonald, Deputy Assistant Att’y Gen., What Do You Know?, Remarks to the British Inst. of Int’l Comparative Law Sixth Annual Trans-Atlantic Antitrust Dialogue (July 6, 2006), available at 2006 WL 4422979.

The International Commission of Jurists reflects on such shortcomings of corporate accountability and governance in a 2008 report, when it states that:

Throughout different jurisdictions the basic principle is that the conduct of a subsidiary will not be identified with its parent for the purposes of assigning legal responsibility. This means that a parent company will not generally be held vicariously liable for its subsidiary's conduct, even in situations where it holds 100% of its subsidiary's shares.<sup>35</sup>

Consequently, effective international multi-lateral anti-cartel competition policy is needed to close this "accountability" gap. Such a step, however, requires close cooperation between the competition authorities of the state where the holding company is registered and the state where the subsidiary is operating. Parisi emphasizes the need for more cooperation regarding competition matters:

As business concerns have increasingly pursued foreign trade and investment opportunities, antitrust compliance issues have arisen which transcend national borders and, thus, have led antitrust authorities in the affected jurisdictions to communicate, cooperate, and coordinate their efforts to achieve compatible enforcement results.<sup>36</sup>

Greater international cooperation can lead to a speedy and effective investigation of such cartel activities. As a consequence, corporate accountability in general will be achieved and with it future corporate perpetrators deterred. An overall facilitation of the enforcement of competition law and policies will eventually benefit the MNC affected, which can concentrate on its core business instead of facing a dragged out competition investigation by multiple completion organizations.

#### C. PROMOTION AND COORDINATION OF INTERNATIONAL COMPETITION POLICIES

##### 1. *The Promotion of International Competition Policies*

Multilateral cooperation in competition matters takes place by international organizations that aim at promoting cooperation between competition authorities and harmonization of existing competition frameworks. This article looks at the role of the International Competition Network, the Organization for Economic Cooperation and Development, the United Nations Conference on Trade and Development, and the World Trade Organization. These bodies exist alongside other regional arrangements and mechanisms responsible for creating and enforcing competition policies such as the European Commission of the European Union.<sup>37</sup>

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35. INT'L COMM'N OF JURISTS, CORPORATE COMPLICITY & LEGAL ACCOUNTABILITY 47 (2008), available at <http://www.icj.org/dwn/database/Volume3-ElecDist.pdf>.

36. John J. Parisi, *Enforcement Co-operation Among Antitrust Authorities*, 20(3) EUR. COMPETITION L. REV. 133, 133 (1999).

37. The European Commission oversees competition policy within the European Union. See *About the European Commission*, [http://ec.europa.eu/about/index\\_en.htm](http://ec.europa.eu/about/index_en.htm) (last visited Jan. 15, 2012).

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a. The International Competition Network

The International Competition Network (ICN) was launched on October 25, 2001 by fourteen states including the United States, European Union, Australia, and South Africa.<sup>38</sup> Budzinski describes the ICN as “a network of competition agencies from around the world, with close interaction of other public and private players who are concerned with international competition issues.”<sup>39</sup> Ugarte identifies a general lack of international collaboration as a key reason for the establishment of the ICN: “[t]he ICN was born out of the recognition by many jurisdictions that multilateral efforts are necessary to ensure convergence and coordination within and between the growing numbers of *competition* enforcement systems around the world.”<sup>40</sup> The ICN provides domestic competition authorities throughout the world with a specialized but informal platform to maintain contact and address competition concerns.<sup>41</sup> It assists domestic competition authorities in the enforcement of competition laws and other competition policies. The ICN operates through specialized working groups and one of these is the working group for cartels. It helps in addressing and governing cartel activities inside and outside the jurisdiction of the member states. The cartel working group is responsible for addressing particular challenges faced by competition authorities when acting against so called “hardcore” cartels. Aims and objectives of the ICN are summarized by Budzinski, who sees the main goal of the ICN as “the promotion of convergence in competition policies, primarily concerning procedural issues but, in the long run, also concerning substantive issues.”<sup>42</sup>

b. The Organization for Economic Cooperation and Development

The Organization for Economic Cooperation and Development (OECD) has been in existence since 1961.<sup>43</sup> Its predecessor, the Organization for European Economic Cooperation (OEEC) was established in 1947 with the aim to administer economic and development aid in Europe received from the United States and Canada under the Marshall Plan for the reconstruction of post war Europe.<sup>44</sup> The OECD, in its current form, provides a discussion forum for states which are “committed to democracy and market economy” in order to “support sustainable economic growth, boost employment, raise living standards, maintain financial stability, assists other countries’ economic development and contribute to growth in the world trade.”<sup>45</sup> At present it has thirty-four member states with most of the industrialized nations as members of the organization.<sup>46</sup> The OECD’s

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38. Cf. Oliver Budzinski, *The International Competition Network: Prospects and Limits on the Road Towards International Competition Governance*, 8(3) COMPETITION & CHANGE 223, 227 (2004).

39. *Id.*

40. Fernando S. Ugarte, *The Int’l Competition Network: Achievements So Far*, 22(10) INT’L FIN. L. REV. 1, 5 (2003).

41. *About the ICN*, <http://www.internationalcompetitionnetwork.org/about.aspx> (last visited Jan. 15, 2012).

42. Budzinski, *supra* note 38, at 223-42.

43. *See About the ICN*, *supra* note 41.

44. *See History of the OECD*, [http://www.oecd.org/pages/0,3417,en\\_36734052\\_36761863\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/pages/0,3417,en_36734052_36761863_1_1_1_1_1,00.html) (last visited Jan. 15, 2012); *see also* OECD COLUMBIA ELEC. ENCYCLOPEDIA (6th ed. 2011).

45. *About OECD*, CORP. SUSTAINABILITY REPORTING, <http://www.reportingcsr.org/oecd-p-41.html> (last visited Jan. 15, 2012).

46. Chile, Slovenia, Israel, and Estonia joined as its latest members in 2010. *See OECD Members & Partners*, [http://www.oecd.org/pages/0,3417,en\\_36734052\\_36761800\\_1\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/pages/0,3417,en_36734052_36761800_1_1_1_1_1,00.html) (last visited Jan. 15, 2012).



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Competition Committee is responsible for competition or antitrust matters.<sup>47</sup> One of the Committee's recent reports highlighted the high priority the organization places on competition law.<sup>48</sup> It publishes annual peer-reviewed reports of states and their competition policy structure. These reports provide other competition agencies with a detailed overview on the progress of the competition policies and laws of countries that were reviewed. These reports are then released to the states that were subject to these reports and a further summary of the report is made available to the wider public by the Secretary General of the OECD.<sup>49</sup>

c. The United Nations Conference on Trade and Development

The first United Nations Conference on Trade and Development (UNCTAD) took place in 1964.<sup>50</sup> It "provided a new forum, for the comprehensive review of trade, aid, and financial question related to development."<sup>51</sup> "It undertakes research, policy analysis, and [economic] data collection."<sup>52</sup> It further "provides technical assistance . . . [to] developing countries" that intend to develop and implement competition law and policy.<sup>53</sup> The so-called Intergovernmental Group of Experts on Competition Law and Policy meets on an annual basis to consult on matters of interest regarding competition laws and policy.<sup>54</sup> It offers a voluntary peer-review mechanism for competition law and policy to developing countries that is undertaken by UNCTAD competition policy experts.<sup>55</sup>

d. World Trade Organization

The World Trade Organization (WTO), which regulates global trade, provides the forum for countries for the initiation of trade negotiations.<sup>56</sup> A Working Group on the Interaction between Trade and Competition Policy (WGTCP) was established in 1996 after a Ministerial Conference in Singapore.<sup>57</sup> Under the more recent Doha Declaration of 2001, the WGTCP "focus[es] on the clarification of core principles, including transparency, non-discrimination and procedural fairness; provisions on hardcore cartels; modalities for voluntary cooperation; and support for progressive reinforcement of competition institutions in developing countries through capacity building."<sup>58</sup>

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47. *Id.*

48. See OECD COMPETITION COMM., BEST PRACTICES FOR THE FORMAL EXCHANGE OF INFORMATION BETWEEN COMPETITION AUTHORITIES IN HARD CORE CARTEL INVESTIGATIONS 2 (2005), available at <http://www.oecd.org/dataoecd/1/33/35590548.pdf>.

49. OECD, COMPETITION POLICY IN OECD COUNTRIES 1993-1994, at 3 (1997).

50. Isaiah Frank, *Aid, Trade and Economic Development: Issues Before the U.N. Conference*, 42 (2) FOREIGN AFF. 210 (1964).

51. Richard N. Gardner, *United Nations Conference on Trade & Development*, 22 (1) INT'L ORG. 120 (1968).

52. *About UNCTAD*, <http://www.unctad.org/Templates/Page.asp?intItemID=1530&lang=1> (last visited Jan. 15, 2012).

53. *Id.*

54. See *UNCTAD Competition Law & Policy*, <http://www.unctad.org/Templates/StartPage.asp?intItemID=2239&lang=1> (last visited Jan. 15, 2012).

55. *Id.*

56. See generally Ed Brown, Jonathan Cloke & Mansoor Ali, *How We Got Here: The Road to GATS*, 8(1) PROGRESS IN DEV. STUDIES 7-22 (2008).

57. See World Trade Organization, *Interaction Between Trade & Competition Policy*, [http://www.wto.org/english/tratop\\_e/comp\\_e/comp\\_e.htm](http://www.wto.org/english/tratop_e/comp_e/comp_e.htm) (last visited Jan. 15, 2012).

58. *Id.* At present the WGTCP is dormant due to the present limitations during the Doha round.

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e. European Union

Competition policy in the European Union (EU) is supervised and enforced by the European Commission, Directorate General for Competition, as the chief EU organ for competition policies and law:

The mission of the Directorate-General for Competition [of the European Commission] is to enforce the competition rules of the Community [Union] Treaties, in order to ensure that competition in the EU market is not distorted and that markets operate as efficiently as possible[, thereby] contribut[ing] to the welfare of consumers and to the competitiveness of the European economy.<sup>59</sup>

Other competition institutions within the EU are the European Courts, the General Court, and the European Court of Justice under Article 19(1) Treaty of the European Union (TEU), which serve as judiciary instance in cases of appeal under Article 263 of the Consolidated Version of the Treaty on the Functioning of the European Union (TFEU) (ex. Article 230 EC Treaty pre Lisbon) and referral by the courts of individual member states under Article 267 TFEU (ex. Article 234).<sup>60</sup> Under Article 3 of Regulation 1/2003,<sup>61</sup> implementation and enforcement of EU competition law takes place in a decentralized form by means of cooperation between the European Commission and the national competition authorities established under domestic competition laws.<sup>62</sup>

Additionally, there exist bilateral antitrust agreements between the EU and selected other states with the explicit goal of harmonizing enforcement actions and avoiding enforcement clashes between the EU and other jurisdictions. Currently, the EU has such bilateral agreements with Canada, Japan, and the United States, as well as further country-specific agreements.<sup>63</sup>

Such bilateral agreements are necessary for overall compliance with EU competition law and its extraterritorial application: “One of the reasons why Europe and the USA entered [into] these agreements was the importance of addressing anti-competitive activities that occur beyond the effective reach of a jurisdiction, but affect it nonetheless because of the internationalisation of today’s markets.”<sup>64</sup>

2. *Coordinating Cooperation Between Competition Agencies*

“One aspect of cooperation in the field of competition is related to law enforcement issues but there is also a fair amount of cooperation on broader issues such as competition

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59. See *DG Competition Mission Statement*, <http://ec.europa.eu/dgs/competition/mission> (last visited Jan. 15, 2012).

60. See SYLVIA HARGREAVES, *EU LAW CONCENTRATE* 62-63 (2d ed. 2011).

61. Council Regulation (EC) No. 1/2003 of 16 December 2002 is a regulation on the implementation of the rules on competition laid down in (former) Articles 81 and 82 of the Treaty (now Articles 101 and 102 TFEU). See *Antitrust Regulations*, <http://ec.europa.eu/competition/antitrust/legislation/regulations.html> (last visited Jan. 15, 2012).

62. See KJ Cseres, *The Impact of Regulation 1/2003 in the New Member States*, 6(2) *COMPETITION L. REV.* 145, 147 (2010).

63. See *Bilateral Relations on Competition Issues*, <http://ec.europa.eu/competition/international/bilateral> (last visited Jan. 15, 2012). The 1991 bilateral agreement with the United States is the most developed one.

64. Markus Muller, *The European Commission’s Decision Against Microsoft: A Violation of the Antitrust Agreements Between the United States and the European Union?*, 26(6) *EUR. COMPETITION L. REV.* 309 (2005).

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advocacy or the proper design of competition laws and competition law enforcement institutions.”<sup>65</sup> The impact of such collaboration on competition issues increases when coupled with additional efforts to achieve harmonization of commercial practice:

The review of commercial practices involves considerable work and costs, both for competition authorities and for the businesses whose conduct is subject to review. If the same commercial practice falls within several jurisdictions the costs increase accordingly. Greater cooperation and the elimination of unnecessary duplication of effort, can reduce costs to competition authorities and business alike.<sup>66</sup>

Newly Industrialized Countries (NICs) like South Africa have experienced an increase of—mostly foreign—MNC and MNE business activities. Consequently, they identified international trans-border competition cooperation as a way of completing investigations into cartel and anti-competitive activities in a time-efficient and effective way.<sup>67</sup> Successful trans-border competition cooperation may deter companies from committing cartel offences. Noting the absence of an established and operational system of cooperation in cartel cases, the Cartel Working Group of the ICN investigated possibilities of closer cooperation between the competition authorities of multiple jurisdictions in a report submitted to the ICN’s annual conference in Moscow in 2007.<sup>68</sup> The report analyzed different methods that might ensure greater cooperation, including those discussed below.

a. Informal Cooperation<sup>69</sup>

This method is based on the 1995 OECD Recommendation on Cooperation. The OECD recommendations provide a broad outline on how member states should deal with “exchanges of information, co-operation in investigations and proceedings, consultations and conciliation of anticompetitive practices affecting international trade.”<sup>70</sup> The ICN points out that there is an overall lack of precedence where this method of cooperation was used during cartel investigations.<sup>71</sup>

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65. Frederic Jenny, *International Cooperation on Competition: Myth, Reality and Perspective*, 48 ANTITRUST BULL. 973, 974 (2003).

66. Leon Brittan & Karel van Miert, *Towards an International Framework of Competition Rules*, 24 INT’L BUS. LAW. 454, 455 (1996).

67. See generally SALLY VAN SICLEN, SOUTH AFRICA—PEER REVIEW OF COMPETITION LAW AND POLICY 47 (2003), available at <http://www.oecd.org/dataoecd/43/58/34823812.pdf> (The peer reviewed OECD report stated that “South Africa has no formal co-operation agreements with other competition agencies. But even without formal arrangements, the Commission has worked with the European Commission, Canada, Australia, and the US in merger matters.”). Such trans-border cooperation takes place in connection to merger as well as cartel activities.

68. See ICN CENTRAL WORKING GROUP, CO-OPERATION BETWEEN COMPETITION AGENCIES IN CARTEL INVESTIGATIONS (hereinafter ICN CARTEL WORKING GROUP REPORT) 5 (May 2007), available at <http://www.internationalcompetitionnetwork.org/uploads/library/doc348.pdf>; see also Jenny, *supra* note 65, at 974, 978 (discusses the importance of international cooperation in competition matters and the various “tools of cooperation”); Claus-Dieter Ehlermann, *The International Dimension of Competition Policy*, 17 FORDHAM INT’L L.J. 833, 835-37 (1993) (the successful use of bilateral agreements in situations where uncompetitive practices have extraterritorial effects).

69. See ICN CARTEL WORKING GROUP REPORT, *supra* note 68, at 9; Jenny, *supra* note 65, at 978.

70. See OECD, REVISED RECOMMENDATION OF THE COUNCIL CONCERNING CO-OPERATION BETWEEN MEMBER COUNTRIES ON ANTICOMPETITIVE PRACTICES AFFECTING INTERNATIONAL TRADE 6 (1995), available at <http://www.oecd.org/dataoecd/60/42/21570317.pdf>.

71. ICN CARTEL WORKING GROUP REPORT, *supra* note 68, at 9.

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The authors submit that voluntary cooperation by competition authorities needs overall willingness and commitment by each participant—something that might often not be the case.

b. Cooperation Based on Waiver<sup>72</sup>

This method applies in cases where a transnational company involved in a cartel applies for immunity or leniency<sup>73</sup> in more than one competition jurisdiction. The company effectively authorizes the respective domestic competition authorities to exchange sensitive information on a particular competition case. This method can only be successful if the competition legislation or policies of the competition jurisdictions involved contain immunity or leniency provisions that are comparable.<sup>74</sup> South Africa, Brazil,<sup>75</sup> and India<sup>76</sup> have similar leniency programs under which a corporation under investigation for alleged cartel activities may apply for immunity from prosecution.<sup>77</sup> Consequently, any competition cooperation between these states should not be problematic in such an instance. In South Africa, the Corporate Leniency Policy was “developed . . . to facilitate the process through which firms participating in a cartel are encouraged to disclose information on the cartel conduct in return for immunity from prosecution.”<sup>78</sup>

The authors submit if one of the jurisdictions in which the cartel operates lacks such a leniency program, this model of cooperative leniency might fail.

c. Cooperation Based on National Laws

Domestic competition legislation and policies may contain provisions that authorize competition agencies to establish collaborative arrangements with agencies from other jurisdictions.<sup>79</sup> Germany, the United States of America, the United Kingdom, and Australia are among the countries with legislation containing provisions of such bilateral effect.<sup>80</sup> As an example, section 82(4) of the South African Competition Act 89 of 1998 provides for such cooperation agreements with other competition agencies: “The President may assign to the Competition Commission any duty of the Republic, in terms of an

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72. *Id.* at 11.

73. *Id.* This ensures that the company will not be prosecuted if it provides the investigative competition authorities with all the necessary information it will need to prosecute participants of the cartel. *Id.*

74. *Id.*

75. SDE, FIGHTING CARTELS: BRAZIL’S LENIENCY PROGRAM 17, 20 (2009), available at <http://www.oecd.org/dataoecd/52/22/43619651.pdf>. The publication states that “the SDE is the antitrust agency with power to negotiate the leniency agreement” and further states the requirements that an applicant has to comply with before the SDE will consider to enter into a leniency agreement. *Id.*

76. Section 46 of the Competition Act provides that “[t]he [Competition] Commission [of India] may, if it is satisfied that any producer, seller, distributor, trader or service provider included in any cartel, which is alleged to have violated section 3, has made a full and true disclosure in respect of the alleged violations and such disclosure is vital, impose upon such producer, seller, distributor, trader or service provider a lesser penalty as it may deem fit, than leviable under this Act or the rules or the regulations.” The Competition (Amendment) Act, 2007, No. 12, Acts of Parliament, 2007, § 46 (India). However, this possibility is subjected to certain provisos. *Id.*

77. *See id.*; SDE, *supra* note 75, at 17; Corporate Leniency Policy §§ 3.1, 3.5 (S. Afr.).

78. Corporate Leniency Policy § 2.5 (S. Afr.).

79. ICN CARTEL WORKING GROUP REPORT, *supra* note 68, at 11.

80. *Id.* at 13.

international agreement relating to the purpose of *this* Act, to exchange information with a similar foreign agency.”<sup>81</sup>

Considering the fact that such cooperation is only limited to a few states, is voluntary, and takes place on an ad hoc basis, it might still lack the necessary impact.

d. Cooperation Based on Non-Competition Specific Agreements Between Jurisdictions<sup>82</sup>

So-called Mutual Assistance Agreements can be invoked if states need mutual assistance in regard to combating cartel activities.<sup>83</sup> Mutual Legal Assistance Treaties (MLATs) are mostly entered into by countries to cooperate in criminal cartel matters.<sup>84</sup> However, the ICN states that there is no automatic need for a “dual criminality” element when cooperation is sought: the criminality of cartels in one jurisdiction does not necessarily prevent cooperation on cartels by a Mutual Assistance Agreement if no such criminal status is given to cartels in the other jurisdiction. It may, however, lead to limited or no cooperation at all if one jurisdiction gives criminal status to cartels and the other one does not.<sup>85</sup> The South African Competition Amendment Act 1 of 2009 grants criminal status to cartels in South Africa<sup>86</sup> and therefore it is possible for South Africa to enter into such MLATs with other countries that have the same criminal approach to cartels.

e. Regional Cooperation Instrument: The European Union Cooperation Network

All member states of the European Union belong to the European Competition Network (ECN).<sup>87</sup> Its key guardian is the European Commission, which is responsible for ensuring the compliance of all EU member states with its competition policies. Regulation (EC) 1/2003<sup>88</sup> of December 16, 2002, introduced a system of decentralized enforcement executed by domestic enforcement bodies—the so-called national competition authorities (NCAs). The ICN regards the EU enforcement network as an example for a successful regional cooperation regime.<sup>89</sup> When the Lisbon Treaty came into force in December 2009, it gave legal personality to the European Union under Article 46A Treaty on the Functioning of the European Union; but we have yet to see whether this new capacity to enter into international treaties will further strengthen the EU competition network.

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81. *Id.* at 13-14.

82. *Id.* at 15.

83. *Id.* (the ICN describes Mutual Assistance Agreements as “treaties on co-operation in criminal matters which create hard law obligations on signatories.”).

84. *Id.*

85. *Id.*

86. Competition Amendment Act 1 of 2009 § 12 (S. Afr.).

87. P.S.R.F. MATHIJSEN, A GUIDE TO EUROPEAN UNION LAW 228 (2004).

88. Regulation 1/2003 introduced a system of decentralized enforcement executed by domestic enforcement bodies, the so called national competition authorities (NCAs).

89. ICN CARTEL WORKING GROUP REPORT, *supra* note 68, at 19; OECD REPORT, *supra* note 70.

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f. Cooperation Based on Competition-Specific Agreements Between Jurisdictions or  
Bilateral Agreements on Competition Matters

The common purpose of these agreements is to promote cooperation between competition authorities.<sup>90</sup> The ICN reports that the first bilateral agreement was concluded between Germany and the United States of America in 1976.<sup>91</sup> Since then, many such bilateral agreements followed: the United States of America and Brazil,<sup>92</sup> Canada and Brazil,<sup>93</sup> Chile and Brazil,<sup>94</sup> and Russia and Brazil<sup>95</sup> have all entered into such bilateral agreements.

Considering the above methods of coordinating cooperation between competition authorities, cooperation based on competition-specific agreements between jurisdictions or bilateral agreements on competition matters seems to be by far the most promising method. Not only do the participating parties retain a high amount of flexibility in terms of identifying anti-competitive practices on which they want to cooperate, but they also have the guarantee that if a competition matter arose they would be able to rely on the cooperation of the country with which the bilateral agreement was concluded. This observation reiterates the earlier ascertainment of the U.S. Federal Trade Commission, whereas “[c]o-operation among antitrust authorities facilitates the effective and efficient enforcement of antitrust laws and thus the maintenance of competition in markets. That is not an expression of economic theory, but rather a fact of life.”<sup>96</sup>

D. A COMPARATIVE OVERVIEW OF COMPETITION LAW AND POLICY OF THE  
EUROPEAN UNION, SOUTH AFRICA, BRAZIL, AND INDIA

1. *Overview*

The following overview introduces and compares the competition policy and laws in South Africa, Brazil, and India with those of the European Union. It highlights the authors’ view that only binding bilateral agreements that synchronize domestic cartel laws and policies—and not only informal cooperation agreements—are necessary to protect

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90. ICN CARTEL WORKING GROUP REPORT, *supra* note 68, at 17.

91. *See id.*

92. Agreement Between the Government of the United States of America and the Government of the Federative Republic of Brazil Regarding Cooperation Between their Competition Authorities in the Enforcement of their Competition Laws, U.S.-Braz., Oct. 26, 1999, T.I.A.S. No. 13,068.

93. Cooperation Arrangement Between the Commissioner of Competition, Competition Bureau of the Government of Canada, and the Council for Economic Defense, the Secretariat of Economic Law of the Ministry of Justice, and the Secretariat for Economic Monitoring of the Ministry of Finance of the Government of the Federative Republic of Brazil Regarding the Application of their Competition Laws, Can.-Braz., Apr. 25, 2008, competitionbureau.gc.ca.

94. Cooperation Arrangement Between the Fiscalía Nacional Económica of Chile and the Council for Economic Defense, the Secretariat of Economic Monitoring of the Ministry of Finance of the Government of the Federative Republic of Brazil Regarding the Application of Their Competition Laws, Chile-Braz., Oct. 2008, *available at* <http://www.cade.gov.br/upload/AB%20Inglés.pdf>.

95. Agreement on Cooperation in the Sphere of Competition Policy Between the Government of the Federative Republic of Brazil and the Government of the Russian Federation, Russ.-Braz., Dec. 12, 2001, [www.oecd.org](http://www.oecd.org).

96. John J. Parisi, *Enforcement Co-operation Among Antitrust Authorities*, 20(3) EUR. COMPETITION L. REV. 133, 133 (1999).

emerging economies from the threat of market distortion posed by cartels. Cross-border cooperation established by bilateral agreements might speed up any investigation into cartel activities by MNCs. The outcomes of an investigation of an alleged transnational cartel activity undertaken by the anti-competition authorities of one jurisdiction can be utilized by the competition authorities of other jurisdictions affected by such cartel activities, instead of having to conduct time-consuming investigations on their own.

## 2. *European Union*

As the main supervisory organ, the European Commission, together with its domestic counterparts at the Member State level,<sup>97</sup> functions as the ‘gatekeeper’ for fair competition and is responsible for the regulation and prevention of anti-competitive cartel activities under Article 101 TFEU (ex. Article 81 EC Treaty),<sup>98</sup> the abuse of dominant positions by dominating undertakings under Article 102 TFEU (ex. Article 82),<sup>99</sup> and the regulation of mergers under the Merger Regulation 139/2004.<sup>100</sup> In addition, it oversees the fair use of state aid by its Member States under Articles 107–109 TFEU (ex. Articles 87–89).<sup>101</sup> The Commission has the power to adopt a decision, to conduct investigations, and to impose penalties when following a complaint or on its own initiative if it finds in a given case that there has been a violation of Articles 101 or 102 of the Treaty.<sup>102</sup> The latter is the measure that has the potential of deterring potential corporate offenders. Under Regulation 1/2003, the Commission has the power to impose fines on undertakings and associations of undertakings not exceeding ten percent of the total turnover realized in the preceding business year by each of the undertakings that participated in the infringement under Article 23 Regulation 1/2003<sup>103</sup> and under Article 24 1/2003 periodic penalty payments not exceeding five percent of their average daily turnover in the preceding business year per day in order to compel undertakings to put an end to an infringement or to comply with a decision ordering interim measures.<sup>104</sup>

Penalties can be in the billions of euros—as two fines of 2009 exemplify. Two gas providers, E.ON and GDF Suez, were fined €553,000,000 each for their collusion in dominating the Franco-German gas market and the computer chip giant, Intel, was fined an impressive €1,060,000,000 for its exclusion of other competitors from the computer chip market.<sup>105</sup>

A major competition matter that made evident the positive effects of international cooperation between competition authorities occurred in 1994, when Microsoft Corporation made a declaration to the U.S. Department of Justice and the European Competition

97. Council Regulation 1/2003, Preamble ¶¶ 3, 4, 2002 O.J. (L 1) 1 (EC).

98. Consolidated Version of the Treaty on the Functioning of the European Union art. 101, Sept. 5, 2008, 2008 O.J. (C 115) 88-89 [hereinafter TFEU].

99. *See id.* art. 102.

100. Council Regulation 139/2004, 2004 O.J. (L 24) (EC).

101. *See* TFEU, *supra* note 98, arts. 107-09.

102. *See id.* art. 105.

103. Reg 1/2003, art. 23.

104. *Id.* art. 24.

105. Press Release, European Commission, Antitrust: Commission Action Against Cartels (July 8, 2009), available at [http://ec.europa.eu/competition/cartels/overview/faqs\\_en.html](http://ec.europa.eu/competition/cartels/overview/faqs_en.html).

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Commission (ECC) to change their licensing practices.<sup>106</sup> This undertaking was made after negotiations with these authorities, following an allegation by Novell against Microsoft that the latter had kept competitors out of the market for PC-operating browser system software by illegally tying Windows and Internet Explorer<sup>107</sup> and bundling Windows Media Player with the Microsoft operating system.<sup>108</sup> The ECC allegedly started its investigations in 2000 independently from the U.S. competition proceedings that had already started in the early 1990s.<sup>109</sup> While investigations were ongoing, Microsoft gave its consent for the exchange of information between the U.S. Department of Justice and the ECC. It waived its right to secrecy regarding both the U.S. Department of Justice and the ECC.<sup>110</sup> This cooperation was greeted as a success for international cooperation:

[T]he negotiation of the undertaking was a historic and unprecedented piece of cooperation between the EC Commission and the United States Department of Justice. It serves as an important model for the future, as it shows how the two authorities can combine their efforts to deal effectively with giant multinational companies. The success of this joint approach sends a strong signal to all multinational companies, including those in other sectors.<sup>111</sup>

### III. Republic of South Africa

#### A. LEGISLATIVE OVERVIEW

At present, the only available action against cartel activity in South Africa is the administrative penalty as provided by the Competition Act 89 of 1998 (the Act).<sup>112</sup> It promotes and protects fair competition in South Africa and came into force October 20, 1998.<sup>113</sup> The Preamble of the Act states that competition law and structures to enforce those laws will “provide for markets in which consumers have access to, and can freely select, the quality and variety of goods and services they desire” and it is also intended to “restrain trade practices which undermine a competitive economy.”<sup>114</sup> It repealed the Maintenance and Promotion of Competition Act of 1979 (the old Act), which regulated competition among corporations.<sup>115</sup> Chapter 2 of the Act prohibits uncompetitive practices that, inter alia, include price fixing and price discrimination.<sup>116</sup> Under section 61 of the Act, corporations involved in cartel activities may be penalized by an administrative fine of up to ten percent of the annual turnover in South Africa or their exports from South Africa during

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106. Press Release, European Commission, Following an Undertaking by Microsoft to Change its Licensing Practices, the European Commission Suspends its Action for Breach of the Competition Rules (Sept. 17, 2004), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/94/653>.

107. *United States v. Microsoft Corp.*, 253 F.3d 34, 45 (D.C. Cir. 2001).

108. Commission Decision Case COMP/C-3/37.792 Microsoft (EC).

109. *See id.* ¶ 4.

110. *Id.*

111. *Id.*

112. Competition Act No. 89 of 1998 (S. Afr.).

113. *See id.* Preamble.

114. *See id.*

115. *See id.* Schedule 2.

116. *See id.* ch. 2.



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the firm's preceding financial year.<sup>117</sup> When determining the penalty, the Competition Tribunal shall look upon various factors, which include "the nature, duration, gravity, and extent of the contravention, any loss or damage suffered as a result of the contravention, and the behavior of the respondent."<sup>118</sup>

The scope of available sanctions will change when the Competition Amendment Act 1 of 2009 (the Amendment Act) comes into force. Corporate and company directors, such as CEOs and CFOs, who are responsible for their undertakings' involvement in cartel activities can now face personal criminal responsibility.<sup>119</sup> South African legislators made a bold move when drafting the Amendment Act. The then president of the Republic of South Africa, Kgalema Mothathle, refused to sign the Competition Amendment Bill of 2008 (the Bill), as the Amendment Act then was called, questioning the constitutionality of certain provisions.<sup>120</sup> Firstly, there was the question of whether evidence obtained during the hearing in front of the competition authorities could be used in a subsequent criminal court case against directors.<sup>121</sup> Secondly, the amendment takes away the burden of proof from the South African prosecuting authorities under which they have to prove beyond reasonable doubt that an offense was committed, in terms of the competition laws, by stating that a person may be prosecuted for an offense if there is proof of or acknowledgement by a firm that it engaged in a prohibited practice.<sup>122</sup> Despite these concerns,<sup>123</sup> Jacob Zuma, the present South African president, signed and assented to the Bill, which became the Competition Amendment Act (Act No 1 of 2009), on August 26, 2009.<sup>124</sup> Section 73A will be inserted into the Act, allowing the prosecution of a "[company] director of a *firm* or while engaged or purporting to be engaged by a *firm* in a position having management authority within the *firm*"<sup>125</sup> causing "the firm to engage in a prohibited practice"<sup>126</sup> or having "knowingly acquiesced"<sup>127</sup> to such activity.

It has yet to be seen whether the new Competition Amendment Act will create enough deterrence to stop such anti-competitive activities.

**B. ENFORCEMENT AGENCIES**

In South Africa, the Competition Commission, the Competition Tribunal, and the Competition Appeal Court were established by the Competition Act 89 of 1998 (the Act)

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117. *See id.* § 61(2).

118. *See id.* § 61(3).

119. *See* Segoane L. Monnye & Sasha-Lee Afrika, *Prison Beckons Directors Involved in Cartels*, 16 JUTA'S BUS. L. 13, 13 (2008).

120. Luke Kelly, *The Introduction of a Cartel Offence into South African Law*, 21 STELLENBOSCH L. REV. 321 (2010).

121. The issue was also discussed at a joint meeting of the Law Society of South Africa's Competition Law Committee and the Constitutional and Human Rights Committee, 8 *De Rebus—SA Attorneys' Journal* (2008).

122. Competition Amendment Bill, § 12 (2008); *see also* Kelly, *supra* note 120, at 331.

123. These concerns were not addressed as the Bill was assented to with exactly the same content. It is therefore possible to expect future litigation after the commencement of the Amendment Act.

124. Competition Amendment Act (Act No. 1, 2009). It was assented to on August 26, 2009 while the date of its entry into force has still not been proclaimed.

125. *Id.* § 12.

126. *Id.*

127. *Id.*

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and are responsible for enforcing competition legislation, policies, and domestic compliance.

The Commission consists of a Commissioner and at least one Deputy Commissioner who is appointed by the Minister of Trade and Industry.<sup>128</sup> The Commission has jurisdiction throughout the Republic of South Africa, is independent, and is only subject to the South African Constitution and the law of South Africa.<sup>129</sup> It functions independently from any interference by any executive organ of state and “each organ of state must assist the Commission to maintain its independence and impartiality, and to effectively carry out its powers and duties.”<sup>130</sup> The Commission has a wide range of implementation and enforcement powers<sup>131</sup> designed to protect the individual consumer’s right to a fair market:

[T]he Commission is representing the public interest and acts as ‘claimant cum prosecutor’. The public interest is that interest that all South Africans have in open and unfettered competition in our economy. The Commission is assigned to this task because of the difficulties facing ordinary citizens in pursuing anti-competitive conduct through normal court channels.<sup>132</sup>

The Tribunal has jurisdiction throughout the Republic, and consists of a chairman who is appointed by the President and at least three, but no more than ten, other members. Under section 27(1), the Tribunal has the responsibility to adjudicate any matter that is prohibited under the Act, which may be considered by it, and review any decision of the Commission that gets referred to in terms of the Act.

Section 36 of the Act establishes the Competition Appeal Court, which has a similar status as a High Court in South Africa. It consists of three judges, of whom one is designated to be the Judge President. The court is responsible for reviewing any decisions of the Competition Tribunal referred to it in terms of the Act and for considering any appeal arising from a decision of the Tribunal.

Overall, the three enforcement bodies have been successful in safeguarding corporate compliance with South Africa’s competition legislation as the case overview below shows.

C. A SHORT OVERVIEW OF SELECTED CARTEL CASES IN SOUTH AFRICA

In recent times, many corporations were under investigation for alleged cartel activities by the Competition Commission. Such cartel activities include collaborations between international MNCs and domestic South African companies, which affect the domestic market; one good example was the well-publicized milk cartel case, involving corporations such as Parmalat SA (Pty) Ltd., Clover SA (Pty) Ltd., and Nestle SA (Pty) Ltd.<sup>133</sup> These and other cartel activities, many which have not yet been discovered, prompt questions.

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128. *Id.* § 19(2).

129. *Id.* § 20(1)(a).

130. *Id.* § 20(3).

131. *Id.* § 21.

132. Competition Comm’n v. Pioneer Foods (Pty) Ltd. 2010 (91/CAC/Feb10) ZACAC 2 (S. Afr.).

133. See Amanda Visser, *Appeal Lodged in Milk Cartel Case*, FIN24 (Sept. 19, 2008, 07:32), <http://www.fin24.com/BusBusin/Appeal-lodged-in-milk-cartel-case-20080919>; see also *S Africa: Regulator Upbeat on “Milk Cartel” Case*, JUST-FOOD (Jan. 19, 2009), [http://www.just-food.com/news/regulator-upbeat-on-milk-cartel-case\\_id105093.aspx](http://www.just-food.com/news/regulator-upbeat-on-milk-cartel-case_id105093.aspx).

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Are MNCs that operate in developing nations more likely to commit prohibited practices? Do the respective national competition authorities, unlike their counterparts in developed member states of the OECD, suffer from a general lack of formal cooperation in their fight against cartels?

Cartel cases that the Commission has investigated include, inter alia, an alleged cartel in the bread industry, a cartel operating in the pipe products and construction industry<sup>134</sup> in which two subsidiaries of Murray and Roberts and Aveng were involved,<sup>135</sup> and an alleged milk cartel.<sup>136</sup>

1. *The Bread Cartel: Competition Commission v. Pioneer Foods (Pty) Ltd.*<sup>137</sup>

In the so-called “bread cartel” case, the Competition Commission of South Africa referred to the Competition Tribunal for a decision on two complaints against Pioneer Foods (Pty) Ltd.; the Western Cape complaint and the National complaint concerned alleged bread cartel activities at the regional and national level. In the Western Cape complaint, the Commission received information about an alleged cartel between the bread producers Premier Foods, Tiger Brands, Foodcorp (Pty) Ltd., and Pioneer Food. These prohibited horizontal agreements<sup>138</sup> between the cartel members aimed at dividing the market by allocating certain areas for business operations to each participant and fixing bread prices, thus contravening §§ 4(1)(b)(i) and (ii)<sup>139</sup> of the Competition Act. During the investigation, Premier Foods decided to cooperate fully with the Commission in order to qualify for immunity under the leniency policy of the Commission. During the early stages of the investigation, Tiger Brands successfully entered into a consent order agreement with the Commission after it provided evidence against the bread cartel. Tiger Brands received an administrative fine of ZAR98.784.869.90. Foodcorp was fined an administrative fine of ZAR45.406.359.82. Only the case of Pioneer Food—with the company denying involvement in any cartel—was referred to the Tribunal. The Tribunal found that Pioneer Foods had indeed contravened § 4 (1) (b) (i) and (ii) of the Act<sup>140</sup> and was punished with a rather robust penalty of ZAR195.718.614 for its involvement in both the Western Cape and national bread cartel.

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134. Competition Comm’n v. S. Pipeline Contractors Conrite Walls (Pty) Ltd. [2010] (23/CFR/Feb09) (S. Afr.); see also Media Release, Competition Commission Busts Pipe Products Cartel (Jan. 30, 2009), <http://www.compcem.co.za/assets/Uploads/AttacheAttach/MyDocuments/30-Jan-09-Competition-Commission-busts-pipe-products-cartel.pdf>.

135. Amanda Visser, *Cartel Firms Get Off Scot-Free*, FIN24 (Mar. 2, 2009), <http://www.fin24.com/Business/Cartel-firms-get-off-scot-free-20090302>.

136. Competition Comm’n v. Clover Indus. Ltd. [2008] (103/CR/Dec06) (S. Afr.).

137. Competition Comm’n v. Pioneer Foods (Pty) Ltd. 2010 (15/CR/Feb07) (S. Afr.) [hereinafter Bread Case].

138. Section 1 of the Competition Act defines a horizontal relationship as a relationship between competitors and an agreement, when used in the context of prohibited practices, includes a contract, arrangement or understanding, whether or not it is legally enforceable. Competition Act No. 89 of 1998 § 1(xi) (S. Afr.).

139. *Id.* § 4(1)(b)(i)-(ii) (S. Afr.).

140. Bread Case, supra note 137, at ¶ 131, namely “direct and indirect fixing of a selling price and other trading conditions in contravention of section 4(1)(b)(i)and(ii) of the Act.”

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2. *Pipes and Construction Cartel: Competition Commission v. Cape Concrete Works (Pty) Ltd.*<sup>141</sup>

In this 2009 case, the Commission found that corporations that operated in the pipe products industry had formed a cartel and were responsible for bid rigging, price fixing, and allocating markets or customers. In December, Rocla (Pty) Ltd. (Rocla) applied for leniency to the Commission in terms of its Corporate Leniency Policy.<sup>142</sup> It was involved in a cartel with other corporations in the precast industry.<sup>143</sup> Rocla informed the Commission that, together with the other corporations, they “[fixed] the selling price of pipes, culverts and manholes[;] [divided] the markets of the production and distribution of pipes, culverts and manholes; and [collusively tendered] in respect of the supply of precast concrete products and precast concrete sleepers to certain suppliers.”<sup>144</sup> The Commission subsequently started an investigation into the cartel. Cape Concrete Works (Pty) Ltd. admitted its involvement in the cartel and agreed, in a plea bargain with the Commission, to pay a fine of ZAR 4.371.386.

3. *The Milk Cartel: Competition Commission v. Clover Industries Limited, Clover SA (Pty) Ltd., Parmalat (Pty) Ltd, Ladismith Cheese (Pty) Ltd., Woodlands Dairy (Pty) Ltd., Nestle SA (Pty) Ltd., and Milkwood Dairy (Pty) Ltd.*<sup>145</sup>

In the milk cartel case, the companies Clover Industries Ltd., Clover SA (Pty) Ltd., Parmalat (Pty) Ltd., Ladismith Cheese (Pty) Ltd, Woodlands Dairy (Pty) Ltd., Nestle SA (Pty) Ltd., and Milkwood Dairy (Pty) Ltd. were accused of fixing the prices of raw and processed milk and manipulating the market to restrict competition.<sup>146</sup> It was alleged that price information was exchanged between the management of the corporations via telephone and email.<sup>147</sup> It was further alleged that price data were circulated and synchronized by making use of a combination of fictitious and actual scenarios where each participant would then provide the price it would charge for the provided scenario.<sup>148</sup> During January 2009, the Commission issued a media statement in which it confirmed a settlement with one of the participants in the milk cartel.<sup>149</sup> Lancewood (Pty) Ltd. admit-

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141. Competition Comm’n v. Cobro Concrete 2009 (23) CR 1 (CT) ¶ 2.1 (S. Afr.).

142. *Id.*

143. *Id.*

144. *Id.*

145. See Competition Comm’n v. Clover Indus. Ltd. et. al. 2006 (103) CR 1 (CT) ¶ 3-4 (S. Afr.); Clover Indus. Ltd. v. Competition Comm’n et. al. 2008 (78) ZACAC 1 (CAC) (S. Afr.); and Ladismith Cheese Ltd. v. Competition Comm’n 2008 (81) ZACAC 1 (CAC) (S. Afr.) for the Competition Appeal Court’s decision after some of the dairy companies, including Clover Industries Limited, Clover SA (Pty) Ltd., and Ladismith Cheese (Pty) Ltd. appealed against three *in limine* points. The first point was whether the letter that was submitted to the Commission, informing the Commission of the possibility of a cartel amongst dairy companies, qualified as an official complaint or only as providing the Commission with information. The second and third *in limine* points were based on a corporate leniency agreement concluded between the Commission and Clover Industries Limited and Clover (SA) Pty Ltd. on Feb. 3, 2006. The appeal, however, failed on all three points *in limine*.

146. Media Statement, S. Afr. Competition Comm’n, Competition Commission Settles with Milk Cartel Participant (Jan. 16, 2009), available at <http://www.compcom.co.za>.

147. *Id.*

148. *Id.*

149. *Id.*

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ted to the Commission that it was involved in the activities as alleged by the Commission and agreed to pay an administrative penalty of ZAR100,000.00.<sup>150</sup>

But the Commission recently withdrew its case against Clover Industries Limited and Clover SA (Pty) Ltd., Nestle SA (Pty) Ltd., Parmalat (Pty) Ltd., and Ladismith Cheese (Pty) Ltd.—the remaining respondents in its long running case.<sup>151</sup> The withdrawal is due to a decision by the Supreme Court of Appeal of South Africa in which it sets aside the complaints initiated by the Competition Commission against the applicants during 2006 and refers the December 7, 2006 Competition Commission complaints to the Competition Tribunal of South Africa.<sup>152</sup>

These cases highlight the important role South Africa's competition authority plays in their quest to ensure fair and healthy competition in order to preserve economic freedom.<sup>153</sup>

D. SANCTIONS AND PENALTIES

At the moment the Act provides for administrative penalties against corporations, which can amount to a total of ten percent of the annual turnover made during the business year in which the corporation was involved in the cartel activity.<sup>154</sup> The amended Act will establish personal accountability of directors and other officers of the company by criminalizing certain acts amounting to prohibited practices of their corporations.<sup>155</sup> With this latter legislation in place, the South African competition penalty system will finally become more in line with the examples of the United States,<sup>156</sup> Canada,<sup>157</sup> and the United Kingdom<sup>158</sup> that all make provisions for custodial sentences for directors who allow the corporation to get involved in cartels.

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150. *Id.*

151. See Media Release, S. Afr. Competition Comm'n, Commission Withdraws Case against Clover, Ladismith, Nestle, and Parmalat (Apr. 20, 2011), available at <http://www.compcom.co.za/assets/Uploads/AttachedFiles/MyDocuments/final-media-release-on-the-milk-case.pdf>.

152. Woodlands Dairy v. Milkwood Dairy 2010 (105) SA 1 (ZASCA) (S. Afr.); see also Ann Crotty, *Milk Cartel Ruling 'Terrible'*, SA TIME (Sept. 15, 2010), [www.iol.co.za/business/business-news/milk-cartel-ruling-terrible-1.692687](http://www.iol.co.za/business/business-news/milk-cartel-ruling-terrible-1.692687).

153. There are more examples of cartel cases. In *Competition Comm'n. v. New Reclamation Group 2008 (37) CR 1 (CT) (S. Afr.)*, the New Reclamation Group confessed to the Commission of its involvement in fixing the price of scrap metal. It was punished with an administration fine of R145,972,065. In *Competition Comm'n. v. Adcock Ingram Critical Care & Tiger Brands Ltd. 2008 (20) CR 1 (CT) (S. Afr.)*, the Commission alleged "that the respondents allocated customers and specific types of goods and services during 2001 and 2002 and engaged in collusive tendering for the supply of large volume parenterals (intravenous medical products) to State Hospitals during 1999 to 2007." Adcock Ingram admitted liability to the Commission during the investigation and agreed to pay an administrative penalty of R53 502 800. This amount represented eight percent of Adcock Ingram's turnover for the financial year ending in 2007. See also Monnye & Afrika, *supra* note 119.

154. Competition Act 89 of 1998 § 61(2) (S. Afr.).

155. See Monnye & Afrika, *supra* note 119.

156. Sherman Antitrust Act of 1890, 15 U.S.C. § 1 (2004).

157. Competition Act, R.S.C. 1985, c. C-34 § 45(2) (Can.).

158. Enterprise Act, (2002) § 188, 1 CURRENT LAW.

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E. CONCLUDING REMARKS

South Africa has an Agreement on Trade, Development, and Cooperation with the European Union,<sup>159</sup> which extends to competition-related matters.<sup>160</sup> Article 35 of the Agreement lists corporate agreements and concerted practices that are incompatible with the validity of the Agreement and that could affect trade between the European Union and South Africa, and where pro-competitive effects do not outweigh such anti-competitive behavior.<sup>161</sup>

An infringement of the anti-competitive provisions of this agreement might lead to direct assistance by the European Union in cases where the South African competition authorities discover a cartel that might affect trade with the European Union or a cartel that has operation in both South Africa and the European Union, thus having effect in the European Union.

**IV. Brazil**

As a dynamic emerging market economy, Brazil has become the host country to many MNCs. In the past, the Brazilian economy was largely centralized and the state took responsibility for regulating and fixing prices.<sup>162</sup> When this system was abolished in the 1990s, corporations enjoyed more economic operative freedom.<sup>163</sup> Consequently, the need for more stringent competition regulation arose to ensure that corporations did not abuse their new position of economic freedom.<sup>164</sup> Changes to the competition legislation formed part of many responses by the Brazilian government to high inflation.<sup>165</sup> In 1994 a new competition law was enacted.<sup>166</sup> Brazil has many cooperation agreements with other countries' competition agencies. These include, inter alia, agreements with Canada, the United States, Chile, the European Union, and Russia.<sup>167</sup>

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159. Agreement on Trade Development and Cooperation, E.C.-S. Afr., Jul. 29, 1999, 142 O.L.J. 311.

160. *Id.*

161. *Id.* art. 35, ¶ 1(a) includes "agreements and concerted practices between firms in horizontal relationships . . . which have the effect of substantially preventing or lessening competition in the territory of the Community or of South Africa, unless the firms can demonstrate that the anti-competitive effects are outweighed by pro-competitive ones . . . ."

162. See GLOBAL COMPETITION REVIEW, THE ANTTITRUST REVIEW OF THE AMERICAS (2009), available at <http://www.globalcompetitionreview.com>); see also John W. Clark, Competition Policy and Regulatory Reform in Brazil: A Progress Report, 2 OECD J. COMPETITION L. & POL'Y 1 (2000) for a comprehensive summary on the competition law developments in Brazil.

163. *Id.*

164. *Id.*

165. See ORG. FOR ECON. CO-OPERATION AND DEV., COMPETITION LAW AND POLICY IN BRAZ. 10 (2010), available at <http://www.oecd.org/dataoecd/4/42/45154362.pdf>.

166. Decreto No. 8884, de Junho de 1994, DIARIO OFICIAL DA UNIAO [D.O.U.] de 11.6.1994 (Braz.).

167. All these agreements are retrievable from <http://www.mj.gov.br/sde>.

A. THE LEGAL FRAMEWORK AND PROHIBITED PRACTICES

Brazil has various statutes that are intended to prevent anti-competitive activities such as cartels.<sup>168</sup> Law No. 8,884/94, the Federal Competition Act (hereafter Federal Law), Law No. 8,137/90; the Brazilian Economic Crimes Law, which criminalizes certain cartel conduct;<sup>169</sup> Law No. 10,446/02, which allows for investigations into cartels with interstate or international impact; and the Presidential Decree of October 7, 2008, which designated October 8 of each year as the annual Anti-Cartel Enforcement Day in Brazil.<sup>170</sup> It is no coincidence that the first leniency agreement,<sup>171</sup> in terms of the Brazilian Leniency Program, came into effect on October 8, 2008. The subsequent proclamation of this day as the official Anti-Cartel Day serves as a further indication of the Brazilian authority's commitment to curb hardcore cartels.<sup>172</sup>

The Federal Law promotes free competition and consumer protection.<sup>173</sup> It has jurisdiction over "individuals, private or public companies, as well as any individual or corporate associations, established *de facto* and *de jure* [on the territory of Brazil]<sup>174</sup>—even on a provisional basis —"irrespective of a separate legal nature, and notwithstanding the exercise of activities" considered legal monopolies.<sup>175</sup> It further provides that the "company and each of its managers or officers shall be jointly liable to the various forms of infringement of the economic order."<sup>176</sup> Articles 20 and 21 of the Federal Law define which corporate behaviors qualify as a violation of the economic order.<sup>177</sup>

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168. INT'L COMPETITION NETWORK, ANTI-CARTEL ENFORCEMENT TEMPLATE, SUBGROUP 2: ENFORCEMENT TECHNIQUES 2 (2009), [http://www.cade.gov.br/upload/Brazil\\_ICN%20Cartel%20Template\\_April%202009.pdf](http://www.cade.gov.br/upload/Brazil_ICN%20Cartel%20Template_April%202009.pdf).

169. Brazilian Economic Crimes Law, No. 8,137/90, § 4.

170. SECRETARIAT OF ECONOMIC LAW, MINISTRY OF JUSTICE, BRAZIL'S ANTI-CARTEL PROGRAM, *available at* <http://www.internationalcompetitionnetwork.org>.

171. In terms of the Brazilian Leniency Program, which was launched in 2000, an agreement might be negotiated by the SDE and an applicant for leniency if (i) the applicant is the first to come forward and confesses his participation in the unlawful practice; (ii) the applicant ceases its involvement in the anticompetitive practice; (iii) the applicant was not the leader of the activity being reported; (iv) the applicant agrees to fully cooperate with the investigation; (v) the cooperation results in the identification of other members of the conspiracy, and in the obtaining of documents that evidence the anticompetitive practice; (vi) at the time the company comes forward, the SDE has not received sufficient information about the illegal activity to ensure the condemnation of the applicant. Secretariat of Economic Law et al., *Fighting Cartels: Brazil's Leniency Program*, BRASÍLIA-DF, CEP 70064-900, 17, 20 (3rd ed. 2009).

172. See ANTI-CARTEL ENFORCEMENT TEMPLATE, *supra* note 168.

173. Federal Law, Decreto No. 8884: 1, de Junho de 1994, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 11.6.1994 (Braz.).

174. *Id.* art. 15 ("[A] foreign company is deemed resident in the Brazilian territory if it operates or has a branch, affiliate, subsidiary, office or place of business, agent or representative in Brazil."); *id.* art. 2.

175. *Id.* art. 15.

176. *Id.* art. 16.

177. *Id.* art. 20. This includes any act that in any way intended or otherwise is able to limit, restrain or in any way injure open competition or free enterprise; to control a relevant market of a certain product or service; to increase profits on a discretionary basis; and to abuse one's market control.

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B. ENFORCEMENT BODIES

The Brazilian Competition Policy System has three bodies<sup>178</sup> for the enforcement of the antitrust legislation:<sup>179</sup> the Secretariat of Economic Monitoring (Secretaria de Acompanhamento Econômico), which is part of the Finance Ministry; the Administrative Council for Economic Defense (Conselho Administrativo de Defesa Econômica); and the Secretariat of Economic Law Enforcement (Secretaria de Direito Econômico), which is part of the Justice Ministry.

The Secretariat of Economic Monitoring (SEAE) is a governmental investigative agency. Its main responsibilities include certain investigative and advisory duties under the competition laws of Brazil, providing economic analysis for economic regulator programs and monitoring market conditions in Brazil.<sup>180</sup> The SEAE may issue non-binding economic opinions in merger reviews and anti-competitive activities.<sup>181</sup>

The Administrative Council for Economic Defense (CADE) was created under Law No. 4137 of September 1962.<sup>182</sup> In terms of the Federal Law, CADE became a federal independent agency with the responsibility to ensure compliance with the Federal Law and its regulations.<sup>183</sup> CADE's board consists of a president and six other board members.<sup>184</sup> Its duties include, inter alia, the task of resolving "purported violations of the economic order" and applying the penalties provided by law, resolving "proceedings instituted by the Secretariat of Economic Law Enforcement," and ordering action to counter possible violations of the economic order.<sup>185</sup>

The Secretariat of Economic Law Enforcement (SDE) seems to be the Brazilian equivalent to the South African Competition Commission and thus the chief investigative body regarding anticompetitive activities<sup>186</sup> It is headed by a secretary who is appointed by the Minister of Justice.<sup>187</sup> SDE's duties include, among others, the enforcement of market compliance with Brazil's Federal Law by monitoring and following up on market practices.<sup>188</sup>

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178. CADE, THE BRAZILIAN SYSTEM OF COMPETITION POLICY, available at <http://www.cade.gov.br/upload/WTOgenevaSBDCtradepolicy2.pdf>.

179. OECD, COMPETITION LAW AND POLICY IN BRAZIL: A PEER REVIEW 11 (2010), available at <http://www.oecd.org/dataoecd/4/42/45154362.pdf>.

180. See generally *id.* (discussing the various roles of the SEAE).

181. *Id.* at 29.

182. Federal Law, art. 3; PEER REVIEW, *supra* note 179, at 10.

183. Federal Law, art. 7.

184. *Id.* art. 4. These members are chosen from among citizens older than thirty years of age reputed for their legal or economic knowledge and unblemished reputation, duly appointed by the President of the Republic of Brazil after their approval by the Senate.

185. *Id.* art. 7.

186. See *Defensa da Concorrença*, <http://www.mj.gov.br/sde> (last visited Jan. 15, 2012).

187. Federal Law, art. 13.

188. *Id.* art. 14(1) ("to ensure compliance with the Federal Law by monitoring and following up on market practices") and art. 14(2) ("to provide for ongoing follow-up on business activities").



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C. A BRIEF OVERVIEW OF CARTEL CASES IN RECENT YEARS

1. *The Rio de Janeiro – São Paulo Airline Case*<sup>189</sup>

In this case, newspapers started the investigation into an affair, which became known as the São Paulo Airline Case. It was alleged that presidents of certain domestic airlines colluded in price fixing ticket prices for the Rio de Janeiro-São Paulo route, because all the ticket prices were going up by ten percent. CADE found the airlines guilty of collusion to increase prices and each airline was fined an amount equivalent to one percent of their revenue on that route.<sup>190</sup>

2. *The Rio de Janeiro Newspaper Case*<sup>191</sup>

In this case, four newspapers in Rio de Janeiro increased their prices by the same price and percentage rates. CADE investigated the matter and found the newspapers guilty of anti-competitive behavior. Each paper was fined one percent of its annual revenue.<sup>192</sup>

3. *The Flat Steel Cartel Case*<sup>193</sup>

This case concerned an agreement between competitors in the steel industry in which the parties planned to increase the prices of flat-rolled steel products. SEAE discovered that certain companies, which were members of the Brazilian Steel Institute, planned to increase the price of flat steel simultaneously. SEAE informed the companies that their plans could lead to a possible disturbance of the economic order; nonetheless, the companies proceeded with the increase. Reasons for the price adjustment, as provided by the relevant companies, were considered unconvincing and the companies were found guilty of price fixing. CADE fined each company one percent of their annual revenue before the proceedings against them were filed.<sup>194</sup>

D. PENALTIES

Article 23 of the Federal Law determines the applicable penalties for anticompetitive behavior that violates the economic order. Companies shall be fined one to thirty percent of the gross, pre-tax revenue of the company in its latest financial year. The fine shall not be lower than the actual competition advantage gained from the infringement. Managers or other officers shall be fined ten to fifty percent of the fine imposed on the company, and the manager will be personally liable for paying this fine. For other individuals and public or private entities, as well as any de facto or de jure associations of entities or persons, even temporary ones, with or without legal identity, the fine can total anywhere

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189. See OECD, GLOBAL FORUM ON COMPETITION'S ROUNDTABLE ON PROSECUTING CARTELS WITHOUT DIRECT EVIDENCE OF AGREEMENT: A CONTRIBUTION BY BRAZIL 3-5 (2006), available at <http://www.oecd.org/dataoecd/61/28/36063750.pdf>.

190. INTER-AMERICAN DEVELOPMENT BANK, COMPETITION LAW AND POLICY IN LATIN AMERICA: PEER REVIEWS OF ARGENTINA, BRAZIL, CHILI, MEXICO AND PERU 76 (2006).

191. See A CONTRIBUTION BY BRAZIL, *supra* note 189, at 82.

192. *Id.*

193. See Clark, *supra* note 162, at 193, for a summary of the case.

194. See A CONTRIBUTION BY BRAZIL, *supra* note 189, at 82.

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between six thousand and six million Brazilian real. In case of a repetition of such an infringement, such fines can be doubled.<sup>195</sup>

**V. India**

**A. LEGAL FRAMEWORK**

The Supreme Court of India stated the primary purpose of competition law is “to remedy some of those situations where the activities of one firm or two lead to the breakdown of the free market system, or, to prevent such a breakdown by laying down rules by which rival businesses can compete with each other.”<sup>196</sup> The first competition legislation in India was the Monopolies and Restrictive Trade Practices Act of 1969 (MRTP Act), which came into force in June 1970.<sup>197</sup> The aim of the MRTP Act was to “provide that the operation of the economic system did not result in the concentration of economic power to the common detriment, for the control of monopolies, for the control of monopolistic and restrictive trade practices and for matter connected therewith or incidental thereto.”<sup>198</sup> Indian authorities felt the need to keep competition policies in line with international economic developments.<sup>199</sup> In 1999, the Indian government appointed the Raghavan Committee, a committee on Competition Policy and Law.<sup>200</sup> In light of India’s growing role as a global economic player, the task of the Raghavan Committee was to oversee Indian competition policies in order to ensure compliance with international competition law developments.<sup>201</sup> Upon submitting the committee’s report, the new Competition Act of 2002 (Competition Act) was enacted. The Competition Act came into effect on September 1, 2009.<sup>202</sup> The overall aim of the act is to “prevent practices that would have an adverse effect on the development of fair competition, to promote and sustain competition in the markets, to protect the interest of consumers and to ensure freedom of trade carried on by other participants in markets in India.”<sup>203</sup> Section 3 of the Competition Act prohibits cartel activity in India “in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services which causes or is likely to cause an appreciable adverse effect on competition.”<sup>204</sup> The Competition Act makes provisions for the Competition Committee of India (CCI) to enter into any memorandum or arrangement with any agency of any foreign country “for the purpose of discharging its duties or performing its functions under this Act.”<sup>205</sup> This may be done with the prior

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195. See Federal Law, art. 23.

196. Competition Comm’n of India v. Steel Authority of India, (2010) 10 S.C.C. 744, 744-45 (India).

197. ANURAG K. AGARWAL, COMPETITION LAW IN INDIA: NEED TO GO SLOW AND STEADY 3 (2005) available at <http://www.iimahd.ernet.in/publications/data/2005-10-05anurag.pdf>.

198. The Monopolies and Restrictive Trade Practices Act, No. 54 of 1969, INDIA CODE (1969).

199. See ARGARWAL, *supra* note 197.

200. Debashree Dutta, *New Competition Regime in India*, LEGALSERVICEINDIA, <http://www.legalserviceindia.com/articles/neew.htm> (last visited Jan. 15, 2011).

201. *Id.*

202. GLOBAL COMPETITION REVIEW, THE ASIA-PACIFIC ANTITRUST REVIEW (2010), available at <http://www.globalcompetitionreview.com>.

203. The Competition Act, 2002, No. 12, Acts of Parliament, 2003 (India).

204. *Id.* § 3(1).

205. *Id.* § 18.

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approval of the Central Government of India.<sup>206</sup> Consequently if the Indian competition authorities feel that cartels will be addressed more efficiently through cooperation, it has the possibility to cooperate with other countries. This intention of Indian authorities was already noticeable during a BRIC international competition conference held in Kazan, Russia.<sup>207</sup> The CCI issued a statement saying that “the (BRIC nations) resolved to take effective measures to tackle cartels and anti-competitive agreements . . . they also stressed upon the need of co-operation and exchange of views and experiences on the matters relating to competition policy development.”<sup>208</sup>

**B. ENFORCEMENT**

The CCI was established under the Competition Act<sup>209</sup> and became operational on October 14, 2003.<sup>210</sup> It “consist[s] of a Chairperson and not less than two and not more than ten other Members [who are all] appointed by the Central Government [of India].”<sup>211</sup> The CCI has “the duty . . . to eliminate practices that have an adverse effect on competition, promote and sustain competition, protect the interest of consumers and ensure freedom of trade carried on by other participants, in markets in India.”<sup>212</sup> It has the power to start inquiries into any alleged contravention of the Competition Act.<sup>213</sup> The Commission can make any order it deems fit should there be a contravention of the Act.<sup>214</sup> The Competition Amendment Act of 2007 amended the Competition Act. The amendment makes provisions for the establishment of a Competition Appellate Tribunal (CAT). The CAT may “hear and dispose of appeals against any direction issued or decision made or order passed by the [CCI].”<sup>215</sup> The CAT “shall consist of a Chairperson and not more than two other Members who will be appointed by the Central Government [of India].”<sup>216</sup> Any decision or order of the CAT may be challenged in the Supreme Court of India.<sup>217</sup>

The revamp of the Indian competition regime also had implications for old cases, investigations, and proceedings started under the auspices of previous competition authorities. The Monopolies and Restrictive Trade Practices Commission (MTRPC) was allowed two years to complete open pending matters after the commencement of the Competition Act in September 2009.<sup>218</sup> From September 2011 on, open cases will be transferred to the Appellate Tribunal for further adjudication.<sup>219</sup> Therefore, because the MTRPC was go-

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206. *Id.*

207. *BRIC Nations to Tackle Cartels Together*, INDIANEXPRESS (Sept. 4, 2009, 1:23 AM), <http://www.indianexpress.com/news/bric-nations-to-tackle-cartels-together/512603>.

208. *Id.*

209. The Competition Act, 2002, No. 12 § 7(1), Acts of Parliament, 2003 (India).

210. Dep’t of Co. Affairs, *The Establishment of the Competition Commission of India*, F. No. 1/10/2003-CL. V (Oct. 14, 2003).

211. The 2002 Competition Act, § 8(1).

212. *Id.* § 18.

213. *Id.* § 19(1).

214. *Id.* § 27.

215. The Competition (Amendment) Act, 2007, No. 70 § 53A(1)(a), Acts of Parliament, 2007 (India).

216. *Id.* § 53C.

217. *Id.* § 53T.

218. *Id.* cl. 50.

219. The 2002 Competition Act, § 66(3).

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ing to dissolve as current matters were taken care of, no new cases were taken by the commission. All of the cases dealing with unfair trade practices, with a few exceptions,<sup>220</sup> were transferred to the National Commission, which was established in terms of the Consumer Protection Act 68 of 1986 (Consumer Act). These cases will be adjudicated as if the cases were filed under the Consumer Act.<sup>221</sup>

C. A SHORT OVERVIEW OF CARTEL INQUIRIES BEFORE THE CCI IN RECENT YEARS

1. *The Glass Bottles Manufacturers' Inquiry*<sup>222</sup>

In this case, a complaint was filed with the Monopolies and Restrictive Trade Practices Commission (MTRPC)<sup>223</sup> and the complaint was transferred to the Competition Commission after it started operating as India's competition enforcement body. The complainant, *All Indian Distillers' Association*, alleged that four of India's major glass bottle manufacturers had formed a cartel and were increasing the sale price of the glass bottles arbitrarily on the pretext of the increase in raw material such as soda ash. The Competition Commission dismissed the case as being based on unsubstantiated rumors, thus not confirming the existence of a cartel between the four glass bottles manufacturers because

as far as the allegation of cartelization by the respondent glass manufacturers is concerned, no reliable material has been placed on record which can lend support to such assertion. Definitely something more than bare allegations is needed to show concerted action on the part of the respondents to fix the prices of glass bottles.<sup>224</sup>

2. *The Hard Disk Drive Industry Inquiry*<sup>225</sup>

Here, a complaint was lodged against a multinational company that had its head office in the Cayman Islands. The complaint alleged that the company, besides other competition law transgressions such as abusing its dominance, was involved in cartel activities with other manufacturers of hard disk drives to increase the prices of hard disk drives as a whole in India. However, the CCI in this case also found that the existence of the alleged cartel was not sufficiently proven by the complainant after scrutiny of the complainant's documentation.

While it is too soon to make a judgment on whether the CCI will ensure the fair enforcement of the competition legislation of India and apply sanctions provided under the Competition Act, the just mentioned cases give rise to some optimism.

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220. Those cases on unfair practices referred to in clause (x) of sub-section(1) of 36A of the MRTP Act which will be transferred to the CAT.

221. The 2002 Competition Act, § 66(4).

222. *All India Distillers' Ass'n, New Delhi v. Haldyn Glass Gujarat Ltd. Baroda & Ors.*, UTPE Case No. 30(146)/ 2008, (Competition Comm'n of India 2010).

223. The MRTPC is a quasi-judicial organ which is tasked to prevent unfair trade practice from happening and works closely with the Central Government of India. *Monopolies and Restrictive Trade Practices Commission (MRTPC)*, MINISTRY OF CORPORATE AFFAIRS GOVERNMENT OF INDIA, <http://www.mca.gov.in/Ministry/mrtpc.html> (last visited Jan. 15, 2011).

224. *Id.* at 4.

225. *Suresh Goel v. Seagate Singapore International Headquarter Pvt. Ltd.*, File No. C- 35/2008/DGIR (Competition Comm'n of India 2010).

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D. CONCLUSION

The benefits of bilateral agreements regarding international cartels are clear—only a synchronized and international approach will help the developing nations in protecting their markets from unfair competition practices. This article has shown the state of anti-cartel policies and legislation in selected jurisdictions, the present state of the coordination of competition policies through cooperation at the bi-national and international level, and highlighted some examples of more publicized anti-competition cases. One observation is that more could be done by the developing NIC nations to increase the collaborative ties of their anti-competition policies and organs as well as ensure that they fall under the wider umbrella of regional competition regimes, such as in the case of South Africa and the European Union. The necessity of safeguarding consumer welfare through effective domestic anti-competition frameworks was highlighted in the discussed cartel cases. Time will tell whether the emerging economies will be able to balance competition policy and consumer welfare in an effective and progressive way without affecting their trade and investment policies.

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## **What’s Wrong with Forum Shopping? An Attempt to Identify and Assess the Real Issues of a Controversial Practice**

MARKUS PETSCHÉ\*

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**Abstract**

*International forum shopping is a controversial issue. While some legal scholars view this practice as a legitimate pursuit of the client's best interest, the existence of doctrines such as forum non conveniens suggests that, at least in some jurisdictions, forum shopping is considered an undesirable and abusive tactic. If the prevailing view is critical of forum shopping practices, no serious attempt to determine the nature and extent of the presumed detrimental impact of those practices has been made to date. This article offers an analysis of the various aspects of the potentially adverse effect of forum shopping on the fairness and efficiency of international dispute resolution. This article will show that such adverse impact is more limited than most critical authors seem to believe. It also highlights the existence of several incentives for litigants not to engage in forum shopping behavior.*

**Introduction**

Forum shopping, both domestic and international, remains a controversial subject.<sup>1</sup> There are, in fact, at least three distinct scholarly positions concerning the appropriateness or legitimacy of forum shopping.<sup>2</sup> The prevailing view seems to be that forum shopping is necessarily “bad” and should thus be avoided or prohibited.<sup>3</sup> For instance, several authors deplore that uniform law conventions have been unable to “eliminate” forum shopping opportunities,<sup>4</sup> implying that such practice is undesirable. A number of other

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1. Domestic forum shopping usually involves choices between courts of different territorial subdivisions and, where applicable, between federal and state courts. To a lesser extent, it may involve a choice between different “types” of courts (e.g. between a civil and a criminal court). In some countries (and notably the United States), domestic forum shopping receives significantly more attention than its international counterpart. For contributions that address both types of forum shopping from an essentially U.S. perspective, see, e.g., Friedrich K. Juenger, *Forum Shopping, Domestic and International*, 63 TUL. L. REV. 553, 553 (1989); Ralph U. Whitten, *U.S. Conflict-of-Laws Doctrine and Forum Shopping, International and Domestic (Revisited)*, 37 TEX. INT'L L.J. 559, 559 (2002).

2. Every categorization of doctrinal viewpoints is necessarily simplistic and fails to reflect the complexity and specificities of the opinions of the various authors. However, it is useful to highlight the basic differences between their respective approaches.

3. That the traditionally prevailing opinion is critical of forum shopping is notably illustrated by the various attempts to refute this point of view. See *infra* notes 7-9. A number of authors have questioned the basic assumption that forum shopping is undesirable. See, e.g., Richard Maloy, *Forum Shopping? What's Wrong With That?*, 24 QLR 25, 25 (2005) (objecting to the “rhetoric [which] simply proclaim[s], almost ipse dixit, that forum shopping [is] wrong, without the slightest explanation as to why.”) (internal quotation omitted).

4. See Franco Ferrari, *'Forum Shopping' Despite International Uniform Contract Law Conventions*, 51 INT'L & COMP. L.Q. 689, 689 (2002) (stating that “[o]ne of the asserted advantages and goals of the unification of substantive law lies in the prevention of ‘forum shopping’” and that “the entry into force of international uniform contract law conventions . . . cannot prevent ‘forum shopping’”). However, Professor Ferrari does not himself express a final opinion on whether forum shopping is problematic or undesirable. Instead, he acknowledges that, “instead of criticising and condemning ‘forum shopping’”, it would be more useful to study “the reasons underlying the policy against ‘forum shopping’”. *Id.* at 707; see also Franco Ferrari, *International Sales Law and the Inevitability of Forum Shopping: A Comment on Tribunale di Rimini*, 26 November 2002, 23 J.L. & COM. 169, 169 (2003-2004); Stéphanie Grignon-Dumoulin, *Forum shopping—Article 31 de la CMR*, 11 UNIF. L. REV. 609, 609-10 (2006) (deploring the fact that, under the CMR Convention, a fundamental question such as the determination of default “considered as equivalent to willful misconduct” is governed by the domestic law of the court seized, rather than by uniform rules and stating that the availability of a variety of forums inevitably leads to forum shopping and, therefore, inequalities and lack of legal security).



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writers implicitly condemn forum shopping through their approval of the doctrine of *forum non conveniens*,<sup>5</sup> allegedly the principal tool to combat forum shopping.<sup>6</sup>

A second group of scholars takes issue with this traditional perception and argues that there is nothing “wrong”<sup>7</sup> with forum shopping because litigants merely avail themselves of legal options that arise from the relevant jurisdictional rules.<sup>8</sup> Any lack of decisional uniformity that may result from forum shopping is not only unavoidable, but even “desirable.”<sup>9</sup> For lawyers, helping their clients locate the most favorable forum is not unethical; on the contrary, they would not be fulfilling their legal duties towards their clients if they failed to make use of jurisdictional options.<sup>10</sup>

A third category of writers, not always easily distinguishable from the second,<sup>11</sup> is less unconditional in their approval of forum shopping. Those authors argue that, depending on the particular circumstances, forum shopping may be either “good” or “bad.”<sup>12</sup> They attempt to define at what point forum selection can be considered as “unfair” or inappropriate in order to distinguish permissible from impermissible forum shopping.<sup>13</sup> To this end, they rely on a number of judicial precedents where courts have either allowed or disallowed particular instances of forum shopping.<sup>14</sup>

What these diverging opinions reveal is that, first of all, there seems to be no agreement on the exact meaning of the concept of forum shopping. Some authors suggest that forum shopping consists of “the parties attempting to bring the case in a forum that will be

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5. See, e.g., Ronald A. Brand, *Comparative Forum Non Conveniens and the Hague Convention on Jurisdiction and Judgments*, 37 TEX. INT'L L.J. 467, 467 (2002); C. G. J. Morse, *Not in the Public Interest? Lubbe v. Cape PLC*, 37 TEX. INT'L L.J. 541, 541 (2002); Linda J. Silberman, *Developments in Jurisdiction and Forum Non Conveniens in International Litigation: Thoughts on Reform and a Proposal for a Uniform Standard*, 28 TEX. INT'L L.J. 501, 501 (1993).

6. See, e.g., Maloy, *supra* note 3, at 55 (referring to *Botello v. Ill. Cent. R.R. Co.*, 809 N.E.2d 197, 208 (Ill. App. Ct. 2004)).

7. Professor Juenger explicitly poses the question: what is wrong with forum shopping? His rather categorical answer is that there is nothing wrong with this practice. See Friedrich K. Juenger, *What's Wrong with Forum Shopping?*, 16 SYDNEY L. REV. 5, 13 (1994) (“[T]here must be a stop put to the customary, almost ritualistic, condemnation of forum shopping”); see also Maloy, *supra* note 3, at 25.

8. See Juenger, *supra* note 7, at 9.

9. *Id.* at 10-11 (considering that the quest for decisional uniformity is “futile” and that it fails to produce good results because the “application of choice-of-law rules that are blind to substantive values” leads to a “massive influx of substandard foreign substantive rules”).

10. See Mary Garvey Algero, *In Defense of Forum Shopping: A Realistic Look at Selecting a Venue*, 78 NEB. L. REV. 79, 81 (1999) (observing that, if an attorney does not seek the most advantageous venue for his client, he could face a malpractice claim).

11. It is not always clear to what extent individual writers tolerate or support the practice of forum shopping. Even a fervent advocate of forum shopping such as Professor Juenger accepts the idea that, “[i]n egregious cases . . . the forum non conveniens doctrine or injunctions to restrain foreign proceedings offer redress to those seriously inconvenienced”. See Juenger, *supra* note 7, at 13.

12. See, e.g., Maloy, *supra* note 3, at 25 (stating that, “like cholesterol and trolls, forum shopping can be good, and forum shopping can be bad”).

13. *Id.* at 33-44 (discussing permissible forum shopping) and 44-50 (discussing impermissible forum shopping). Professor Dowling distinguishes between “forum selection” and “forum shopping.” See Donald C. Dowling, Jr., *Forum Shopping and Other Reflections on Litigation Involving U.S. and European Businesses*, 7 PACE INT'L L. REV. 465, 467 (1995). However, his distinction is not based on whether a particular practice can be considered as fair or appropriate, but rather on the idea that what a plaintiff regards as legitimate forum selection may be perceived as “forum shopping” by the defendant.

14. See, e.g., Maloy, *supra* note 3, at 33-50.

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advantageous to them”<sup>15</sup> or “the act of seeking the most advantageous venue in which to try a case.”<sup>16</sup> Though sensible, those definitions are inappropriately broad because they hardly leave any room for a distinction between forum “shopping” and mere forum “selection.” In fact, any plaintiff who has a choice between two or several forums, will—normally—opt for the “most advantageous” one.

Other scholars take the view that, in order for a practice to be considered as forum shopping, it must involve some element of “unfairness.” Professor Juenger, for example, observes that “counsel, judges and academicians employ the term ‘forum shopping’ to reproach a litigant who, in their opinion, *unfairly* [emphasis added] exploits jurisdictional or venue rules to affect the outcome of a lawsuit.”<sup>17</sup> Similarly, Professor Maloy submits that “forum shopping is the taking of an *unfair* [emphasis added] advantage of a party in litigation.”<sup>18</sup>

This article takes the position that the more adequate definition of forum shopping is the second, more restrictive one. If forum shopping is to be a useful concept, it must have a meaning that is different from mere “forum selection.” Assuming that certain practices of forum selection are indeed “bad” (for example, because they are “unfair”, as Professors Juenger and Maloy suggest), then the term “forum shopping” would adequately apply as a concept that characterizes only specific forms of forum selection. If there were no such thing as “bad” forum selection, then the term forum shopping simply would have no legitimacy and should be avoided. In other words, either forum shopping is different from forum selection, or it does not exist at all.

The second lesson to be learned from the discrepancies between scholarly opinions on forum shopping is that there seems to be no clear, agreed upon answer to the question: “what, if anything, is wrong with forum shopping?”<sup>19</sup> The opponents of forum shopping are unable or unwilling to point out what exactly it is that makes this practice undesirable or “bad.” The argument put forward by its advocates that forum shopping cannot possibly be “bad” because law authorizes it is simplistic and notably fails to explain the contradiction that exists between the apparent authorization of forum shopping and doctrines aimed at curtailing such practice.<sup>20</sup> The authors of the “golden middle” have shown that courts tolerate certain types of forum shopping (more appropriately, forum selection) and

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15. See Patrick J. Borchers, *Punitive Damages, Forum Shopping, and the Conflict of Laws*, 70 LA. L. REV. 529, 530 (2010).

16. See Algero, *supra* note 10, at 79. Courts have sometimes adopted similar definitions. A California court, for example, has defined forum shopping as “the practice of choosing the most favorable jurisdiction . . . in which a claim might be heard”. See *California v. Posey*, 82 P.3d 755, 774 n.12 (Cal. 2004) (quoting BLACK LAW DICTIONARY 666 (7th ed. 1999)).

17. Juenger, *supra* note 1, at 553.

18. Maloy, *supra* note 3, at 28.

19. This is, it is recalled, the question posed by Professors Juenger and Maloy in their respective articles. See *supra* notes 3 and 7.

20. The principal doctrine aimed at rendering attempts to forum shop ineffective is the doctrine of *forum non conveniens*. In very simplistic terms, this doctrine allows a court, in certain circumstances, to decline to exercise jurisdiction if a more “convenient” or “appropriate” forum exists. For basic commentary on this doctrine, see, e.g., Brand, *supra* note 5. For an excellent critical examination of *forum non conveniens*, see Hu Zhenjie, *Forum Non Conveniens: An Unjustified Doctrine*, 48 NETH. INT’L L. REV. 143 (2001).

not others,<sup>21</sup> but have not (yet) offered a test, let alone a theory, allowing to separate forum selection from forum shopping.

This article, bearing in mind Professor Ferrari's proposal for further inquiry,<sup>22</sup> intends to make a step forward in understanding why and how forum selection can be "bad." A better and more profound understanding of this question is indeed vital, as it is necessary not only in order to design appropriate policies to address forum shopping (if at all necessary), but also in order to assess current practices. While this article is primarily concerned with *international* forum shopping, references are made to decisions and commentary relating to domestic forum shopping (especially in the United States), to the extent that those can adequately be transposed to the international level.

The first part of this article attempts to identify the 'criteria' by which the potentially detrimental impact of forum selection can be measured. Other writers have addressed some of those criteria, generally in an isolated fashion, but none have provided an all-encompassing analysis or conceptualization of the potential problems caused by forum selection. Based on this determination of potential problem areas, this article analyzes the nature and extent of the possible adverse effect of forum selection. The latter is more limited than most critical writers habitually think, and some traditional criticisms are fundamentally ill conceived.

The second part of this article explores how significant or "real" the potentially adverse impact of forum selection is as a matter of practice. To this effect, this article discusses two factors that contribute to limiting the actual detrimental effect of forum shopping. First, the article shows that the very *raison d'être* of forum shopping opportunities, namely the availability of jurisdictional alternatives, is beneficial to the international dispute resolution "system." In other words, the existence of opportunities to forum shop is deliberate and, in this sense, unavoidable. Second, this article explains that, from the point of view of prospective plaintiffs, there are incentives to refrain from forum shopping—for them, forum shopping frequently represents a "Damocles sword."

### **I. An Analysis of the Potentially Detrimental Impact of Forum Selection**

When attempting to determine the potentially adverse consequences of forum selection, it is helpful to consult the writings of scholars who have discussed the issue of forum shopping.<sup>23</sup> In addition, useful insights can be gained from judicial applications of the

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21. Unfortunately, courts use the term forum shopping not only when they disapprove of a particular forum selection (which generally causes them to dismiss the case), but also when they consider that a plaintiff's choice of forum should be tolerated. *See, e.g.* *Ferens v. John Deere Co.*, 494 U.S. 516, 520 (1990). In this case, a farmer who was injured while working on his farm in Pennsylvania failed to bring a claim in Pennsylvania within the two-year statutory time limit and thus filed negligence and product liability claims in a Mississippi federal district court. In addition, he moved for the case to be transferred to Pennsylvania on *forum non conveniens* grounds. Although the court found that such behavior constituted "forum shopping," it nevertheless granted the request.

22. *See* Ferrari, *Forum Shopping*, *supra* note 4, at 707. Professor Ferrari calls for "a study of the reasons underlying the policy against 'forum shopping,'" as well as for an examination of whether those reasons are "valid ones." This article undertakes the analysis contemplated by Professor Ferrari. It also examines whether, in addition to the problems he lists, there may be other factors that would justify a policy prohibiting forum shopping.

23. *See supra* notes 1, 3, 4, and accompanying text.

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doctrine of *forum non conveniens*, as well as from scholarly discussions of this principle.<sup>24</sup> In fact, as this article has already mentioned, the doctrine of *forum non conveniens* allows a court to dismiss a case even though it would “normally” have jurisdiction because of the “inconvenience”<sup>25</sup> (or inappropriateness) of the chosen forum. This inconvenience is, in fact, identical to what this article refers to as the detrimental impact of forum shopping.

A combined reading of the writings on forum shopping and those on *forum non conveniens* suggests that the two principal problems that forum selection may cause are (i) unfairness and (ii) lack of efficiency. This article will define the exact meaning of these fundamental notions hereinafter.<sup>26</sup> In addition, one cannot avoid discussing the issue of lack of decisional uniformity that is probably the most commonly mentioned drawback of forum shopping.<sup>27</sup> Even though lack of uniformity is partly related to the issue of fairness, it is a more complex issue, and this article will thus examine it separately.<sup>28</sup>

One may, of course, identify additional problems that forum shopping may cause. Two related issues that have been identified are: (i) that forum shopping may “overburden certain courts,” and (ii) that forum shopping “creates unnecessary expenses” (ultimately born by the taxpayers) because cases may not be brought before the courts that are most closely connected to the facts of the dispute.<sup>29</sup> While this article does not deny the relevance of these issues, it will not address them because they reflect essentially public interests that are not the most vital ones when it comes to international litigation.

A. UNFAIRNESS OF FORUM SELECTION

Very few people would disagree with the idea that international litigation should be fair and that the plaintiff’s selection of a forum should not contravene this basic objective.<sup>30</sup> Professor Maloy considers that unfairness is the distinguishing feature of forum shopping (as opposed to mere forum selection).<sup>31</sup> U.S. courts addressing the question of forum

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24. See *supra* note 5; see also Christopher Bougen, *Conflicting Approaches to Conflicts of Jurisdiction: The Brussels Convention and Forum Non Conveniens*, 33 VICTORIA U. WELLINGTON L. REV. 261, 261 (2002); Gilles Cuniberti, *Forum Non Conveniens and the Brussels Convention*, 54 INT’L & COMP. L.Q. 973, 973 (2005); Richard G. Fentiman, *Jurisdiction, Discretion and the Brussels Convention*, 26 CORNELL INT’L L.J. 59, 59 (1993); Edwin Peel, *Forum Shopping in the European Judicial Area—Introductory Report*, Research Paper in University of Oxford Faculty of Law Legal Studies Research Paper Series, OXFORD LAW (Sept. 2006), available at <http://papers.ssrn.com/Abstract=927198>.

25. The term “inconvenience” does probably not constitute the most accurate description of situations that may trigger the application of *forum non conveniens*. On this point, see, e.g., *Spiliada Mar. Corp. v. Cansulex Ltd.*, [1987] A.C. 460 at 474 (Eng.) (opinion of Lord Goff expressing “doubt whether the Latin tag *forum non conveniens* is apt to describe this principle. For the question is not one of convenience, but of the suitability or appropriateness of the relevant jurisdiction”).

26. See *infra* Part I.A and I.B.

27. See, e.g., Thomas O. McGarity, *Multi-Party Forum Shopping for Appellate Review of Administrative Action*, 129 U. PA. L. REV. 302, 314 (1980) (discussing how forum shopping can “threaten . . . attempts to apply policy uniformly”).

28. See *infra* Part I.C.

29. See, e.g., Ferrari, *Forum Shopping*, *supra* note 4, at 707.

30. See David J. Dorward, Comment, *The Forum Non Conveniens Doctrine and the Judicial Protection of Multinational Corporations from Forum Shopping Plaintiffs*, 19 U. PA. J. INT’L ECON. L. 141, 151-52 (1998) (stating that the “most obvious problem with forum shopping is that it allows plaintiffs to exploit [unfair] loopholes in the system”).

31. Maloy, *supra* note 3, at 28.

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shopping have similarly recognized that this practice may lead to unfair results, in particular because it undermines equal protection of the law.<sup>32</sup> *Forum non conveniens* decisions also suggest that forum selection may be unfair.<sup>33</sup> In its first decision expressly dealing with this matter, the U.S. Supreme Court considered that a plaintiff's choice of forum "may not . . . 'vex', 'harass', or 'oppress' the defendant by inflicting . . . expense or trouble not necessary to his own right to pursue his remedy."<sup>34</sup> Courts in the United Kingdom<sup>35</sup> and Australia<sup>36</sup> have applied, and to some extent continue to apply,<sup>37</sup> similar standards.

Although forum shopping is regularly linked to the concept of "unfairness," neither court rulings nor academic discussions have clarified what exactly this means. To better understand how forum selection may "unfairly" disadvantage the defendant and what kind of unfairness may be at stake, it is necessary to start from the basic idea that fairness requires *equal* treatment of the parties to a dispute. Two aspects of such equal treatment can be distinguished. First, the parties should be equal with regard to the applicable laws (both substantive and procedural). Second, they should also be equal with regard to a number of other factors that may cause a particular forum selection to be, from a more practical point of view, more or less "convenient."

1. *Unfairness as Far as the Applicable (Substantive and Procedural) Laws are Concerned*

Let us first examine unfairness as far as the applicable laws are concerned. In forum shopping debates, it is generally acknowledged that forum selection may unduly favor the plaintiff, and thus disadvantage the defendant, when it comes to governing laws.<sup>38</sup> In fact, divergences between conflict of laws norms of possible forums (which lead to the application of different substantive laws),<sup>39</sup> as well as the "advantageousness" of the procedural rules

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32. *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938) (dealing with domestic forum shopping). In this case, the Court departed from the principle established in *Swift v. Tyson* (41 U.S. 1 (1842)), according to which federal diversity suits are governed by federal common law, which had led to a situation where outcomes varied within a single state depending on whether the case was brought in a state or a federal court. According to the Court, the *Swift* doctrine "had prevented uniformity in the administration of the law of the state" and, thus, "rendered impossible equal protection of the law." *Erie*, 304 U.S. at 75.

33. See Dorward, *supra* note 30, at 158.

34. *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 508 (1947). However, today, *forum non conveniens* dismissals in the United States no longer require a showing that the plaintiff's forum selection was vexatious or oppressive. See *Piper Aircraft Co. v. Reyno*, 454 U.S. 235 (1981).

35. This was the traditional approach in the United Kingdom. For early decisions affirming this rule, see, e.g., *Logan v. Bank of Scotland*, [1906] 1 K.B. 141 (A.C.) (Eng.); *St. Pierre v. S. Am. Stores (Gath & Chaves) Ltd.*, [1936] K.B. 382 (A.C.) at 398 (Eng.) (holding that in order for a *forum non conveniens* plea to be successful the defendant must notably prove that "the continuance of the action would work an injustice because it would be oppressive or vexatious to him").

36. Brand states "Australian courts have chosen to stay with the traditional theory of *forum non conveniens* requiring proof of process that is oppressive, vexatious, or abusive, rather than the more modern approach in other common law countries that focuses on the concept of the appropriate forum." See Brand, *supra* note 5, at 486.

37. However, in the United Kingdom, more recent decisions do not seem to require that the plaintiff's forum selection be oppressive or vexatious. See *Spiliada Maritime Corp. v. Cansulex Ltd.*, [1987] A.C. 460 (H.L.) (appeal taken from Eng.).

38. See, e.g., Juenger, *supra* note 1, at 571.

39. See Borchers, *supra* note 15, at 529-30 (arguing that plaintiffs "forum shop" in order to be awarded punitive damages and that they therefore examine whether the conflict norms of potential forums designate a substantive law which authorizes the allocation of such damages); see also Juenger, *supra* note 1, at 558 (stating

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of particular jurisdictions,<sup>40</sup> are commonly regarded as the reasons underlying a significant portion of forum shopping cases.

Thus, there may be instances where the result achieved by a particular forum selection may, at first sight, appear to be unfair. This may be the case, for example, where a resident of state A, who was injured in state A, files a lawsuit in state B because he did not bring a claim within the time limit stipulated under the laws of state A.<sup>41</sup> One may react in a similar way to a case where, in the aftermath of an airplane crash that occurred in country A and that involved a plane owned by an airline of country B, the heirs of the victims brought product liability cases in country C, notably in order to escape the otherwise applicable damages ceiling.<sup>42</sup> But what exactly makes (or could make) the behavior of these plaintiffs unfair?<sup>43</sup>

The first, most immediate, answer to this question is: nothing, really. In both cases, the basic question is whether a particular procedural (statute of limitations) or substantive (amount of damages) rule is unfair. This requires a comparative analysis of the outcomes produced by the rule applied by the court and those that may be applied by other courts potentially having jurisdiction. And, in reality, any statement suggesting that a law or rule of country A is fairer than a law or rule of country B is highly problematic. In particular, simplistic views equating the availability of a remedy with superior fairness are largely unjustified,<sup>44</sup> because they are generally based on an undue preference for one's domestic laws.

More fundamentally, both from a public international law and a conflict of laws point of view, the affirmation that a specific law of country A is "fairer" than, or superior to, a law of country B is hardly tenable. It would be incompatible with the basic notion that all states (and hence their laws) must be regarded as equal. More importantly, it would also run counter to the classical understanding of the conflict of laws that the most appropriate law governing an international relationship is not determined by reference to the actual

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that "[c]hoice-of-law doctrines present yet another incentive to the forum shopper"; Whitten, *supra* note 1 (agreeing with Professor Juenger's views).

40. At least in the United States, most writers concur that the differences between procedural rules are a more significant factor causing forum shopping than discrepancies between conflict norms. See Juenger, *supra* note 1, at 573; Whitten, *supra* note 1, at 564 (stating that "U.S. conflicts law is not the dominant incentive in domestic forum shopping"); Silberman, *supra* note 5, at 502 (observing that "[c]ourts in the United States attract plaintiffs . . . because they offer procedural advantages beyond those of foreign forums"). On the procedural law reasons causing forum shopping more generally, see ANDREW BELL, FORUM SHOPPING AND VENUE IN TRANSNATIONAL LITIGATION 26-36 (2003).

41. See *Ferens v. John Deere Co.*, 494 U.S. 516, 519-20 (1990).

42. These were the relevant facts of a number of lawsuits filed in relation to a crash of a DC-10 owned by a Turkish airline that occurred near Paris, France. See S. SPEISER, LAWSUIT 420-69 (1980).

43. Both *Ferens* and the airplane crash case are usually cited as examples of forum shopping. However, the relevant courts did not find that such forum shopping was unfair or unacceptable.

44. However, such views are sometimes expressed by courts, notably in the United States and England. See, e.g., *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 254 (1981) (stating that, "if the remedy provided by the alternative forum is so clearly inadequate or unsatisfactory that it is no remedy at all, the unfavorable change in law may be given substantial weight"); *Lubbe v. Cape PLC*, [2000] 1 W.L.R. 1545 (H.L.) at 1554 (appeal taken from Eng.) (observing that a stay on the basis of *forum non conveniens* will be granted if "the plaintiff can establish that substantial justice will not be done in the appropriate forum"). It should be noted that, in both cases, the question was not whether the plaintiff's choice of forum was fair, but rather whether dismissal on *forum non conveniens* grounds would be unfair. However, it nevertheless usefully illustrates how the question of the applicable substantive law may be perceived as affecting the fairness of the outcome.

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substance or “quality” of the laws concerned, but based on considerations of “spatial” justice.<sup>45</sup> The conflict of laws knows, of course, exceptions whereby foreign laws that are considered contrary to fundamental notions of justice or “public policy” may be disregarded.<sup>46</sup> However, this public policy exception assesses a law’s unfairness from the perspective of the legal system of the forum, whereas the question here is whether it is possible to assert that a particular law may be unfair in “absolute terms.” It is difficult to see how an affirmative answer can be given to this question.

There may, however, be a way to argue that a particular law of country A is unfair. One could, indeed, rely on the idea of “international standards” and assert that, where a particular law deviates from accepted international standards, such law may be considered as “unfair.” If, for example, the law of country A allows a plaintiff to receive full compensation even though he has contributed to his damage by his own negligence, while all (or the vast majority of) other laws either exclude or limit recovery, then this law of country A may, under such an approach, be regarded as unfair.

However, in reality, such an analysis is flawed, mainly because it does not actually overcome the above-mentioned public and private international law obstacles. Though implicit in numerous writings,<sup>47</sup> allegations of unfairness of the applicable substantive or procedural rules are thus unjustified or, at the very least, highly controversial. Interestingly, this conclusion is in conformity with the way in which the courts of several countries apply the doctrine of *forum non conveniens*. Unfairness, under this doctrine, is essentially equated with practical inconvenience, rather than unfairness of the applicable laws. Quite to the contrary, courts usually tolerate a certain degree of substantive unfairness, i.e. that a plaintiff derives “a legitimate personal or *juridical* [emphasis added] advantage”<sup>48</sup> from his forum selection. More generally, courts are usually reluctant to attach great significance to a change of the applicable substantive law when examining *forum non conveniens* pleas.<sup>49</sup>

A last issue that should be looked at when examining whether the application of a particular substantive or procedural law may be unfair is predictability. *Asahi Metal Industry v. Superior Court* can notably illustrate this.<sup>50</sup> In this case, a motorcyclist suffered damage as a result of a collision with a tractor in California. He filed claims against various parties, including the Taiwanese manufacturer of the tire tube. The latter filed a claim for indemnification against several codefendants and joined Asahi, the Japanese manufacturer of the tube’s valve assembly. Could Asahi reasonably predict that it would face a lawsuit in

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45. As is well known, this traditional approach has been challenged by a number of U.S. writers during the so-called “conflict revolution” of the 1950s and 60s. Those authors advocated a variety of outcome-based conflict approaches. For a recent discussion of their theories, see, e.g., Markus A. Petsche, *International Commercial Arbitration and the Transformation of the Conflict of Laws Theory*, 18 MICH. ST. J. INT’L L. 453, 466-69 (2010).

46. See *id.* at 462.

47. See Algero, *supra* note 10, at 79-80; Juenger, *supra* note 1, at 553. The respective authors define forum shopping as an unfair manipulation of the outcome and the taking of an unfair advantage, thus implying that the application of particular laws (obtained precisely by the act of forum shopping) may be “unfair.”

48. *MacShannon v. Rockware Glass Ltd.*, [1978] A.C. 795 (H.L.) at 812 (appeal taken from Eng.) (emphasis added).

49. See, e.g., *Piper*, 454 U.S. at 247 (holding that “[t]he possibility of a change in substantive law should ordinarily not be given conclusive or even substantial weight in the *forum non conveniens* inquiry.”).

50. *Asahi Metal Indus. v. Super. Ct. of Cal.*, 480 U.S. 102 (1987).

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California and that California law would govern? If not, is the application of California law unfair?<sup>51</sup>

The answer to this question is, once again, negative. In fact, if one argues that the application of the law of country A is unfair because it could not be reasonably predicted by the defendant (either because he could not predict the forum in which the plaintiff would bring his case or because he could not foresee the choice-of-law determination of the court seized), the issue is not the substantive unfairness of the said law. Rather, the perceived “problem” will generally stem from the fact that the selected court is not the “natural” forum (which was the case in *Asahi*)<sup>52</sup> or that the conflict norms applied are “unusual.” The fairness of the applicable laws is not directly at stake.

2. *Unfairness in Terms of Unequal Convenience*

Having concluded that forum selection does not cause any fairness problems in terms of the applicable substantive and procedural laws, we can now turn to the second aspect of potential unfairness, i.e. the inconvenience caused by the plaintiff’s choice of forum. It is undeniable that, in certain circumstances, the selected forum may be less convenient for the defendant than for the plaintiff. This may occur, for example, when the plaintiff sues a foreign defendant in his (i.e. the plaintiff’s) home jurisdiction or, more generally, when the forum selection causes considerable expense or practical difficulties (such as the difficulty to obtain the necessary visas to travel to the forum country).

That forum selection may unfairly inconvenience the defendant has been recognized by a number of courts examining *forum non conveniens* claims. Those courts have held that a case may be dismissed on *forum non conveniens* grounds when the forum selection by the plaintiff is vexatious or oppressive to the defendant.<sup>53</sup> However, it is not always clear whether, in a particular case, the dismissal is based on such unfair inconvenience or, rather, on considerations of efficiency.<sup>54</sup>

More generally, the basic evolution of the *forum non conveniens* doctrine (in the countries that apply this principle) indicates that an even significant imbalance in terms of the relative convenience of a forum for the parties only plays a very limited role. In the

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51. The issue in *Asahi* was not whether the case should be dismissed on *forum non conveniens* grounds, but whether the relevant California court at all had jurisdiction over Asahi. The Supreme Court held that it was unreasonable and thus unconstitutional to require a Japanese defendant who did not market a product directly in the United States to defend a claim brought by another foreign manufacturer. *Id.* at 113-116.

52. In fact, a California court can hardly be considered as the “natural” forum for a claim filed by a Taiwanese plaintiff against a Japanese defendant, merely because the claimant himself is a defendant in a connected lawsuit brought in that court. On the emergence and the meaning of the concept of “natural” forum, see BELL, *supra* note 40, at 86-129.

53. See Brand, *supra* note 5; Logan v. Bank of Scotland, [1906] 1 K.B. 141 (A.C.) (Eng.); St. Pierre v. S. Am. Stores (Gath & Chaves) Ltd., [1936] K.B. 382 (A.C.) at 398 (Eng.).

54. In *Gulf Oil*, for example, the plaintiff, a Virginia resident, alleged that the defendant, a Pennsylvania corporation doing business in Virginia, had negligently caused the destruction of a warehouse owned by the plaintiff in Virginia. Rather than bringing his case before a court in Virginia or Pennsylvania, he filed suit in a New York district court. The U.S. Supreme Court upheld the dismissal of the claim on *forum non conveniens* grounds. However, it can reasonably be argued that the Court’s decision may not have been based on the practical inconvenience that litigating in New York represented for the defendant, but rather on the overall “inappropriateness” of that forum, notably in light of the multiple ties with the state of Virginia. *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 502 (1947).



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United Kingdom and Canada, for example, the “vexatious and oppressive” test has been expressly abandoned.<sup>55</sup> Significantly, in the United States, Section 1404(a) of Title 28 of the U.S. Code, which codifies the *forum non conveniens* doctrine for domestic purposes, refers to the “convenience of parties,” rather than to an inconvenience caused to the defendant.<sup>56</sup>

This trend suggests that the possibility of unfair inconvenience may have been overestimated in the past and that it does not pose a significant problem in current international litigation. There may be a number of reasons for this. Generally, it is unrealistic, in any international litigation, to expect that the forum will be equally convenient for the parties because many cases are brought either in the defendant’s or plaintiff’s home jurisdiction. Also, improved international judicial cooperation (notably regarding the taking of evidence abroad)<sup>57</sup> and the use of modern technologies help reducing the cost and inconvenience of litigating in foreign forums.

**B. LACK OF EFFICIENCY ENSUING FROM THE PLAINTIFF’S FORUM SELECTION**

A plaintiff’s forum selection may potentially have an adverse impact on “efficiency.” This term refers, in the first place, to the efficiency of the proceedings. What is meant is that the proceedings are, or ought to be, conducted in such way as to avoid unnecessary cost and delay. It also implies that the court is enabled to render a “correct” decision. As can easily be understood, forum selection may affect the efficiency of the proceedings. For example, if the trial takes place in a jurisdiction only loosely connected to the material facts, this may generate a variety of additional costs<sup>58</sup> and slow down the proceedings.<sup>59</sup> Difficulties in obtaining and examining relevant evidence may complicate the fact-finding task of the court and ultimately affect the accuracy of its decision.

There are a number of specific reasons that may cause a plaintiff’s forum selection detrimentally to impact efficiency. First and foremost, a plaintiff will frequently seek the most advantageous forum in terms of the governing substantive and procedural law. Hence, considerations of efficiency may only play a secondary role in his choice. As the

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55. As far as the United Kingdom is concerned, *see Spiliada Maritime Corp. v. Cansulex Ltd.*, [1987] A.C. 460 (H.L.) (appeal taken from Eng.). As regards Canada, *see, e.g.*, 472900 B.C. Ltd. v. Thrifty Can. Ltd., (1998) 168 D.L.R. 4th 602, para. 32 (Can. B.C. C.A.) (stating that “[t]here is now no burden on the applicant to establish that the action would be vexatious, oppressive and/or an abuse of the process of the court.”).

56. 28 U.S.C. § 1404(a) (1996) (“For the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought . . . .”).

57. Among the international instruments that have facilitated such judicial cooperation one should mention the 1970 Hague Convention on the Taking of Evidence Abroad in Civil and Commercial Matters and, at the European level, Council Regulation (EC) No. 1206/2001 on cooperation between the courts of the Member States in the taking of evidence in civil or commercial matters. Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, Mar. 18, 1970, 23 U.S.T. 2555, 847 U.N.T.S. 231; Council Regulation 1206/2001, 2001 O.J. (L 174) 1 (EC).

58. Those costs may include *inter alia* travel and accommodation expenses for both parties, their legal representatives, experts, and witnesses; translation and interpretation costs (if the language of the forum is different from the language of the contract and/or other relevant documents); costs flowing from the need to locate and compensate foreign counsel; and costs associated with the need to familiarize oneself with the rules and procedures of the foreign forum.

59. Litigating in a foreign forum renders the process more complex, which may ultimately lead to an increase in the duration of the proceedings.

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Paris airplane crash case illustrates,<sup>60</sup> a plaintiff may be attracted to a particular forum because it offers the best chances of recovery (and higher amounts of compensation) and may thus attach limited importance to choosing a forum closer connected to the facts underlying the dispute.

Lack of efficiency constitutes probably the most significant issue for the purposes of the application of the *forum non conveniens* doctrine. Classical examples include (i) the dismissal of a claim brought in a U.S. court by a Danish seaman against a Danish sea captain for back wages;<sup>61</sup> (ii) the dismissal of a claim brought in a federal district court in New York by a Virginia resident against a Pennsylvania corporation for damage suffered as a result of the destruction of a warehouse in Virginia;<sup>62</sup> and (iii) the dismissal of a wrongful death action filed in a California state court by Scottish plaintiffs against defendants from Pennsylvania and Ohio arising from an airplane crash in Scotland.<sup>63</sup>

The second aspect of efficiency relates to the enforceability of the decision. Enforcement may in fact be an issue where the decision is rendered by a court of a jurisdiction in which the defendant does not own assets. In this case, it will be necessary to seek enforcement of the decision abroad. A plaintiff's forum selection may potentially complicate such enforcement because, as has already been mentioned, other considerations relating to the applicable procedural and substantive rules may receive more attention. Plaintiffs may thus not always contemplate enforcement issues when initiating proceedings and may notably fail to examine the applicable legal framework(s) to possible enforcement actions.

Also, there are two specific reasons why the pursuit of strategic advantages through forum selection may lead to enforcement problems. First of all, if a plaintiff chooses a particular forum (forum A) in order to obtain a more favorable decision, then there is a possibility that such decision may be considered as substantively "unfair" in potential enforcement forums (forums B and C). Under the laws of most countries, foreign decisions may in fact be refused (recognition and enforcement) if they violate the enforcement forum's public policy.<sup>64</sup> In other words, if the plaintiff succeeds in securing the expected advantage and if this advantage is "excessive," then this may ultimately work to the plaintiff's detriment.<sup>65</sup>

The second reason relates to the fact that, when choosing a favorable forum, plaintiffs may (intentionally) fail to take into account efficiency, i.e. the closeness with the material facts of the dispute. If, in addition, the plaintiffs rely on very "liberal" jurisdictional grounds of the chosen forum, then this may ultimately cause the decision to be denied enforcement by foreign courts. In fact, under the laws of a number of countries, foreign

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60. See SPEISER, *supra* note 42, at 420-69.

61. *Willendson v. Forsoket*, 29 F. Cas. 1283, 1284 (D. Pa. 1801) (No. 17,682).

62. *Gulf Oil Corp. v. Gilbert*, 301 U.S. at 502-03.

63. *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 235, 261 (1981).

64. As far as the United States is concerned, see, e.g., Cedric C. Chao and Christine S. Neuhoff, *Enforcement and Recognition of Foreign Judgments in United States Courts: A Practical Perspective*, 29 PEPP. L. REV. 147, 157-59 (2001-2002). For European perspectives, see Council Regulation 44/2001, art. 34(1), 2001 O.J. (L 12) 1 (EC).

65. A good example would be a case involving two parties from civil law countries (which oppose the granting of punitive damages as a matter of public policy) which the plaintiff decides to bring before a U.S. court, precisely in order to be awarded punitive, in addition to compensatory, damages. Such a decision (or at least the punitive damages award) would not be enforceable in most countries, including the defendant's home jurisdiction. See also *infra* Part II.B.1.

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decisions will only be enforced if the court that rendered the decision had jurisdiction under the rules of the enforcement court.<sup>66</sup> If, for example, the jurisdiction of country A is based on the mere fact that the defendant was temporarily present in country A and served with a notice during this time (“service-jurisdiction”),<sup>67</sup> and if such jurisdictional basis is not recognized in country B, then it is possible or likely that the decision rendered in country A will not be enforced in country B.

C. LACK OF UNIFORMITY OF DECISIONS

A number of writers recognize that forum shopping may lead to an undesirable lack of decisional uniformity. Without taking a final position on its “undesirability,” Professor Ferrari acknowledges that forum shopping “goes against the principle of consistency of outcomes, apparently a fundamental tenet of virtually any legal system.”<sup>68</sup> In his article *defending* the practice of forum shopping, Professor Juenger exclusively focuses on the issue of “decisional harmony,”<sup>69</sup> thus implying that this is its only (or, at the very least, main) adverse consequence. Grignon-Dumoulin associates decisional variations with “inequalities” and “a threat to legal security.”<sup>70</sup>

Before attempting to examine why lack of uniformity may be detrimental, i.e. what interests may be affected, it is necessary to clarify the nature of the situations concerned. Lack of decisional uniformity must not be (mis)understood as the existence of two contrasting decisions regarding the same (or rather a substantially identical) lawsuit. In fact, a forum shopper generally chooses the most favorable forum and litigates in that forum only. Practices that consist of initiating proceedings in several countries (with the hope to prevail at least somewhere) are rather exceptional and not, as such, an integral part of the basic concept of forum shopping.<sup>71</sup>

Hence, the lack of decisional harmony here only exists at the level of the domestic or international legal order (depending on whether it is domestic or international forum shopping). At the party level, it is merely “hypothetical.” If a plaintiff brings his claim in

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66. See, as far as the United States is concerned, Chao and Neuhoff, *supra* note 64, at 156 (stating that “[w]hen a defendant asserts that the foreign court lacked personal jurisdiction, United States courts generally inquire whether the foreign court’s exercise of personal jurisdiction conformed to standards of due process as recognized in the United States”). In France, as far as non-EU judgments are concerned, enforcement similarly requires that the foreign court had jurisdiction in accordance with the views of the French enforcement court. See the decision of the French *Cour de cassation* of January 7, 1964 in *Munzer*. *Cour de cassation* [Cass.] [supreme court for judicial matters] 1e civ., Jan. 7, 1964, Bull. civ. I, No. 15 (Fr.).

67. Service-jurisdiction is notably recognized in a number of U.S. states. In Wisconsin, for example, Section 801.05 affirms the personal jurisdiction of the local courts vis-à-vis defendants who were “present within this state [*i.e.* Wisconsin] when served.” However, Professor Juenger has pointed out that service-jurisdiction may no longer be compatible with constitutional requirements. See Juenger, *supra* note 1, at 557 (discussing *Shaffer v. Heitner*, 433 U.S. 186 (1977), and observing that Justice Marshall’s opinion “suggests that jurisdiction premised solely on personal service within the state is no longer proper”).

68. Ferrari, *Forum Shopping*, *supra* note 4, at 707 (internal footnote omitted).

69. Juenger, *supra* note 7, at 6-12.

70. Grignon-Dumoulin, *supra* note 4, at 610.

71. In fact, such practices would be highly problematic for the plaintiffs concerned. Amongst other things, they are excessively onerous (the plaintiff bears the cost not of one, but of two or several trials) and create enforcement problems when a court dismisses the plaintiff’s case and when such decision is then either (i) sought to be recognized in the enforcement jurisdiction or (ii) relied upon to object to the enforcement of another judgment which is favorable to the plaintiff.

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forum A and achieves result A, while he *would have* obtained result B in forum B, then there is no actual lack of uniformity because only one decision exists. However, if another plaintiff, in a comparable case, decides to sue in forum B, then there will be a situation in which the same (or a similar) matter will have been decided differently, simply because the plaintiffs chose different forums. At the level of the relevant legal order, it results in inequalities between parties, and especially defendants, who are essentially in the same situation.

Lack of uniformity understood in this sense potentially raises two issues. The first one is precisely the question of the lack of fairness arising from the dissimilar treatment of similar parties. Is it unfair if similar defendants will be subjected to varying obligations to compensate, depending on the particular forum in which the respective plaintiffs have brought their cases? Is it unfair if the claims of some plaintiffs are successful, while those of similar plaintiffs are not, merely because the former plaintiffs' choice-of-forum was "wiser?"

This is a difficult question. Common sense would suggest that it should be preferable to avoid situations where legal subjects who are in similar situations receive different treatment. But, ultimately, this may not be a valid proposition at the international level. It does make sense to argue that, within a given domestic legal order, there should be uniformity of decisions and thus equal application of the law.<sup>72</sup> However, is this reasonable at the international level? Is it unfair if, in purely domestic cases, a defendant in Germany pays X damages for certain tortious conduct, while another defendant in the United States pays X plus a significantly higher amount in punitive damages? The answer to this question is no because the relevant laws reflect notions of justice and fairness of the respective communities and because, as this article has highlighted above, it is highly problematic to assert that the laws of country A are fairer than those of country B.

Of course, forum shopping does not involve purely domestic cases that are brought before the respective domestic courts, but international (or inter-state) cases that may be heard in the courts of several countries (or states). However, the analysis is the same. If we agree that neither the application of law A by court A, nor the application of law B by court B is, as a matter of principle, unfair, then differences in treatment between similar defendants cannot be regarded as unfair either.

The second issue raised by lack of decisional uniformity is probably the more pressing one. It is the issue of predictability. The basic argument is that, because the eventual outcome of a given dispute may depend on the plaintiff's forum selection (which is unknown to the defendant), such outcome is not reasonably predictable for the defendant. At first sight, this seems to be a very plausible argument. It is frequently referred to as a problem affecting "legal security" or "security of transactions."<sup>73</sup>

However, a closer look reveals that the equation forum shopping (or forum selection) equals unpredictability of outcome is debatable, if not misleading. First of all, forum se-

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72. There are two reasons why decisional uniformity should be a greater concern at the domestic level. First of all, from a practical point of view, decisional uniformity can much more easily be achieved at the domestic than at the international level. In fact, domestic laws are presumably applied in a uniform fashion within any given domestic legal system (leaving the problems caused by federalism aside). Second, from a purely legal point of view, it should be noted that, in many countries, the principle of "equality before the law" constitutes a constitutional norm.

73. See Grignon-Dumoulin, *supra* note 4, at 610.

lection only makes predictability more difficult; it does not necessarily undermine it. In fact, for any international dispute, more than one forum is generally available<sup>74</sup> and, depending on the specific connections of the transaction (or event giving rise to the dispute) with different countries, those alternative forums may be identified without too much hassle. Similarly, gaining basic information pertaining to the applicable conflict norms in those forums, as well as to peculiarities of the respective substantive laws, does not necessarily require excessive efforts.

More importantly, the assumption that, in the absence of forum shopping, defendants can perfectly predict the outcome is unrealistic. This view implies that each case has only one “natural” forum, which is not generally the case in international litigation. Also, it assumes that parties are perfectly familiar with the conflict and substantive norms of this “natural” forum (or their home forum, if the comparison is with domestic litigation), which, again, is questionable. Moreover, perceived unpredictability frequently stems not so much from the plaintiff’s choice of a particular forum, but rather from the unpredictability of the facts or incident giving rise to the dispute.<sup>75</sup> Lastly, though there may be several other relevant factors, predictability issues can, as far as contractual disputes are concerned, easily be solved through the conclusion of choice-of-law or forum selection clauses.

None of the above arguments should be understood as suggesting that it is not desirable to achieve greater harmonization of conflict and substantive norms at the international level, especially as far as the law governing business transactions is concerned.<sup>76</sup> However, as this article has shown, the problems of unfairness and unpredictability that the absence of uniformity may cause are far less severe than is often assumed. In fact, the very existence of such problems is questionable.

## II. The Reality of the Detrimental Impact of Forum Selection

The first part of this article has examined the adverse “potential” of forum selection in international litigation, *i.e.* the question of whether, as a matter of principle, forum selection can have a detrimental impact. It has identified the various criteria by which such impact may be measured and concluded (i) that unfairness is not a “real” issue as far as the applicable laws are concerned; (ii) that, however, unfairness in terms of unequal convenience may potentially be a (rather minor) problem; (iii) that lack of uniformity is merely hypothetical at the level of the parties to a given dispute and thus not significant as a factor reducing (again) fairness and predictability; and (iv) that lack of efficiency may be the most serious “danger” of forum selection.

This second part analyzes the extent to which the potentially detrimental impact of forum selection affects the actual practice of international litigation. Rather than focusing

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74. This is largely due to the fact that most countries recognize that a court’s jurisdiction in international cases may be based on a plurality of grounds. For a more detailed analysis of this issue, *see infra* Part II.A.1.

75. How can a manufacturer know where a consumer – with whom he has no contractual relationship – will be injured by one of his products? How can parties know where tortious conduct will occur, or where the effects of such conduct will be produced?

76. Thus, while this article agrees with Professor Juenger that the international unification of conflict norms is unrealistic, it respectfully disagrees with his view that it is also undesirable or “futile.” *See* Juenger, *supra* note 7, at 10.

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on empirical data (which would be hard to find and interpret<sup>77</sup>), this article discusses two factors that suggest that the already limited “detrimental potential” of forum selection is not generally fully “exploitable” in practice. Those factors are (1) that the availability of alternative forums (the reason why we have forum shopping) is generally conducive to the achievement of fairness and efficiency and (2) the existence of incentives for plaintiffs to refrain from engaging in forum shopping practices.

A. THE AVAILABILITY OF ALTERNATIVE FORUMS: FORUM SHOPPING OPPORTUNITIES AS A “NECESSARY EVIL”

Forum shopping would not be a practical and academic issue if litigants did not have the possibility to choose between two or several alternative forums. It is sometimes argued that the availability of more than one forum is caused by the “alternative” nature of the relevant jurisdictional rules. At the international level, this is not entirely accurate because the availability of alternatives does not stem from the jurisdictional rules of a given country, but from the interplay between the jurisdictional rules of several countries.<sup>78</sup> If, for example, a French plaintiff is entitled to sue a German defendant in Germany (the place of residence of the defendant) and France (the place where the defendant’s tortious conduct occurred), then this is the combined result of German and French jurisdictional rules.<sup>79</sup> While the existence of alternative jurisdictional rules is not a necessary prerequisite for options at the international level (divergences between the various domestic rules would suffice), evidently, it significantly enhances their likelihood and number.

When a legal system applies alternative jurisdictional rules in the domestic sphere, it generally recognizes that, at the international level, its courts’ jurisdiction may similarly be based on a plurality of connecting factors (such as, for example, the domicile or nationality of the defendant, the place of the conclusion or performance of the contract etc.).<sup>80</sup> There is, of course, a reason behind this. In fact, alternative jurisdictional rules, both at the domestic and at the international level, are aimed at contributing to the fairness and efficiency of the litigation process. In other words, alternative rules pursue precisely those objectives that may be undermined by the practice of forum shopping. Overall, as this article shall explain, the potentially negative effect of alternative rules (*i.e.*, of jurisdictional options) is outweighed by their advantages. Moreover, any alternative system that would

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77. Indeed, it is difficult to locate decisions involving forum shopping because courts may not necessarily employ that expression and because it is generally difficult to distinguish between forum shopping and mere forum selection. Also, the exact impact that a plaintiff’s choice in a given case has on the achievement of fairness and efficiency is almost impossible to determine with any accuracy.

78. Only where an international instrument establishes common norms for States parties does it make sense to use the term “alternative rules.” With regard to EC Council Regulation 44/2001, it is thus appropriate to state that it establishes a system based on alternative rules of jurisdiction.

79. In this specific case, both the German and the French rules would be found in Regulation 44/2001, which is directly applicable in all member states and takes precedence over any other domestic norms pertaining to matters falling within the scope of the Regulation. The jurisdictional options in this hypothetical case would thus derive from the application of Articles 2(1) and 5(3) of the Regulation.

80. In France, for example, absent an international agreement governing the issue, the jurisdiction of French courts in international disputes is determined by way of a “transposition” of the domestic jurisdictional rules contained in Articles 46-48 of the *Code de Procédure Civile*. *Code de Procédure Civile* (C.P.C.) art. 46-48 (Fr.).

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be based on exclusive jurisdictional rules would not only be unrealistic, but also a source of problems.

1. *Fairness and Efficiency of Alternative Jurisdictional Rules*

Virtually all legal systems recognize that, in international disputes, the jurisdiction of their courts may be based on a plurality of connecting factors. As far as specific types of disputes are concerned, however, exclusive jurisdictional rules may exceptionally apply.<sup>81</sup> The real differences between the various countries only relate to the question of how many such alternative factors are recognized. Those not based on a significant connection with the parties or the facts underlying the dispute (and are not widely applied) are habitually referred to as “exorbitant” grounds.<sup>82</sup> Overall, however, there is rather widespread agreement on basic jurisdictional principles.

Within the European Union, for example, EU Council Regulation 44/2001 transforms the Brussels-Lugano Convention into a piece of EU legislation and governs all disputes involving a defendant who resides or is domiciled in a member state of the European Union.<sup>83</sup> Under this Regulation, the plaintiff is required to bring his claim before the courts of the defendant’s domicile.<sup>84</sup> In addition, the Regulation provides for a number of rules of “special jurisdiction” that plaintiffs have the right to rely upon.

In contractual matters, for example, the Regulation allows a plaintiff to bring his claim before the courts “for the place of the performance of the obligation in question,” i.e., the obligation that the plaintiff alleges has been violated.<sup>85</sup> In tort cases, claims may be brought in the courts “for the place where the harmful event occurred or may occur.”<sup>86</sup> Where the defendant’s tortious conduct occurred in state A and the plaintiff suffered damage in state B, the action may be brought before the courts of both countries.<sup>87</sup>

In the United States, the basic approach is not dissimilar. U.S. courts generally have no difficulty asserting jurisdiction over local defendants.<sup>88</sup> Hence, they recognize that the defendant’s domicile or residence constitutes a proper jurisdictional basis.<sup>89</sup> A wide range of cases involving foreign (or non-resident) defendants illustrates that other jurisdictional

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81. See *infra* Part IIA.2.

82. For a recent discussion of such exorbitant grounds, see Guiditta Cordero Moss, *Between Private and Public International Law: Exorbitant Jurisdiction as Illustrated by the Yukos Case*, 32 REV. CENT. & E. EUR. L. 1, 1 (2007).

83. For an examination of the ways in which the Regulation modified the legal regime established under the Brussels-Lugano Conventions, see Astrid Stadler, *From the Brussels Convention to Regulation 44/2001: Cornerstones of a European Law of Civil Procedure*, 42 COMMON MKT. L. REV. 1637, 1637 (2005).

84. See Article 2(1) of the Regulation: “. . . persons domiciled in a Member State shall, whatever their nationality, be sued in the courts of that Member State.”

85. Council Regulation 44/2001, *supra* note 64, art. 5(1).

86. *Id.* art. 5(3).

87. Case 21/76, *Bier v. Mines de Potasse d’Alsace*, 1976 E.C.R. 1735, ¶ 19.

88. See Silberman, *supra* note 5, at 516 (“Formal jurisdiction over these defendants [American or other multinational manufacturers] in some United States court almost always exists . . .”).

89. However, U.S. courts sometimes dismiss cases brought against domestic corporations based on *forum non conveniens*. For critical views on such judicial practice, see, for example, Jacqueline Duval-Major, *One-Way Ticket Home: The Federal Doctrine of Forum Non Conveniens and the International Plaintiff*, 77 CORNELL L. REV. 650, 670 (1992) (“[F]orum non conveniens may unjustifiably protect MNCs [multinational corporations] from any liability.”) and David W. Robertson, *The Federal Doctrine of Forum Non Conveniens: “An Object Lesson in Uncontrolled Discretion,”* 29 TEX. INT’L L. J. 353, 371-75 (1994).

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grounds are acknowledged. In those cases, the courts focus on whether they have personal jurisdiction over the foreign entity or individual. In most states, this question is governed by so-called long-arm statutes, which, generally, either provide for a number of specific bases for jurisdiction (not unlike Regulation 44/2001)<sup>90</sup> or incorporate the requirements of the constitutional Due Process Clause.<sup>91</sup>

The meaning of those requirements, which apply throughout the United States, has been clarified by a number of Supreme Court decisions in which the Court established two tests to determine whether, in a given case, a U.S. court may validly exercise jurisdiction over a non-resident or foreign defendant. Under the first such test, the minimum contacts requirement established in *International Shoe Co. v. Washington*<sup>92</sup> (and developed further in *Helicopteros Nacionales de Colombia v. Hall*<sup>93</sup> and *Asahi Metal Industry Co. v. Superior Court of California*),<sup>94</sup> a U.S. court may have jurisdiction over a foreign defendant if (i) he conducts a certain threshold of activities in the relevant state, or (ii) the cause of action arises from an activity of the defendant in that state, even if it merely constitutes an isolated activity. Under the second test, the reasonableness requirement laid down in *World-Wide Volkswagen Corp. v. Woodson*,<sup>95</sup> the exercise of jurisdiction must be "reasonable" in light of the relationship between the defendant and the forum.<sup>96</sup>

This very basic overview of U.S. jurisdictional rules illustrates that U.S. courts recognize a variety of factors as grounds upholding their jurisdiction in international cases. As this article has already mentioned, the domicile or place of business of the defendant is one such factor, and U.S. courts therefore generally hold that they have jurisdiction over cases brought against defendants who are domiciled or reside in the United States. In cases involving foreign defendants, courts take into account a number of different aspects relating to the defendant's presence in, or connection with, the United States. Not unlike

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90. See Ronald A. Brand, *Tort Jurisdiction in a Multilateral Convention: The Lessons of the Due Process Clause and the Brussels Convention*, 24 BROOK. J. INT'L L. 125, 132 (1998) ("The process of applying a list-type longarm statute is not unlike the application of the jurisdictional rules of the Brussels Convention [which has been adopted, with minor changes, by Regulation 44/2001].").

91. U.S. CONST. amend. XIV, § 1 ("[N]or shall any State deprive any person of life, liberty, or property, without due process of law . . .").

92. See *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 313-16 (1946). The Court ruled that the Washington state courts had jurisdiction over a Delaware corporation having its principal place of business in St. Louis, Missouri because it employed between eleven and thirteen salesmen who resided in Washington. The Court held that "due process requires only that in order to subject a defendant to a judgment in personam, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend 'traditional notions of fair-play and substantial justice.'" (citing *Milliken v. Meyer*, 311 U.S. 457, 463 (1940)).

93. *Helicopteros Nacionales de Colombia v. Hall*, 466 U.S. 408, 408 (1984) (denying jurisdiction of the Texas state courts over a claim brought against a Colombian corporation on the basis of a helicopter crash in Peru).

94. See *Asahi Metal Industry Co. v. Superior Court of Cal.*, 480 U.S. 102, 102 (1987) (denying jurisdiction of California courts over a Japanese manufacturer in a product liability case involving an allegedly defective valve stem sold to a Taiwanese tire manufacturer and ultimately incorporated into a motorcycle sold and used in California).

95. See *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 292 (1980).

96. *Id.* at 292 ("The relationship between the defendant and the forum must be such that it is 'reasonable . . . to require the corporation to defend the particular suit which is brought there.'" (quoting *Int'l Shoe Co.*, 326 U.S. at 317) and holding that the Oklahoma courts do not have jurisdiction over a product liability suit brought by New York residents who had purchased a car in New York from a New York corporation merely because the accident occurred while the plaintiffs were driving through Oklahoma).



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Regulation 44/2001, the U.S. legal system embraces the idea of alternative rules of jurisdiction.

By recognizing alternative jurisdictional bases, legal systems (and notably the U.S. and European legal systems) promote fairness (especially equality between the parties) and efficiency of international litigation. Alternative jurisdictional rules are fair because they achieve an adequate balance between the interests of the parties. On the one hand, the rule allocating jurisdiction to the defendant's home courts, a principle of virtually universal application,<sup>97</sup> protects interests of defendants.<sup>98</sup> On the other hand, alternative rules also take into account the interests of plaintiffs by offering them the possibility to choose between two or several options.

In order for those options not to create an imbalance that would disadvantage the defendant, the relevant rules must be crafted carefully. Importantly, save for exceptional circumstances,<sup>99</sup> the plaintiff's domicile or residence (or nationality) should not constitute a connecting factor. If it did, plaintiffs would systematically bring most lawsuits in their home courts, which would clearly disfavor defendants. Therefore, alternatives to the defendant's home court should bear a material connection with the dispute because this ensures both (a certain degree of) predictability for the defendant and overall efficiency.

If jurisdictional rules do indeed limit alternative forums to those that are connected to the dispute, then they also help to ensure a certain degree of efficiency. As this article has discussed earlier, the closeness of the forum to the relevant facts underlying the dispute enhances speed and cost-effectiveness of the process. In addition, it must not be forgotten that the basic rule allocating jurisdiction to the defendant's home court also benefits one particular aspect of efficiency, namely the enforceability of the prospective decision.<sup>100</sup>

Finally, the fact that alternative jurisdictional rules are inherently flexible probably also constitutes an advantage. Flexibility is, of course, not per se objective, but it enables the plaintiff to avoid solutions that would be particularly unfair or inefficient. Where, for example, an exclusive jurisdictional rule would lead to allocating jurisdiction to the courts of a country whose judicial system is particularly inefficient (and where trials are excessively long), alternative rules provide a remedy. Similarly, where such rule would lead to the courts of country A deciding a dispute under the laws of country B (which may be inconvenient), an alternative rule providing for the jurisdiction of the courts of country B may be in the common interest of the parties.

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97. See Arthur Taylor Von Mehren, *Must Plaintiffs Seek Out Defendants? The Contemporary Standing of Actor Sequitur Forum Rei*, 8 KING'S COLLEGE LAW JOURNAL 23, 23 (1997-1998) (quoting J. SCHRÖDER, INTERNATIONALE ZUSTÄNDIGKEIT 229, 229 (1971)).

98. *Id.* at 29 (acknowledging that litigating in the defendant's forum favors the defendant, at least as far as "accessibility and familiarity" is concerned). However, this author also rightly emphasizes that such general statements are inappropriate as far as substantive and procedural matters are concerned. He observes that, "[t]he defendant's domicile may well turn out to favour . . . plaintiffs while the plaintiff's domicile favours defendants." *Id.*

99. Exceptional circumstances that may warrant allocating jurisdiction to the plaintiff's home courts may consist of contractual relationships involving parties with unequal bargaining powers. See, e.g., Council Regulation 44/2001, art. 16(1), 2000 O.J. (L 012) (EC) (authorizing a consumer to bring claims before the courts of his domicile).

100. In fact, if the plaintiff obtains a favorable decision from a court of the defendant's domicile/residence, then it will not be necessary to seek enforcement abroad.

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2. *Exclusive Jurisdictional Rules: An Unrealistic and Problematic Alternative*

The alternative to the current legal regime that is based on jurisdictional options for plaintiffs would be a system that removes those options and establishes rules of exclusive jurisdiction. At present, most legal systems actually apply exclusive jurisdictional rules, but only with regard to specific categories or types of disputes.<sup>101</sup> Those exceptional rules reflect the existence of exclusive jurisdiction of specialized public law bodies in certain matters<sup>102</sup> and the public interests involved in others.<sup>103</sup>

The system contemplated here is very different. It is based on a general application of exclusive jurisdictional rules for all possible disputes (and on their uniform application at the international level). Such a system would certainly present some advantages. For one, it would ensure a high degree of predictability and limit, or even exclude, litigation relating to jurisdictional issues. Second, it would—at least in theory—produce the best results in terms of efficiency because all rules of jurisdiction could be formulated with a view to achieving this particular objective.

But such a system seems difficult, if not impossible, to establish. In fact, it requires general agreement at the international level on what those exclusive jurisdictional rules should be. In the absence of such international uniformity, jurisdictional conflicts would be inevitable. There would be, first of all, positive conflicts, *i.e.*, situations where the courts of two or several countries would assert jurisdiction over a particular claim—a situation that constitutes a return to alternative rules. Second, and this may be more problematic, a non-uniform system of exclusive jurisdictional rules may lead to negative conflicts, *i.e.*, scenarios where no court considers that it has jurisdiction over a particular dispute.

The effectiveness of such a model thus depends on international consensus regarding the precise contents of the various rules of (exclusive) jurisdiction. That the achievement of international agreement on jurisdictional rules is generally problematic, to say the least, is notably illustrated by the negotiations conducted under the auspices of the Hague Conference on Private International Law in relation to the drafting of a multilateral convention on jurisdiction and the recognition and enforcement of judgments.<sup>104</sup> As Brand predicted, basic differences between U.S. and European approaches, as well as mutual lack of understanding, have proven to be an insurmountable stumbling block in this context.<sup>105</sup>

Moreover, many countries may be opposed to the very idea of exclusive jurisdiction. The adoption of rules of exclusive jurisdiction would mean that, as a practical matter,

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101. *See, e.g.*, Council Regulation 44/2001, *supra* note 64, at art. 22.

102. *See, e.g., id.* at art. 22(4) (providing that disputes concerning the validity of intellectual property rights can only be heard by the courts of the place where the relevant rights have been deposited or registered).

103. The vitality of those interests notably explains why disputes regarding rights pertaining to immovable property are generally considered to fall within the exclusive jurisdiction of the courts of the place where the relevant property is located. *See, e.g., id.* at art. 22(1).

104. The drafting of such a convention was initially proposed by the United States back in 1992 and notably led to the adoption of a first draft in 1999. Due to irreconcilable differences between the negotiating parties, the project was eventually narrowed down to cover only the issue of choice-of-court agreements. *See generally* SAMUEL P. BAUMGARTNER, *THE PROPOSED HAGUE CONVENTION ON JURISDICTION AND FOREIGN JUDGMENTS, TRANS-ATLANTIC LAWMAKING FOR TRANSNATIONAL LITIGATION* (2003).

105. Brand, *supra* note 90, at 127 (“The successful negotiation of a multilateral treaty on jurisdiction and the recognition and enforcement of judgments will not be an easy task.”).

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many claims brought against defendants domiciled in country A may not be heard in the courts of country A (provided that one adopts a closest-connection approach). This, however, stands in contrast with a deeply-rooted tradition according to which states allege to have an interest in having their domestic courts hear claims involving their nationals. In some countries, this has historically led to the recognition of “jurisdictional privileges,”<sup>106</sup> affording nationals systematic access to their home courts. While this may no longer be a prevalent approach,<sup>107</sup> remnants of this philosophy may create obstacles to the acceptance of rules of exclusive jurisdiction.

Assuming that an international system based on exclusive jurisdictional rules is achievable, it would not, however, be the best solution. First of all, the benefits mentioned above (predictability and efficiency) are only relative. Even if a rule provides for the exclusive jurisdiction of a particular court, the formulation of the connecting factor that the rule is based upon may create options. If, for example, the rule provides that tort claims must be brought in the courts of the country “where the harmful event occurred,” this may include both the place of the causal event and the place where the actual damage is suffered.<sup>108</sup> Moreover, both the causal event and the damage may occur in more than one country, which again creates additional jurisdictional options. Hence, exclusive rules seem unable to prevent alternatives that are the result of factually complex situations.

Also, the achievement of efficiency via exclusive jurisdictional rules may be questionable in individual cases. In fact, it may be difficult to elaborate a rule that ensures the greatest possible efficiency in a large majority of cases. Again, the hypothetical rule stated in the preceding paragraph (jurisdiction of the courts of the place where the harmful event occurred) is illustrative. While, as a general rule, relevant evidentiary documents and witnesses are likely to be located in the country “where the harmful event occurred,” this may not always be true. For example, in a case where one German tourist negligently causes physical harm to another German tourist while on a trip in Arizona, and where all witnesses are also German tourists, the exclusive jurisdiction of the courts of Arizona would not be the most efficient solution.<sup>109</sup>

The adoption of an internationally uniform set of rules of exclusive jurisdiction is thus not only highly unrealistic, but probably even undesirable. Undeniably, it is appropriate to limit the number of grounds (or connecting factors) upon which a court's jurisdiction

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106. In France, for example, those “*privilèges de juridiction*” are found in Articles 14 and 15 of the Code civil, which provide for the right of both French plaintiffs and French defendants to have their cases heard by French courts. See Code civil [C. civ.] art. 14-15 (Fr.); see also BELL, *supra* note 40, at 10 (discussing Article 14).

107. Jurisdictional privileges are hardly compatible with international comity and practical necessities. Thus, in France, for example, courts have recognized the possibility to “waive” these privileges. Moreover, Articles 14 and 15 do not apply where international law obligations provide otherwise. See Code civil [C. civ.] art. 14-15 (Fr.). Most notably, as far as disputes involving defendants domiciled in the European Union are concerned, those provisions are superseded by the regime established under EC Council Regulation 44/2001. See generally Council Regulation 44/2001, *supra* note 64.

108. *Id.*

109. This example is borrowed from Martine Stückelberg, *Lis Pendens and Forum Non Conveniens at the Hague Conference*, 26 BROOK. J. INT'L L. 949, 949 (2000). Admittedly, this is a rather exceptional scenario. Also, this article does not deny the possibility for an exclusive jurisdictional rule to take such exceptional circumstances into account. The hypothetical rule on jurisdiction over tort matters could thus allocate jurisdiction to the courts of the place where the harmful event occurred (or where the effects are produced), unless both the plaintiff and the defendant are domiciled in the same foreign state.

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may be based in an international case. In this respect, the exclusion of exorbitant rules is particularly helpful. However, the availability of alternatives to the defendant's home court, provided that those are based on considerations of efficiency, is the better solution.

**B. INCENTIVES FOR PLAINTIFFS NOT TO FORUM SHOP**

As has certainly become evident by now, in international (but also domestic) disputes, a plaintiff's forum selection is frequently based on the pursuit of specific strategic interests. However, this pursuit of advantages may turn out to be counter-productive and have undesired side effects. In fact, for a number of reasons, the plaintiff may ultimately be deprived of the benefits of a favorable decision when he seeks to have that decision enforced abroad. Inasmuch as it may complicate enforcement of the decision, forum shopping thus plays the role of a Damocles sword hanging over the plaintiff's head.

This Damocles sword creates an incentive for the plaintiff to refrain from attempting to obtain results that would be considered grossly unfair in the likely enforcement jurisdiction. It also prompts the plaintiff to select a forum whose jurisdiction will be recognized by the enforcement court. In other words, it creates an incentive for the plaintiff not to forum shop. In addition, the plaintiff has an evident personal interest in selecting an efficient forum, which contributes to limiting actual forum shopping practices.

*1. Incentive to Avoid Outcomes That Would be Considered Grossly Unfair in Potential Enforcement Jurisdictions*

The logic of this Damocles sword is simple. The plaintiff selects a forum that is, *a priori*, not the most appropriate one, but the one that allows him to obtain a particularly favorable decision. He sues the defendant in a country other than the latter's home country and will ultimately need to have the decision enforced in the defendant's home jurisdiction. If the decision handed down is perceived to be grossly unfair or inadequate by the enforcement court, then enforcement may be denied based on a violation of the enforcement court's public policy.<sup>110</sup>

A classic example of such situations is provided by punitive damages cases.<sup>111</sup> A European plaintiff sues a European defendant in a U.S. court because of the prospect of being awarded punitive damages. The facts of the case are not directly linked to the United States, but the court decides that it has jurisdiction, rules in favor of the plaintiff, and awards punitive damages. When the plaintiff attempts to have the decision enforced in the defendant's home jurisdiction, the competent court refuses enforcement on the grounds that punitive damages are contrary to its domestic public policy.<sup>112</sup>

Hence, in such cases, rational plaintiffs will refrain from seeking the advantage of punitive damages, as they will only incur additional cost without any actual benefit. As this example illustrates, plaintiffs have an incentive not to seek particularly favorable outcomes if such outcomes would be contrary to the basic notions of fairness and justice of probable

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110. See Chao & Neuhoff, *supra* note 64, at 157-59.

111. See generally Borchers, *supra* note 15.

112. Virtually all European States consider punitive damages awards to be contrary to public policy. For an insightful discussion of this position, see Helmut Koziol, *Punitive Damages—A European Perspective*, 68 L.A. L. REV. 741, 741-64 (2008).

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enforcement jurisdictions. This incentive will be particularly effective if the defendant does not own any assets in jurisdictions other than his home jurisdiction.<sup>113</sup>

2. *Incentive to Select a Court Whose Jurisdiction is Based on International Standards*

As this article has already pointed out, the pursuit of strategic interests may prompt a plaintiff to consider a large number of potential courts and to select a forum that is only loosely connected to the parties or the facts underlying the dispute. Sometimes, the jurisdiction of the chosen court may be based on an exorbitant ground of jurisdiction such as the presence of defendant-owned assets<sup>114</sup> or the temporary presence of the defendant himself<sup>115</sup> that allowed him to be served in the jurisdiction concerned.

Here, again, this may lead to enforcement problems. In fact, under the laws of many countries, one of the requirements that must be met in order for a foreign court decision to be enforced is that the jurisdictional basis relied upon by that court is recognized in the enforcement jurisdiction.<sup>116</sup> In other words, country A will only enforce judgments rendered in country B if the exercise of jurisdiction by the relevant court of country B is in accordance with country A's own rules on international jurisdiction. If, for example, the jurisdiction of a court is only based on the presence of assets owned by the defendant, then the judgments rendered by this court may not be enforced in those countries that do not recognize this particular jurisdictional ground.

These potential enforcement problems constitute an incentive for plaintiffs to refrain from bringing claims in courts whose jurisdiction would be based on unusual or exorbitant grounds. Thus, they contribute to narrowing the scope of jurisdictions in which a plaintiff can reasonably be expected to initiate proceedings. By limiting the number of practical options, this incentive helps limiting forum-shopping strategies.

3. *Plaintiffs' Interest in Efficiency*

As this article has explained, one of the potential detrimental consequences of forum selection is lack of, or limited, procedural efficiency. But the achievement of such efficiency is, obviously, in the interest of the plaintiff. Therefore, he will only choose an inefficient forum if the loss of efficiency is compensated by advantages pertaining to the actual outcome, to practical convenience, or to the ease of enforcement. The interest that the plaintiff has in an efficient conduct of the proceedings thus constitutes another factor that limits recourse to forum-shopping tactics.

**Conclusion**

This article has shown that the concept of forum shopping can only be useful if distinguished from the broader term forum "selection." Accordingly, forum shopping can adequately define those instances of forum selection where the actual choice made by the

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113. If, in the above example, the defendant also owns assets in the United States (or more generally in any country that enforces punitive damages awards), then the incentive for the plaintiff not to forum shop will be (much) more limited.

114. See Juenger, *supra* note 1, at 554 (discussing attachment-jurisdiction).

115. See *supra* note 67 and accompanying text.

116. See *supra* note 66 and accompanying text.

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plaintiff adversely affects the legitimate objectives pursued by rules on international jurisdiction. In essence, those objectives are fairness and efficiency (as defined earlier).

The basic conclusion of this article is that the potentially detrimental impact of forum selection is limited. Contrary to what numerous writers argue, tactics aimed at benefiting from favorable procedural or substantive laws are not detrimental to the achievement of fairness and should not, therefore, be considered as forum shopping. Also, the lack of decisional uniformity caused by the practice of forum selection is not, as such, problematic—not because of the reasons put forward by Professor Juenger (essentially the desirability of applying the substantively superior *lex fori*), but because lack of uniformity does not directly impact the equality between the parties (fairness). Thus, the real issues that forum selection may cause are issues of efficiency and, to a more limited extent, issues of unequal convenience.

Importantly, this article has also shown that, at the international level, forum shopping is inevitable as long as litigants are offered jurisdictional options or alternatives. This article has also shown that the availability of such alternatives, though it generates forum shopping opportunities, is ultimately beneficial to the interests of international litigation inasmuch as it strikes a reasonable balance between efficiency and fairness, on the one hand, and the interests of the plaintiff and those of the defendant, on the other. Finally, this article has also emphasized that, as a practical matter, litigants have incentives to refrain from forum shopping, which contributes to limiting the practical significance of this problem.

The identification of potential problems caused by forum selection, as well as the overall conclusion that the magnitude of such problems is limited, should be borne in mind when elaborating policies addressing forum shopping, or when assessing current approaches. In particular, it may usefully inform the rather controversial debate surrounding the objectives pursued by the doctrine of *forum non conveniens*.

## Chinese Investments Overseas: Onshore Rules and Offshore Risks

LUTZ-CHRISTIAN WOLFF\*

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### Abstract

*Chinese investments overseas have seen strong growth rates in recent years. This has caused much interest, but also some concerns. Taking recently published official data as a starting point, this article first recalls how overseas investments of Chinese enterprises have evolved in the past and discusses what the current trend is. It then summarizes the main features of China's outward*

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*investment regime and discusses practical consequences of related rules and regulations. In its main part, this article explores the broader implications of China's increasing outbound investments by analyzing possible future scenarios and consequential risks, as well as available legal reactions.*

## **I. Introduction**

China's<sup>1</sup> economy recovered quickly from the global financial crisis of 2008–2009. During the first quarter of 2011, China's economy grew 9.7%, which is an impressive, although slightly lower, growth rate compared to the 10.3% of the first quarter of 2010.<sup>2</sup> It is believed that "China has surpassed Japan to become the second largest economy in the world."<sup>3</sup> Some commentators expect China to take the number one spot from the United States of America soon.<sup>4</sup>

In line with these developments, Chinese multi-nationals, in particular Chinese state-owned enterprises (SOEs),<sup>5</sup> are pushing across the borders. Consequently, Chinese overseas investments have seen strong growth rates in recent years. This has caused much interest, but also some concerns. Taking statistical data recently published by the PRC Ministry of Commerce (MOFCOM),<sup>6</sup> this article first recalls how overseas investments of Chinese enterprises have evolved in the past and discusses what the current trend is. China controls foreign inward investments by way of a variety of regulatory tools,<sup>7</sup> and the same is true for outward investments of Chinese enterprises. Section three, therefore, summarizes the main features of China's outward investment regime.<sup>8</sup> Section four discusses practical consequences of related rules and regulations. It also explores the broader implications of China's increasing outbound investments. Based on possible future scenarios, it identifies risks and possible legal reactions.

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1. Here and in the following "China" stands for the Chinese mainland excluding Hong Kong, Macau, and Taiwan. After more than 150 years under colonial rule, Hong Kong and Macau became part of the People's Republic of China and obtained the status of Special Administrative Regions on July 1, 1997 and on Dec. 20, 1999 respectively. Based on the "one country, two systems-doctrine," invented by the late Deng Xiaoping, the legal systems of Hong Kong and Macau will remain unchanged for a period of fifty years from the date of the so-called hand-over. Lutz-Christian Wolff, *China's Private International Investment Law: One-Way Street into PRC Law?*, 56 AM. J. COMP. L. 1039, 1047-048 (2008). The situation of Taiwan is less settled, because both the central government in Beijing and Taiwan's government officially claim to be the legitimate representative for all of China. *Id.* at 1048.

2. Cary Huang, *Foreigners Put Focus on China Services Sector*, SOUTH CHINA MORNING POST, May 18, 2011, at B6.

3. Frances L. Woo, Malcolm Moller & Tiffany Chan, *China Outbound: To Infinity and Beyond—Offshore*, CHINA OUTBOUND INVESTMENT GUIDE, 2011, at 55, available at <http://www.ifr.com/Article/2836570/Channel/193438/China-Outbound-To-infinity-and-beyondOffshore.html>.

4. John Gong, *A Lot of Hot Air*, SOUTH CHINA MORNING POST, May 23, 2011, at A15.

5. LUTZ-CHRISTIAN WOLFF, CHINA OUTBOUND INVESTMENTS: A GUIDE TO LAW AND PRACTICE 4 (2011).

6. PRC MINISTRY OF COMMERCE, 2010 STATISTICAL BULLETIN OF CHINA'S OUTWARD FOREIGN DIRECT INVESTMENT (Nov. 18, 2011), available at <http://hzs.mofcom.gov.cn/accessory/201109/1316069658609.pdf>.

7. LUTZ-CHRISTIAN WOLFF, MERGERS & ACQUISITIONS IN CHINA: LAW AND PRACTICE 5-12 (4th ed. 2010).

8. Section 3 is an updated summary of a comprehensive study that was published in May 2011. See WOLFF, CHINA OUTBOUND INVESTMENTS, *supra* note 5.



## II. Chinese Investments Overseas in Numbers<sup>9</sup>

### A. INWARD VS. OUTWARD VOLUME

In the past, the focus of investment projects related to China was always on inward projects conducted by foreign entities on the Chinese mainland. The huge potential of the Chinese market and the relatively low labor costs suggested chances and opportunities that were not to be missed. Recent data indicate that this trend will continue. For example, between January and July 2011, the contracted foreign investment volume amounted to 140,276 billion U.S.D., marking an increase of 20.71% year on year.<sup>10</sup> The volume of actual used foreign investment was 69,187 billion U.S.D., which was an increase of 18.57% compared to 2010.<sup>11</sup>

Overseas investments of Chinese enterprises have seen similar impressive growth rates only in recent times. Between 1990 and 2000, China's outward investment volume was less than three billion U.S.D. per year.<sup>12</sup> China's outward investment volume has, however, increased considerably since the beginning of the new millennium.<sup>13</sup> The Chinese government pushed this development with the initiation of its so-called "going-out policy," which was driven, in part, by the goal to convert China's huge foreign exchange reserves of over two trillion U.S.D. into less risky tangible assets.<sup>14</sup> After a temporary slowdown resulting from the global financial crisis in 2008–2009, China's economy recovered quickly, finally yet importantly due to a government stimulus package worth four trillion RMB.<sup>15</sup> The volume of Chinese investment projects overseas has rebounded accordingly.<sup>16</sup>

In 2009 China ranked sixth worldwide in terms of its overseas investments,<sup>17</sup> contributing 5.1% to the aggregate global outward investment volume.<sup>18</sup> In 2010 China's overseas investment volume was, for the first time, bigger than Japan's. China now ranks fifth

9. *Id.* at 1-6.

10. PRC MINISTRY OF COMMERCE, STATISTICS OF JANUARY–JULY 2011 ON NATIONAL ABSORPTION OF FDI (Nov. 18, 2011), available at <http://english.mofcom.gov.cn/aarticle/statistic/foreigninvestment/201109/20110907723320.html>.

11. Compare *id.*, and Jane Cai, *FDI Tapers Off Amid Global Turbulence*, SOUTH CHINA MORNING POST, Oct. 20, 2011, at B3 (reporting that foreign direct investment in mainland China grew 7.88% in Sept. 2011, marking a decrease from the 11.1% growth in Aug. 2011), with Denise Tsang, *Rising Costs to Hit China's FDI Rate*, SOUTH CHINA MORNING POST, Nov. 17, 2011, at B1-2.

12. Mellisa Murphy, *Freeman Briefing: Issue in Focus: China's "Going Out" Investment Policy*, CENTER FOR STRATEGIC & INT'L STUD., May 27, 2008, at 1, available at <http://csis.org/publication/freeman-briefing-may-27-2008>.

13. See PRC MINISTRY OF COMMERCE, *supra* note 6, at 82.

14. *A Brave New World: The Climate of Chinese M&A Abroad*, ECONOMIST INTELLIGENCE UNIT, 2010, at 7; Mark O'Neill, *China's Western Front*, SOUTH CHINA MORNING POST MAGAZINES, Sept. 19, 2011, at 16, available at <http://www.scmp.com/portal/site/SCMP/menuitem.1d923702d0f3d4b2b5326b10cba0a0a0/?vgnextoid=05071ad157d52310VgnVCM100000360a0a0aRCRD&vgnextfmt=mag&issue=20110919&ss=Money&s=Magazines>.

15. Wang Weidong & Geoffrey Mullen, *China's Stimulus Package and the Infrastructure Sector*, ASIAN-COUNSEL, Mar. 2009, at 32-34.

16. United Nations Conference on Trade and Development, *World Investment Report 2010*, 6, U.N. Doc. UNCTAD/WIR/2010 (July 22, 2010), available at [http://www.unctad.org/en/docs/wir2010\\_en.pdf](http://www.unctad.org/en/docs/wir2010_en.pdf).

17. *Id.*

18. Woo, Moller & Chan, *supra* note 3, at 55.

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worldwide<sup>19</sup> and has reached a total outflow volume of 68,811.31 billion U.S.D., of which 12.5% was financial and 87.5% was non-financial in nature.<sup>20</sup> As of the end of 2010, more than 13,000 Chinese outward investors had invested in 16,000 foreign enterprises located in 178 countries and regions.<sup>21</sup> During the first half of 2011, Chinese companies invested in 2,169 foreign enterprises in 117 countries and regions.<sup>22</sup> There is broad consensus that China's overseas investment volume will continue to grow with force in the future.<sup>23</sup>

**B. TARGET COUNTRIES**

According to official statistics,<sup>24</sup> in 2010, Chinese overseas direct investments were spread in terms of the cumulative volume among different target regions as follows:<sup>25</sup>

- Asia: 65.24%
- Latin America: 15.31%
- Europe: 9.82%
- North America: 3.81%
- Africa: 3.07%
- Oceania: 2.75%

China's investments in Asia have slightly decreased since 2010, mirrored by a modest increase of investments in Europe, Latin America, and North America. In 2010, the following countries were ranked the top twenty-five destinations for Chinese investments overseas (the 2009 top destinations are indicated in parenthesis):<sup>26</sup>

- |   |                                |
|---|--------------------------------|
| (1) Hong Kong (Hong Kong)                   | (14) Brazil (South Korea)      |
| (2) British Virgin Islands (Cayman Islands) | (15) Cambodia (Algeria)        |
| (3) Cayman Islands (Australia)              | (16) Turkmenistan (Congo)      |
| (4) Luxembourg (Luxembourg)                 | (17) Germany (Indonesia)       |
| (5) Australia (British Virgin Islands)      | (18) South Africa (Cambodia)   |
| (6) Sweden (Singapore)                      | (19) Hungary (Laos)            |
| (7) USA (USA)                               | (20) United Arab Emirates (UK) |
| (8) Canada (Canada)                         | (21) Japan (Germany)           |
| (9) Singapore (Macau)                       | (22) Pakistan (Nigeria)        |
| (10) Myanmar (Myanmar)                      | (23) UK (Kyrgyzstan)           |
| (11) Thailand (Russia)                      | (24) Laos (Egypt)              |
| (12) Russia (Turkey)                        | (25) Vietnam (Iran)            |
| (13) Iran (Mongolia)                        |                                |

19. United Nations Conference on Trade and Development, *World Investment Report 2011*, 9, 47, U.N. Doc. UNCTAD/WIR/2011 (July 26, 2011), available at [http://www.unctad.org/en/docs/wir2011\\_embargoed\\_en.pdf](http://www.unctad.org/en/docs/wir2011_embargoed_en.pdf).

20. PRC MINISTRY OF COMMERCE, *supra* note 6, at 79.

21. *Id.*

22. PRC MINISTRY OF COMMERCE, STATISTICS OF CHINA'S NON-FINANCIAL FOREIGN DIRECT INVESTMENT IN THE FIRST HALF OF 2010 (Nov. 18, 2011), available at <http://hzs.mofcom.gov.cn/aarticle/date/201107/20110707660092.html>.

23. Woo, Moller & Chan, *supra* note 3, at 56.

24. PRC MINISTRY OF COMMERCE, *supra* note 6, at 83-87.

25. For 2009 see WOLFF, CHINA OUTBOUND INVESTMENTS, *supra* note 5, at 2-3.

26. PRC MINISTRY OF COMMERCE, *supra* note 6, at 83-87; for 2009 see WOLFF, CHINA OUTBOUND INVESTMENTS, *supra* note 5, at 2.

For tax structuring reasons, it is common practice for Chinese inward and outward investors to take advantage of special purpose offshore companies. Special purpose companies are normally located in low or zero tax jurisdictions and are used only to hold investments onshore, sometimes through additional layers of other special purpose companies. It is therefore not surprising to find Hong Kong, Luxembourg, the Cayman Islands,<sup>27</sup> and the British Virgin Islands<sup>28</sup> among the top destinations for Chinese investments. In particular, more than fifty-five percent of China's investments overseas were "channeled" through Hong Kong in past years.<sup>29</sup>

In 2010, Chinese acquisitions of Canadian and U.S. companies increased by eighty-one percent to 6.8 billion U.S.D.<sup>30</sup> This is seen as only the "beginning of a tidal wave" as another one trillion to two trillion U.S.D. of Chinese investments in U.S. targets alone is envisaged this decade.<sup>31</sup> Commentators expect that Chinese investments in Europe will also see a substantial increase in the years to come.<sup>32</sup> At the same time, Chinese investments in African countries have dropped proportionally from 3.8% of China's total overseas investment volume in 2009 to 3.07% in 2010.<sup>33</sup>

### III. China's Outward Investment Regime

#### A. GENERAL

China's overseas investment regime is laid out in a variety of rules and regulations covering a number of subject areas, with different authorities in charge of their enactment, interpretation, and enforcement. The existing legislative diversity, as well as the power structure of the concerned government authorities, often makes it difficult to understand the precise procedure to be followed by a Chinese enterprise planning to invest abroad.

Additional problems arise from the fact that laws and regulations are partly unclear, inconsistent, or incomplete.<sup>34</sup>

The main features of China's outward investment regime are summarized in the following.<sup>35</sup>

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27. For investments in Africa via the Cayman Islands, Mauritius, and the Seychelles, see Woo, Moller & Chan, *supra* note 3, at 55.

28. See Naomi Rovnick, *Caribbean Tax Haven Adds Heat to China's Hot Money*, SOUTH CHINA MORNING POST, May 19, 2011, at A1, A4.

29. Enoch Yiu, *Rules Hamper Use of Yuan for Overseas Investment*, SOUTH CHINA MORNING POST, June 14, 2011, at B3. For the practice of "round-tripping" see *infra*, Section 3, Part D.

30. Woo, Moller & Chan, *supra* note 3, at 55; James Flanigan, *Ailing U.S. Firms Survive with a Helping Hand from China*, INTERNATIONAL HERALD TRIBUNE, July 8, 2011, at 16 (in 2010, the value of Chinese investments in U.S. companies was U.S. \$5 billion); Eric Ng, *PetroChina Quits Deal for Canada Gas Firm Stake*, SOUTH CHINA MORNING POST, June 23, 2011, at B4 (withdrawing from a Canadian \$5.4 billion stake in a natural gas project "has not affected PetroChina's overseas development plan and business strategy in North America.").

31. Flanigan, *supra* note 30, at 16.

32. Woo, Moller & Chan, *supra* note 3, at 58.

33. Cf. WOLFF, CHINA OUTBOUND INVESTMENTS, *supra* note 5, at 2.

34. Cf. WOLFF, MERGERS & ACQUISITIONS IN CHINA, *supra* note 7, at 16.

35. Cf. WOLFF, CHINA OUTBOUND INVESTMENTS, *supra* note 5, at 13-27 (discussing approval and registration requirements); *id.* at 81-105 (discussing China's outbound investment tax aspects).

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**B. NDRC APPROVAL**

First, overseas investments in the form of direct investments, or M&A transactions, conducted directly or indirectly through offshore subsidiaries by Chinese individuals, legal persons, or other entities<sup>36</sup> require the approval of the National Development and Reform Commission (NDRC).<sup>37</sup> The NDRC approval requirement is meant to ensure: (1) compliance with Chinese laws and regulations; (2) compliance with industrial policies; (3) non-violation of the sovereignty, security and public interest of the Chinese state and of international law; (4) general compliance with the overall economic and financial state planning and development; (5) financial viability; and (6) technical feasibility of Chinese overseas investment projects.<sup>38</sup>

Chinese outward investors are not allowed to sign any legally binding documents before obtaining a NDRC Approval Certificate or a Filing Certificate.<sup>39</sup> The Approval or Filing Certificate issued by the NDRC, or the State Council, is required for Chinese outward investors to go through mandatory foreign exchange, customs, immigration, and tax procedures.<sup>40</sup> In principle, the NDRC decides whether approval is granted within twenty working days from the acceptance of the project application report.<sup>41</sup>

The power of different NDRC levels to approve outward investment projects differs depending on the size of a project, the target industry, and the target country or region.<sup>42</sup> Generally speaking, central level NDRC approval—in special cases with State Council endorsement—is necessary for big or strategically important projects.<sup>43</sup> Less important projects are within the approval power of provincial-level NDRC branches or NDRC branches at the level of municipalities directly under the central government, autonomous

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36. Notice on Issues Concerning the Improvement of the Administration of Overseas Investment Projects (promulgated by the Nat'l Dev. & Reform Comm'n, June 8, 2009, effective June 8, 2009), art. 2 (China).

37. *Compare* Notice on Issues Concerning the Improvement of the Administration of Overseas Investment Projects (promulgated by the Nat'l Dev. & Reform Comm'n, June 8, 2009, effective June 8, 2009) (China), *and* Notice on Record-Filing Certification for Overseas Investment Projects (promulgated by the Nat'l Dev. & Reform Comm'n Gen. Office, May 30, 2007, effective May 30, 2007) (China), *with* Notice on Relevant Issues Concerning the Establishment of Risk Guarantee Mechanism for Key Overseas Investment Projects (promulgated by the Nat'l Dev. & Reform Comm'n and the China Export & Credit Ins. Corp., Jan. 25, 2005, effective Jan. 25, 2005) (China).

38. Interim Measures for the Administration of Verification and Approval of Overseas Investment Projects (promulgated by the Nat'l Dev. & Reform Comm'n, Oct. 9, 2004, effective Oct. 9, 2004), art. 18 (China) [hereinafter Interim Measures].

39. *Id.* art. 20 (supplemented by Notice on Relevant Issues Concerning the Establishment of Risk Guarantee Mechanism for Key Overseas Investment Projects (promulgated by the Nat'l Dev. & Reform Comm'n and the China Export & Credit Ins. Corp., Jan. 25, 2005, effective Jan. 25, 2005)) (China); Notice on Record-Filing Certification for Overseas Investment Projects (promulgated by the Nat'l Dev. & Reform Comm. Gen. Office, May 30, 2007, effective May 30, 2007) (China); Notice on Issues Concerning the Improvement of the Administration of Overseas Investment Projects (promulgated by the Nat'l Dev. & Reform Comm'n, June 8, 2009, effective June 8, 2009) (China); Notice on Delegating Powers on Approval of Overseas Investment Projects to Authorities at Lower Levels (promulgated by the Nat'l Dev. & Reform Comm'n, Feb. 14, 2011, effective Feb. 14, 2011) (China).

40. Interim Measures, *supra* note 38, arts. 19-20.

41. *Id.* art. 11.

42. Notice on Delegating Powers on Approval of Overseas Investment Projects to Authorities at Lower Levels (promulgated by the Nat'l Dev. & Reform Comm'n, Feb. 14, 2011, effective Feb. 14, 2011) at 1-4, (China).

43. Interim Measures, *supra* note 38, arts. 4, 7.

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regions, cities under separate state planning, and the Xinjiang Production and Reform Commission.<sup>44</sup>

C. MOFCOM APPROVAL

Non-financial overseas investments by Chinese entities with legal person status<sup>45</sup> also require the approval of MOFCOM.<sup>46</sup> The MOFCOM approval requirement applies whether an investment is direct or via the M&A mode, as well as in relation to the acquisition of control over foreign targets through other means.<sup>47</sup> An “Enterprise Overseas Investment Certificate” issued by MOFCOM upon approval<sup>48</sup> enables a Chinese overseas investor to handle foreign exchange, bank, customs, and other formalities.<sup>49</sup> In addition, offshore investments of subsidiaries controlled by Chinese outward investors are subject to a MOFCOM filing requirement.<sup>50</sup>

Central-level MOFCOM approval is required for relatively large projects and projects that are politically sensitive or that are conducted through special purpose companies.<sup>51</sup> Projects with an investment volume between ten million and one hundred million U.S.D., projects in the field of energy and minerals, and projects needing to raise funds within China, require provincial level MOFCOM approval.<sup>52</sup> For projects that are not within the approval power of central level MOFCOM or of provincial level MOFCOM, a standardized Application Form for Overseas Investment<sup>53</sup> must be submitted online.<sup>54</sup> According to MOFCOM, about eighty-five percent of all Chinese overseas investment projects should fall within this category.<sup>55</sup>

D. INDUSTRY-RELATED REQUIREMENTS

Special restrictions apply to Chinese overseas investments in regulated industry sectors. Overseas investments by financial institutions are subject to the approval of the China

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44. *Id.* art. 5.

45. Measures for the Administration of Overseas Investments (promulgated by the Ministry of Commerce, May 1, 2009, effective May 1, 2009), art. 2 [hereinafter Administrative Measures]. Overseas investments by individuals and by China Investment Corporation (China’s sovereign wealth fund company) are not covered by the Administrative Measures. Neal Stender, Lin Lawrence Zhou & Yan Zeng, *Outbound unbound?*, CHINA L. & PRAC., Apr. 15, 2009, at 18-19.

46. See Administrative Measures, *supra* note 45, and Notice on Joint Annual Inspection of Overseas Investments (promulgated by the Ministry of Commerce and the State Admin. of Foreign Exch., Dec. 28, 2009, effective Dec. 28, 2009) (China); WOLFF, CHINA OUTBOUND INVESTMENTS, *supra* note 5, at 17 (for special rules enacted at provincial and municipal level). Overseas investments are prohibited if they endanger China’s sovereignty, national security or public interest, if they violate Chinese law, damage the relationships with a foreign country, or involve technology or goods that are prohibited from being exported. Administrative Measures, *supra* note 45, art. 9.

47. Administrative Measures, *supra* note 45, art. 38.

48. *Id.* arts. 5, 15.

49. *Id.* arts. 29, 30.

50. *Id.* art. 39.

51. *Id.* art. 6; *id.* art. 37 (for the term ‘special purpose company’).

52. *Id.* arts. 7, 14.

53. *Id.* art. 8.

54. *Foreign Investment Management System*, MINISTRY OF COMMERCE, <http://femhzs.mofcom.gov.cn/fecpmvc/pages/fem/LoginedHome.html> (last visited Dec. 22, 2011).

55. Michael Tan, *Chinese Overseas Investment Summarized*, CHINA L. & PRAC. Feb. 3, 2010, at 24-25.

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Banking Regulatory Commission and the State Administration of Foreign Exchange (SAFE).<sup>56</sup> The China Insurance Regulatory Commission must approve overseas investments in the insurance sector.<sup>57</sup> Overseas investment projects of securities companies are subjected to the approval of the China Securities Regulatory Commission (CSRC).<sup>58</sup> Similarly, overseas investments by companies listed on the Shanghai or Shenzhen stock exchange, as well as investments into foreign listed target companies, also require CSRC approval. Finally, involvement of the State-owned Assets Supervision and Administration Commission (SASAC) may be required for the state-owned sector.<sup>59</sup>

E. ROUND-TRIPPING

It has long been common practice for Chinese companies to engage in so-called round-tripping practices.<sup>60</sup> Round-tripping entails the establishment of a special purpose company abroad that then re-invests in China by establishing (artificial) foreign investment enterprises (FIEs).<sup>61</sup> The main goal of these structures was originally tax-related, as FIEs enjoyed special tax holidays in China.<sup>62</sup> China's corporate income tax reform in 2008 and the recent steps to prevent tax evasion have made the use of round-trip investments for legal tax optimization more difficult.<sup>63</sup> According to anecdotal evidence round-tripping, however, is still widely used for tax avoidance purposes. Round-tripping also offers access to overseas debt financing through the special purpose company,<sup>64</sup> and it allows circumventing onshore regulatory as well as practical problems related to listings on one of the

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56. Law of the People's Republic of China of Regulation of and Supervision over the Banking Industry (promulgated by the Standing Comm. of the Nat'l People's Cong., Oct. 31, 2006, effective Feb. 1, 2007), art. 2; Certain Provisions on Financial Management of Financial Holding Companies (promulgated by the Ministry of Finance, Sept. 1, 2009, effective Sept. 1, 2009), art. 13 (China); Financial Rules for Financial Enterprises (promulgated by the Ministry of Finance, Dec. 7, 2006, effective Jan. 1, 2007), arts. 24, 27 ¶ 4 (China); Notice on Issues Concerning Foreign Exchange Administration for Overseas Direct Investment of Domestic Banks (promulgated by the State Admin. of Foreign Exch., June 30, 2010, effective Sept. 1, 2010) (discussing SAFE involvement).

57. Measures for the Administration of the Establishment of Overseas Insurance Institutions by Insurance Companies (promulgated by the China Ins. Regulatory Comm'n, July 31, 2006, effective Sept. 1, 2006), art. 14 (China); Provisions on the Administration of Insurance Companies (promulgated by the China Ins. Regulatory Comm'n, Sept. 25, 2009, effective Oct. 1, 2009), art. 74 (China); Administrative Measures Regarding Investment of Non-Insurance Institutions in Overseas Insurance Enterprises (promulgated by the China Ins. Regulatory Comm'n, July 31, 2006, effective Sept. 1, 2006), art. 6 (China); Measures for the Administration of Insurance Conglomerates (Interim) (promulgated by the China Ins. Regulatory Comm'n, Mar. 12, 2010, effective Mar. 12, 2010), arts. 9, 15 (China); Joel H. Rothstein, *Insurance as a Transforming Force for China Real Estate*, CHINA L. & PRAC. Dec. 9, 2009, at 20-23; Zhan Hao, *Ruling the Expanding Insurance Group Kingdom*, CHINA L. & PRAC. May 12, 2010, at 20-21.

58. Regulations on the Supervision and Administration of Securities Companies (promulgated by the State Council, Apr. 23, 2008, effective June 1, 2008), art. 13 (China).

59. Interim Measures for Administration of Overseas State-owned Property Rights of Central Enterprises (promulgated by the State-owned Assets Supervision & Admin. Comm'n of the State Council, June 14, 2011, effective July 1, 2011), arts. 2, 8 (China).

60. Also called: "outbound-inbound investments."

61. See WOLFF, *MERGERS & ACQUISITIONS IN CHINA* *supra* note 7, at 202 (providing a historical background).

62. *Id.*

63. *Id.*

64. Robert Cookson, *Investors Warned of Chinese Debt Danger*, FIN. TIMES, July 21, 2011, at 35.

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Chinese stock exchanges in Shanghai or Beijing<sup>65</sup> by listing the special purpose company offshore. Offshore special purpose companies established by mainland entities for round-tripping purposes have also been popular targets of investments by foreign private equity funds.<sup>66</sup>

Since 2005, Chinese legislators have taken a tougher stance against round-tripping.<sup>67</sup> A SAFE registration and MOFCOM approval system for all outward foreign currency transfers was created.<sup>68</sup> The SAFE registration requires not only a prior issuance of the MOFCOM approval document,<sup>69</sup> but also a track record of at least three years for domestic enterprises using offshore special purpose companies for round-trip investments as well for the special purpose company itself.<sup>70</sup> Furthermore, if any round-trip transaction entails the acquisition of an onshore domestic enterprise, such enterprise will in principle not enjoy FIE status<sup>71</sup> and will be subject to central MOFCOM approval.<sup>72</sup> Finally, the overseas listing of an entity owned by mainland shareholders and established as a special purpose company for such listing purpose is subject to CSRC approval, MOFCOM approval, NDRC verification, and SAFE approval and must comply with certain other preconditions.<sup>73</sup>

F. FOREIGN EXCHANGE CONTROL

China still operates a rather strict foreign exchange control system.<sup>74</sup> As a matter of principle, foreign exchange (FOREX) cannot be used for payment purposes in China.<sup>75</sup>

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65. Lu Haitian et al., *Venture Capital and the Law in China*, 37 HONG KONG L.J. 229, 251 (2007).

66. Marcia Ellis & Auria Styles, *Rethinking M&A in China*, 34 CHINA BUS. REV. 36, 36 (2007).

67. See WOLFF, *MERGERS & ACQUISITIONS IN CHINA*, *supra* note 7, at 202-204.

68. See Notice on Relevant Issues Concerning the Administration of Foreign Exchange from Domestic Residents' Financing Through Overseas Special Purpose Vehicles and for Round-trip Investments (Circular 75), (promulgated by the State Admin. of Foreign Exchange Oct. 21, 2005, effective Nov. 1, 2005) (LEXIS China Online) (China); Neil Stender & Zeng Yan, *It's SAFE Again for China Venture Capital Round-trip & Red-chip Listings*, CHINA L. & PRAC., Nov. 2005, at 15-18; Neil Stender et al., *SAFE Plugs Holes for China/Offshore Round-trip Investments*, CHINA L. & PRAC., July 2007, at 58-60; see also Operation Rules on Relevant Issues regarding Foreign Exchange Control over the Financing and Return of Investment of Domestic Residents through Overseas Special Purpose Companies, (promulgated by the State Admin. of Foreign Exchange, May 20, 2011, effective July 1, 2011) (LEXIS China Online).

69. Stender, *supra* note 68, at 58-60.

70. WOLFF, *CHINA OUTBOUND INVESTMENTS*, *supra* note 5, at 23; see now the SAFE Rules of Operation for the FOREX Administration of Financing and Round-trip Investments of Chinese Citizens through Special Purpose Companies (promulgated by the State Admin. of Foreign Exchange, May 20, 2011, effective July 1, 2011) (LEXIS China Online) (China) (relating to individual round trip investors).

71. Acquisition of Domestic Enterprises by Foreign Investors Provisions (promulgated by the Ministry of Commerce, effective June 22, 2009), art. 9, ¶ 3 (LEXIS China Online) (China).

72. *Id.* art. 11.

73. *Id.* arts. 40-47; Ellis, *supra* note 66, at 36; Jonathan Zhou, *Little Red Chips Get an Overseas Opening*, CHINA L. & PRAC., May 2009, at 18.

74. Regulations of the People's Republic of China on Foreign Exchange Administration (promulgated by the State Council of the People's Republic of China, effective Aug. 5, 2008) (LEXIS China Online) (China) [hereinafter PRC Regulations on Foreign Exchange Administration] (supplemented by a large number of Circulars on specific topics).

75. *Id.* art. 8.

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SAFE approval is required for the provision of security to foreign parties<sup>76</sup> and the granting of commercial loans to foreign parties by domestic non-banking institutions.<sup>77</sup>

Only designated financial institutions<sup>78</sup> are allowed to engage in FOREX business and have to operate special FOREX accounts for this purpose.<sup>79</sup> All incoming and outgoing FOREX payments have to be reported.<sup>80</sup> SAFE registration is required before foreign investors can open FOREX accounts.<sup>81</sup> SAFE has the right to inspect and examine FOREX transactions at any time.<sup>82</sup> SAFE can also impose penalties in case of violations.<sup>83</sup>

In response to the difficulties caused by the global financial crisis, China's foreign exchange control system saw some liberalization in 2009.<sup>84</sup> Amongst other measures,<sup>85</sup> the FOREX management system related to overseas investments was improved.<sup>86</sup> Chinese enterprises are now allowed to make overseas investments with their own foreign exchange funds, domestic foreign exchange loans, foreign exchange purchased with RMB funds, tangible assets, intangible assets, and other FOREX sources,<sup>87</sup> subject to SAFE registration and approval.<sup>88</sup> Chinese entities and individuals no longer need to convert current account FOREX receipts into RMB.<sup>89</sup> Moreover, Chinese individuals and entities may now keep offshore current account FOREX receipts offshore, *i.e.* these receipts

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76. *Id.* art. 19.

77. *Id.* art. 20.

78. *Id.* art. 24.

79. *Id.* art. 24.

80. *Id.* arts. 6–7.

81. *Id.* art. 16.

82. *Id.* arts. 12, 33; Amy Chen & Jonathan Salvadoray, *PRC Foreign Exchange Administration Regulations Revised*, CHINA L. & PRAC., Oct. 2008, at 27.

83. PRC Regulations on Foreign Exchange Administration, arts. 39–49 (LEXIS China Online).

84. *See, e.g.*, Notice on Questions Regarding the Administration of Onshore FOREX Accounts of Foreign Institutions (promulgated by the State Admin. of Foreign Exchange, July 13, 2009, effective Aug. 1, 2009) (LEXIS China Online) (China).

85. WOLFF, *MERGERS & ACQUISITIONS IN CHINA*, *supra* note 7, at 226–228.

86. *See, e.g.*, Provisions on Foreign Exchange Administration for Overseas Direct Investments by Domestic Institutions (promulgated by the State Admin. of Foreign Exchange, July 13, 2009, effective Aug. 1, 2009) (LEXIS China Online) (China); *see also* Notice Regarding Foreign Exchange Administration of Overseas Direct Investment by Domestic Banks (promulgated by the State Admin. of Foreign Exchange, June 30, 2010, effective Sept. 1, 2010) (LEXIS China Online) (China); Measures for the Assessment of the Implementation of Foreign Exchange Regulations by Banks (promulgated by the State Admin. of Foreign Exchange, effective Aug. 1, 2010) (LEXIS China Online) (China).

87. Provisions on Foreign Exchange Administration for Overseas Direct Investments by Domestic Institutions (LEXIS China Online).

88. PRC Regulations on Foreign Exchange Administration, art. 9 (LEXIS China Online); Notice on Cancelling and Adjusting the Examination and Approval Power and Administration Policies for Some Foreign Exchange Businesses under Capital Accounts (promulgated by State Admin. of Foreign Exchange, May 23, 2011, effective June 1, 2011) (LEXIS China Online) (China); Circular on Several Issues Regarding the Submission of Tax Certificates for Overseas Payments in the Service Industry (jointly promulgated by the State Admin. of Foreign Exchange & the State Admin. of Tax'n, Nov. 25, 2008, effective Jan. 1, 2009) (LEXIS China Online) (China) (providing that tax certificates need to be submitted to competent tax authorities when domestic entities and individuals make overseas payments of more than 30,000 U.S.D.).

89. PRC Regulations on Foreign Exchange Administration, art. 13 (LEXIS China Online); Notice on Issues Regarding the Administration of Foreign Exchange for Foreign Lending by Domestic Enterprises (promulgated by State Admin. of Foreign Exchange, June 9, 2009, effective Aug. 1, 2009) (LEXIS China Online) (China); Liu Yi & Philip Zhengyu Ding, *Shareholder Loans Permitted to Overseas Subsidiaries*, CHINA L. & PRAC., July 2009, at 40.



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do not have to be repatriated.<sup>90</sup> Even RMB investments overseas are now possible under measures introduced in early 2011,<sup>91</sup> although Chinese outward investors still seem to prefer using FOREX for overseas investment purposes supposedly due to the much easier approval procedure.

G. FINANCING<sup>92</sup>

Since December 6, 2008, qualified commercial Chinese banks are allowed to grant loans for M&A purposes to domestic purchasers of target companies and their offshore special purpose companies.<sup>93</sup> In this regard, certain preconditions must be fulfilled, *e.g.* banks must establish suitable risk-management systems and meet a high capital adequacy ratio of at least ten percent and maintain a specific loan loss reserve adequacy ratio of at least one hundred percent.<sup>94</sup> FOREX debt financing of overseas investment projects has been possible since August 2009.<sup>95</sup> Upon fulfillment of certain preconditions, domestic enterprises can provide loans to their offshore subsidiaries by making use of their foreign exchange funds, purchased foreign exchange funds, or currency sourced from foreign currency pools of their group companies.<sup>96</sup>

H. MERGER CONTROL

China's rather new merger control regime is developing fast and has generated a lot of interest in recent years. China's merger control rules apply to transactions inside and outside mainland China, provided that they affect competition within the Chinese markets.<sup>97</sup> Chinese outward investments may consequently fall within the scope of applicability.<sup>98</sup>

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90. PRC Regulations on Foreign Exchange Administration, art. 9 (LEXIS China Online); Chen, *supra* note 82, at 26; Operation Rules on Relevant Issues Regarding Foreign Exchange Control over the Financing and Return of Investment of Domestic Residents through Overseas Special Purpose Companies (promulgated by the State Admin. of Foreign Exchange, May 20, 2011, effective July 1, 2011) (LEXIS China Online) (China).

91. Administrative Measures for the Pilot RMB Settlement of Outbound Direct Investment (promulgated by the People's Bank of China, Jan. 6, 2011, effective Jan. 6, 2011) (LEXIS China Online) (China).

92. See Jun Dai, *Financing of China Outbound Investments*, in WOLFF, CHINA OUTBOUND INVESTMENTS, *supra* note 5, at 9–70; see also Xi Chao, *Qualified Domestic Institutional Investors*, in WOLFF, CHINA OUTBOUND INVESTMENTS, *supra* note 5, at 71–79.

93. Guidelines for Risk Management of the Merger Loans of Commercial Banks (promulgated by the China Banking Regulatory Commission, Dec. 6, 2008, effective Dec. 6, 2008) (LEXIS China Online) (China).

94. *Id.* § 1.

95. Notice on Issues Regarding the Administration of Foreign Exchange for Foreign Lending by Domestic Enterprises (promulgated by the State Admin. of Foreign Exchange, June 9, 2009, effective Aug. 1, 2009) (LEXIS China Online) (China).

96. Notice on Relevant Issues Concerning the Foreign Exchange Administration of Overseas Loans Granted by Domestic Enterprises, arts. 1, 6, and 7 (promulgated by the State Admin. of Foreign Exchange, June 9, 2009, effective Aug. 1, 2009); *Regulator Makes Outbound Investment Easier*, CHINA L. & PRAC., July 2009, at 9.

97. People's Republic of China Anti-Monopoly Law, art. 2 (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 30, 2007, effective Aug. 1, 2008) (LEXIS China Online) (China) [hereinafter PRC Anti-Monopoly Law]; Marc Williams, *The Impact of the Anti-Monopoly Law*, in CHINA OUTBOUND INVESTMENTS, *supra* note 5, at 43–58 (2011).

98. PRC Anti-Monopoly Law, art. 2 (LEXIS China Online).

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China's current merger control regime is based on the *PRC Anti-Monopoly Law*, which became effective on August 1, 2008.<sup>99</sup> The merger control rules of the *PRC Anti-Monopoly Law* are supplemented by a large number of implementation rules and regulations<sup>100</sup> enacted after August 2008 and to be enacted in the future. Supervision and enforcement of China's merger control rules are within the scope of authority of MOFCOM.<sup>101</sup> MOFCOM must be notified<sup>102</sup> and specific documents must be submitted if a transaction meets one of the following thresholds:<sup>103</sup>

(1) the aggregate global turnover<sup>104</sup> of all the concerned enterprises exceeded RMB 10 billion in the previous financial year and the turnover within China<sup>105</sup> of at least two of the parties exceeded RMB 400 million in the previous financial year; or

(2) the aggregate turnover within China of all the concerned parties exceeded RMB 2 billion in the previous financial year, and the turnover within China of at least two concerned parties exceeded RMB 400 million in the same period.<sup>106</sup>

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99. PRC Anti-Monopoly Law; *supra* note 97, art. 57; Williams, *supra* note 97; WOLFF, *MERGERS & ACQUISITIONS IN CHINA*, *supra* note 7, at 247–71.

100. See, e.g., Regulations Concerning Thresholds for the Notification of Concentrations of Business Operators (promulgated by the State Council of the People's Republic of China, Aug. 3, 2008, effective Aug. 3, 2008) (LEXIS China Online) (China); Guidelines for Conducting Anti-Monopoly Examinations Regarding Concentrations of Business Operators (Jan. 1, 2009); Guidelines for the Notification of Concentrations of Business Operators (promulgated by the Anti-Trust Bureau of the Ministry of Commerce, Jan. 5, 2009, effective Jan. 5, 2009) (LEXIS China Online) (China); Guidelines for the Documents and Materials for the Notification of Concentrations of Business Operators (promulgated by the Anti-Monopoly Bureau of the Ministry of Commerce, Jan. 5, 2009, effective Jan. 5, 2009) (LEXIS China Online) (China); Guidelines of the Anti-Monopoly Commission Under the State Council Concerning the Definition of Relevant Markets (promulgated by Anti-Monopoly Comm'n of the State Council, May 24, 2009, effective, May 24, 2009); Measures for the Examination of the Concentrations Between Undertakings, (promulgated by the Ministry of Commerce, Nov. 21, 2009, effective Jan. 1, 2010) (LEXIS China Online) (China); Measures for the Reporting of Concentrations of Business Operators (promulgated by the Ministry of Commerce, Nov. 21, 2009, effective Jan. 1, 2010 China) (LEXIS China Online) (China); Tentative Provisions on Implementing Divestiture of Assets or Business in Concentration of Undertakings (promulgated by the Ministry of Commerce, July 5, 2010, effective July 5, 2010) (LEXIS China Online) (China); Measures for the Calculation of Turnover for the Consolidated Declaration of the Business Operators in Financial Industry (promulgated jointly by the Ministry of Commerce, the People's Bank of China, China Banking Regulatory Comm'n, China Securities Regulatory Comm'n, and China Insurance Regulatory Comm'n, July 15, 2009, effective Aug. 15, 2009) (LEXIS China Online) (China).

101. WOLFF, *MERGERS & ACQUISITIONS IN CHINA*, *supra* note 7, at 251. MOFCOM has established an Anti-Monopoly Bureau. See MOFCOM, *Anti-Monopoly Bureau*, <http://fdj.mofcom.gov.cn> (last visited on Nov. 18, 2011). The Anti-Monopoly Commission of the State Council is in charge of strategic and coordination work. PRC Anti-Monopoly Law, *supra* note 97, art. 9 ¶ 1; see also Susan Ning, *Overview of the Anti-Monopoly Law*, CHINA L. & PRAC., Oct. 2007, at 23–25; Sharon Mann, *Competition Law and Policy Developments in China: the New Anti-Monopoly Law*, ASIAN COUNSEL, June 2008, at 42–46.

102. For details of the notification requirements, see Measures for the Reporting of Concentrations of Business Operators (LEXIS China Online).

103. Regulations Concerning Thresholds for the Notification of Concentrations of Business Operators, art. 3 (LEXIS China Online); Alexander Vincent, *Notification Thresholds for Merger Control*, CHINA L. & PRACT., Sept. 2008, at 42–43.

104. For a definition of "turnover," see Measures for the Reporting of Concentrations of Business Operators, arts. 4–7 (LEXIS China Online).

105. "In China" is defined in Measures for the Reporting of Concentrations of Business Operators, art. 4, ¶ 2 (LEXIS China Online).

106. For transactions conducted within the finance industry by banks, securities companies, futures companies, and other financial institutions, the turnover that triggers the notification requirement shall be calcu-

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MOFCOM can allow transactions subject to the fulfillment of certain conditions.<sup>107</sup> MOFCOM should reach a final decision within ninety days.<sup>108</sup> Between 2008 and the end of 2010, MOFCOM cleared over 207 transactions, subjected six transactions to conditions, and disallowed one transaction.<sup>109</sup> Until mid-December 2011, an additional 194 notifications had been received of which 160 have been reviewed and closed.<sup>110</sup> Four cases were granted conditional approval and five cases were withdrawn.<sup>111</sup> None of the published MOFCOM decisions involve any Chinese overseas investment project or relates to purely Chinese transactions without foreign involvement.<sup>112</sup>

I. INVESTMENTS IN HONG KONG, MACAU, AND TAIWAN

In line with the concept “one country, two systems,”<sup>113</sup> investments by mainland enterprises in Hong Kong and Macau are treated like investments in foreign countries.<sup>114</sup> Special rules apply in relation to investments by mainland enterprises in Taiwan.<sup>115</sup> These rules have been enacted against the background of the conclusion of an *Economic Cooperation Framework Agreement* (ECFA), which was signed by mainland and Taiwan representatives in June 2010 and became effective on September 12, 2010.<sup>116</sup> Investments by mainland entities in Taiwan, including investments via offshore vehicles, require NDRC and MOFCOM approval.<sup>117</sup> In addition, the State Council’s Taiwan Affairs Office has to be involved in the approval process.<sup>118</sup> Preferential treatment under the ECFA as well as special government support, e.g. in the form of special consultancy services, are available

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lated on the basis of only ten percent of the turnover. Measures for the Calculation of Turnover for the Consolidated Declaration of the Business Operators in Financial Industry (LEXIS China Online).

107. PRC Anti-Monopoly Law, *supra* note 97, art. 23.

108. For the possibility to extend this period see *id.* art. 26, ¶ 2.

109. Susan Ning & Huang Jing, *MOFCOM Revealed Yearly Merger Control Statistics*, CHINA LAW INSIGHT, Sept. 26, 2011, <http://www.chinalawinsight.com/2011/09/articles/corporate/antitrust-competition/mofcom-revealed-yearly-merger-control-statistics>.

110. Susan Ning, Liwei Wang & Hazel Yin, AMB Director Shang Ming Speaks on Merger Enforcement in 2011, CHINA LAW INSIGHT, Jan. 4, 2012, <http://www.kingandwood.com/practice.aspx?id=antitrust-competition&language=en>.

111. *Id.*

112. WOLFF, *MERGERS & ACQUISITIONS IN CHINA*, *supra* note 7, at 261–62.

113. Wolff, *supra* note 1.

114. This is because regulations such as the “Administrative Measures on Matters to be Verified for Investments in and Establishment of Enterprises in the Hong Kong and Macau Special Administrative Regions by Mainland Enterprises,” originally effective Aug. 31, 2004, are no longer in force.

115. Measures for the Administration of Investments of Mainland Enterprises in Taiwan (promulgated by the National Development and Reform Comm’n, the Ministry of Commerce, and the Taiwan Affairs Office of the State Council, Nov. 9, 2010, effective Nov. 9, 2010) (CHINA L. & PRACT.) (China); Yujing Shu et al., *New Regulations Governing Investment in Taiwan by Mainland Enterprises*, CHINA OUTBOUND INVESTMENT GUIDE 2011, at 87–89, available at <http://www.iflr.com/Article/2836629/Channel/193438/New-regulations-governing-investment-in-Taiwan-by-mainland-enterprises.html>; Wolff, *Approval and Registration Requirements*, in WOLFF, CHINA OUTBOUND INVESTMENTS, *supra* note 5, at 13–27.

116. Economic Cooperation Framework Agreement, Ministry of Economic Affairs, Republic of China, [http://www.moea.gov.tw/Mns/populace/news/News.aspx?kind=1&menu\\_id=40&news\\_id=19723](http://www.moea.gov.tw/Mns/populace/news/News.aspx?kind=1&menu_id=40&news_id=19723) (last visited Dec. 22, 2011).

117. Administrative Measures for Mainland Enterprises Investing in the Taiwan Region, arts. 4–6. (promulgated by the Ministry of Commerce, the Nat’l Dev. & Reform Comm’n, and the Taiwan Affairs Office of the State Council, Nov. 9, 2010, effective Nov. 9, 2010) (LEXIS China Online) (China).

118. *Id.* art. 7.

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subject to the fulfillment of certain criteria.<sup>119</sup> NDRC examination and MOFCOM examination of Taiwan investment projects are to be conducted in line with the *Interim Measures* and the *Administrative Measures*.<sup>120</sup> The completion as well as any amendment of the investment formalities in Taiwan must be registered with the NDRC, MOFCOM, and the State Council's Taiwan Affairs Office within fifteen working days.<sup>121</sup>

#### **IV. Status Quo and Possible Future Developments: Is Action Required?**

##### **A. DELAYS OF ONSHORE APPROVALS**

As set out in the previous sections, Chinese enterprises are facing a number of restrictions when investing overseas. China's outward investment regime is diversified and complex.<sup>122</sup> Consequently, it is often difficult in practice to find out what precisely the legal requirements are in a particular case to obtain clearance for an overseas investment project.<sup>123</sup> Furthermore, in some cases it was troublesome to obtain the necessary approvals at all. It has even been suggested that delays of over one year may have to be expected depending on the facts of a particular case despite the existing statutory timelines. In many other cases, however, the process apparently did not create any difficulties and the necessary approvals were obtained without many problems after some negotiations with the relevant authorities.<sup>124</sup>

Chinese outward investors and their foreign counterparts can of course be adversely affected by any delay. The fact that it cannot be predicted precisely at what point in time the Chinese approval authorities may clear a project creates uncertainties, which require close attention.<sup>125</sup> As the required approvals are *de facto* closing conditions for overseas investment projects, China's overseas investment rules need to be considered with great care when planning and structuring Chinese outward transactions as well as when drafting underlying documentation. Statutory timelines and the possibility of delays beyond those timelines must be taken into account.<sup>126</sup> Moreover, it has been reported that the approval requirements may have, in some cases, jeopardized the chances of Chinese outward investors by delaying the finalization of investment decisions and giving other non-Chinese investors a competitive advantage in terms of timing when it came to bid for lucrative targets.<sup>127</sup>

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119. *Id.* art. 14.

120. *Id.* arts. 7, 9.

121. *Id.* art. 11.

122. *See supra* section III.

123. *Id.*

124. *See* Jason Chan, *Restructuring First for Outbound Chinese M&A*, CHINA L. & PRAC., Apr. 2011, at 15.

125. For a similar problem in relation to inward investments, *see* Lutz-Christian Wolff, *International M&A and the Problem of the Effective Date under Chinese Law*, 33 COMMON LAW WORLD REV. 283, 283-94 (2004).

126. Benesh, Friedlaender, Coplan & Aranoff, LLP, *China Goes Global: Examining China's Outbound Investment*, CHINA INSIGHTS, Jan. 2010, at 5; Stender, *supra* note 45, at 18-19.

127. Economist Intelligence Unit, *supra* note 14, at 198.

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B. IS CHINA TAKING CONTROL OF THE WORLD'S MARKETS?

While its rapidly increasing outward investment volume evidences China's economic strength, many other parts of the world are struggling to overcome ongoing economic problems. In particular, it became clear in the summer of 2011 that the global economic problems, which had been thought to be solved in the aftermath of the 2008-2009 crisis, continue to exist. The crisis is ongoing and may have even deepened. All of a sudden, China is seen not only as being strong enough to come to the aid of failing European economies, but also as "a potential savior of the global economy."<sup>128</sup>

At the same time, enterprises, particularly in the West and in Japan, have become cheap targets for Chinese investments.<sup>129</sup> This provokes the question of whether many parts of the world's economies will soon be controlled by Chinese enterprises, and, if so, whether this should give rise to concerns and whether any action is required. Cases in which proposed Chinese investments have been blocked by competent state authorities, in particular in the United States and Australia for state security reasons,<sup>130</sup> seem to confirm fears along these lines.<sup>131</sup> In this regard, it must also be considered that Chinese SOEs are the driving force behind China's overseas investments.<sup>132</sup> Even more than other Chinese enterprises SOEs are said to be ultimately controlled by the Chinese Communist Party.<sup>133</sup> Is it consequently necessary to assume that the Chinese Communist Party will soon be in charge of a rapidly growing number of non-Chinese multi-nationals and, thus, greater portions of

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128. Cary Huang, *World's Banker of Choice*, S. CHINA MORNING POST, Oct. 1, 2011, at A7, available at <http://topics.scmp.com/news/china-news-watch/article/Worlds-banker-of-choice>.

129. See Economist Intelligence Unit, *supra* note 14, at 4; Takahiko Hyuga, *Japan Says "Ni Hao" as Brands Trump Diplomatic Tensions in China Takeovers*, BLOOMBERG (Dec. 16, 2010, 1:12 AM), <http://www.bloomberg.com/news/2010-12-15/japan-says-ni-hao-as-brands-trump-diplomacy-for-china-deals.html>; Woo, Moller & Chan, *supra* note 3, at 56.

130. See Susan Ning, Yin Ranran & Huang Jing, *List of Outbound Investments by Chinese Companies Scrutinized for National Security Concerns*, CHINA LAW INSIGHT (Mar. 11, 2011, 6:37 PM), <http://www.chinalawinsight.com/2011/03/articles/corporate/antitrust-competition/list-of-outbound-investments-by-chinese-companies-scrutinized-for-national-security-concerns/>; Bien Perez, *Huawei Calls US' Bluff on Security Threat Claims*, S. CHINA MORNING POST, Feb. 26, 2011, at A1, A6; see also UNCTAD World Investment Report 2010, *supra* note 16, at 76-81 (reporting that recent developments at the level of national investment regimes are to a certain extent ambivalent. On the one hand, there is a trend to increasing liberalization. On the other hand, domestic regimes, as well as the attitude of those bodies in charge of the implementation of these regimes, show signs of new protectionism.).

131. In light of national security systems in other countries and the increasing foreign investment volume in China via the M&A route, China has, in the meantime, established its own national security system based on article 31 of the Anti-Monopoly Law of the People's Republic of China. See generally *Anti-Monopoly Law of the People's Republic of China* (promulgated by the Standing Comm. of the Nat'l People's Cong., Aug. 30, 2007, effective Aug. 1, 2008), translated in 2008 China Law LEXIS 1761. See also generally Circular of the General Office of State Council on Establishment of the Security Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors (promulgated by the General Office of the State Council, Feb. 3, 2011, effective Mar. 4, 2011), translated in 2011 China Law LEXIS 118; Provisions of the Ministry of Commerce on the Implementation of the Safety Review System for Merger and Acquisition of Domestic Enterprises by Foreign Investors (promulgated by the Ministry of Commerce, Aug. 25, 2011, effective Sept. 1, 2011), translated in 2011 China Law LEXIS 573.

132. See *supra* note 5 and accompanying text.

133. See RICHARD MCGREGOR, *THE PARTY: THE SECRET WORLD OF CHINA'S COMMUNIST RULERS* 54 (2010).

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foreign markets<sup>134</sup> Do potential target countries have to tighten controls of Chinese inward investments via their national security control systems?

A closer look reveals that related fears are unsubstantiated, at least at this point in time. First, it appears to be a natural consequence of China's new economic strength and the liberalization of the Chinese economic system over the past three decades that Chinese enterprises are globalizing their operations.<sup>135</sup> There is no hard evidence suggesting that Chinese outward investors are not behaving like any other multi-national enterprise with headquarters in other countries. In particular, it cannot be argued that Chinese outward investors are following a more aggressive investment policy than other countries. There is also no evidence that Chinese investments overseas are aimed at conquering foreign markets in order to increase China's political power.<sup>136</sup> In particular, China's overseas investment regime, as outlined above, appears to be more restrictive than those in most Western countries. Furthermore, UNCTAD has drawn attention to the fact that while most of China's outward investors are SOEs, it appears that the number of Chinese SOEs that have invested abroad is still comparatively small.<sup>137</sup> Finally, despite China's impressive growth rates, its overseas investment volume is still rather moderate compared with the size of the country and its population in relation to its gross domestic product (GDP).<sup>138</sup> Also, as already mentioned, in 2010 China's portion of global foreign direct investment (FDI) outflows reached only approximately 5.1%.<sup>139</sup>

C. GLOBAL IMPACT OF ECONOMIC AND SOCIO-POLITICAL ONSHORE PROBLEMS

While China's economic development in the past years was impressive, as outlined in the previous sections, it cannot be ignored that there are actual and potential problems and risks. In fact, some commentators have argued that China's fast economic growth is unbalanced and unsustainable:

One worry is that the first wave of bad loans from China's huge 2008-2009 stimulus is about to hit. The bigger concern is how growth in recent years left the domestic financial system less resilient. China's expansion relies on various counterproductive policies: an undervalued, nonconvertible currency, off-balance-sheet arrangements to mask debt and ample credit to politically connected firms that don't necessarily make the most productive use of capital.<sup>140</sup>

In this regard, China's economic growth over the past decades in absolute numbers does not say much about the economic competitiveness and the sustainability of its econ-

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134. *Id.*

135. WOLFF, *MERGERS & ACQUISITIONS IN CHINA*, *supra* note 7, at 197.

136. *Id.*

137. UNCTAD World Investment Report 2011, *supra* note 19, at 31.

138. *Compare* Gong, *supra* note 4, at A15 (describing China's GDP and GDP per capita) *with supra* Part IIA (describing China's overseas investment volume).

139. Woo, Moller & Chan, *supra* note 3, at 79; PRC MINISTRY OF COMMERCE, *supra* note 6, at 79.

140. William Pesek, *John Paulson, Subprime God, Flees Muddy Waters*, BLOOMBERG (June 21, 2011, 2:00 PM), <http://www.bloomberg.com/news/2011-06-21/john-paulson-subprime-god-flees-muddy-waters-william-pesek.html>. *See also* David Barboza, *Threat Lurking Under China's Explosive Growth*, INT'L HERALD TRIB., July 8, 2011, at 1, 17; MCGREGOR, *supra* note 133, at 269.

omy.<sup>141</sup> In 2011, China's current GDP does not even reach one-tenth of the per-capita level of that of the United States.<sup>142</sup> While some commentators have argued that "there is no imminent threat of an economy-collapsing banking crisis,"<sup>143</sup> China's finance industry has been said to carry huge risks due to bad loans.<sup>144</sup> Moreover, the rising off-balance sheet exposure of Chinese banks<sup>145</sup> could at any time trigger a chain reaction within the Chinese economy that may be difficult to control.<sup>146</sup>

In addition, debt-financing strategies through offshore special purpose companies<sup>147</sup> could lead to considerable risk exposure of inward investors.<sup>148</sup> If money borrowed by a special purpose company is—as usual—used for investments in China, then foreign creditors have no direct entitlement to the assets of the onshore investee company if the company encounters economic difficulties.<sup>149</sup> In addition, under mainland China's foreign exchange control rules, the investee company would, in such a case, be able to remit only after-tax profits abroad to service the offshore debt via the special purpose company.<sup>150</sup> Commentators have drawn attention to the fact that these profits—if any—may be insufficient under the current market conditions to pay off offshore debts leading to refinancing needs in due course.<sup>151</sup>

The lack of transparency due to insufficient corporate governance structures of Chinese companies, as recently exposed in relation to Chinese companies listed overseas, adds to the problems and a declining confidence in the Chinese economy.<sup>152</sup> It must also be considered that China can no longer automatically be regarded as a low-cost country.<sup>153</sup> In contrast, China must compete globally, *i.e.*, based on technological innovation and superior market expertise.<sup>154</sup> If and how China will be able to meet this challenge remains to be seen.

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141. Gong, *supra* note 4.

142. *Id.* Gong also points out that immediately before the downfall of the Qing dynasty in 1912, China held the top GDP spot worldwide, at 241 billion U.S.D.

143. Barboza, *supra* note 140, at 17; *see also* INT'L MONETARY FUND, *People's Republic of China: Financial System Stability Assessment: IMF COUNTRY REPORT NO. 11/321 7 (2011)* [hereinafter IMF REPORT], available at <http://www.imf.org/external/pubs/cat/longres.aspx?sk=25350.0>.

144. *See* Pesek, *supra* note 140; IMF REPORT, *supra* note 143, at 28.

145. *See* IMF REPORT, *supra* note 143, at 25; Barboza, *supra* note 140, at 1; Lulu Chen, *Fitch Sees Growing Risk on Mainland*, S. CHINA MORNING POST, June 23, 2011, at B3; Pesek, *supra* note 140, at B10.

146. *See* IMF REPORT, *supra* note 143, at 35.

147. *See supra* Part III.E.

148. Cookson, *supra* note 64, at 23.

149. *Id.*

150. *Id.*

151. *Id.*

152. *See* Pesek, *supra* note 140, at B10 (observing that "China's prospects are becoming as murky as the governance of its companies"); Sophie Yu, *Mainland Net Stocks Fall on U.S. Fraud Allegations*, S. CHINA MORNING POST, Oct. 1, 2011, at B1.

153. Gong, *supra* note 4.

154. *See id.*

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Moreover, China's dramatic income disparity has caused concern.<sup>155</sup> About 150 million Chinese live on less than one U.S.D. per day.<sup>156</sup> Human rights violations, struggles over land rights, management-labour problems,<sup>157</sup> economic problems, and social unrest are reported almost on a daily basis,<sup>158</sup> although one must assume that only a very small percentage of what is actually happening is being published.

Considering all of this from the viewpoint of Chinese investments overseas, it is obvious that the more interwoven China's economy is with foreign economies, the greater the risk that onshore problems could also have a considerable impact abroad.<sup>159</sup> At this point in time, one can, of course, only speculate how severe these onshore problems are and precisely what their impact may be. Despite the pessimistic comments reported above, it seems unlikely that China's national economy will, in the short and medium term, run into large-scale problems triggering a global crisis. It is, however, prudent not to ignore the situation altogether, but to assume that it is possible that Chinese overseas investors may encounter economic difficulties.<sup>160</sup> Careful structuring of cooperation projects with Chinese partners and diligent drafting of the underlying contract documents should aim at avoiding unnecessary exposure.

One special aspect that should be considered is the possibility that Chinese entities with overseas investments and Chinese business partners in general become insolvent.<sup>161</sup> China has revised its insolvency system as of June 1, 2007 when the new *PRC Enterprise Bankruptcy Law* entered into force.<sup>162</sup> The new *PRC Enterprise Bankruptcy Law* unifies the previously applicable separate regimes for SOEs and other entities<sup>163</sup> and now covers all mainland business entities with legal person status.<sup>164</sup> It was one of the main goals of the reform of China's insolvency system to provide a practicable set of rules to address the

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155. See *id.* (describing the problem in terms of per capita GDP); Jerome A. Cohen, *Happy Returns?*, S. CHINA MORNING POST, June 21, 2011, at A13, available at <http://www.usasialaw.org/wp-content/uploads/2011/06/2011.06.22-SCMP-Cohen-Happy-returns.pdf>.

156. Press Release, Economic and Social Council, Anti-Poverty Experts in Commission for Social Development Offer Ways to Keep Ranks of People Without Adequate Food, Clothing, Shelter From Swelling; Disconnect Between Reality of Poverty—Actions of Governments Explored, as Panelists, Delegates Alike Call for Alternative Poverty-Eradication Paradigm, U.N. Press Release SOC/4772 (Feb. 10, 2011), available at <http://www.un.org/News/Press/docs/2011/soc4772.doc.htm>.

157. See, e.g., Mimi Lau, *Strikers Dragged Off as Police and Bosses Get Tough*, S. CHINA MORNING POST, June 24, 2011, at A7; see also Cohen, *supra* note 155.

158. See Minxin Pei, *Spilling Over*, S. CHINA MORNING POST, June 20, 2011, at A13; see also generally Cohen, *supra* note 155, at A13.

159. See Barboza, *supra* note 140, at 17 (opining that "any significant slowdown . . . would have international repercussions").

160. See May Chan, *S.M.E. Credit Crisis "Could Sweep China" After a Wave of Businesses Failures in Wenzhou Caused by Firms Forced to Borrow at Steep Rates, Economists Fear the Problem Will Be Contagious*, S. CHINA MORNING POST, Oct. 4, 2011, at A1.

161. See *id.*

162. See generally P.R.C. Enterprise Bankruptcy Law (promulgated by the Standing Comm. Nat'l People's Congress, Aug. 27, 2006, effective June 1, 2007).

163. Lutz-Christian Wolff, *Insolvency, Dissolution, Liquidation*, China Company L. Guide (CCH) 280-750 (2004).

164. *Id.* at 280-760. The PRC Enterprise Bankruptcy Law is supplemented by the "Provisions of the Supreme People's Court on the Appointment of Insolvency Administrators in Enterprise Insolvency Cases," the "Provisions of the Supreme People's Court on the Determination of Insolvency Administrators' Remuneration in Trial of Insolvency Enterprise Cases," the "Provisions of the Supreme People's Court on Several Issues on the Applicable Laws for Enterprise Insolvency Cases Pending at the Time of Implementation of the



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situation of insolvent companies, in particular SOEs.<sup>165</sup> While on paper the previous regimes may have been sufficient in this regard, it was the implementation of related rules that had failed.<sup>166</sup> It is still unclear if the new *PRC Enterprise Bankruptcy Law* has really improved the situation.<sup>167</sup>

Under China's insolvency regime, the insolvency of legal person entities can lead to their liquidation, reorganization, or settlement arrangements between the debtor and its creditors.<sup>168</sup> Proceedings are commenced on the basis of a non-mandatory application by a creditor (or even the debtor itself) to the competent People's Court.<sup>169</sup> As for cross-border insolvency, more precisely the availability of overseas assets for the distribution to creditors of an insolvent Chinese legal entity, the *PRC Enterprise Bankruptcy Law* applies the concept of universality.<sup>170</sup> From the perspective of Chinese law, onshore insolvency proceedings should also cover overseas assets, including stakes in foreign business entities.<sup>171</sup> The implementation of this rule is, of course, subject to the laws of the country where related assets are located.<sup>172</sup>

D. GEO-POLITICAL AND STRATEGIC RISKS

China's outward investment projects, in particular China's investments in Africa, have sparked some discussion as to the way they were implemented and the rationale behind the selection of particular target countries.<sup>173</sup> As indicated above,<sup>174</sup> a relatively large percentage of China's investments overseas found its way into Asian target countries, while a still remarkable portion ended up in Africa and Latin America.<sup>175</sup> In contrast, cumulative investment ratios in North America and Europe are relatively low, although this appears

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PRC Insolvency Law," all effective as of June 1, 2007, and the "Provisions on Certain Issues Regarding the Application of the 'PRC Enterprise Bankruptcy Law' (1)," effective as of Sept. 26, 2011.

165. See Travis Hodgkins, *China's New Bankruptcy Law—First Report From the Ground*, CHINA L. BLOG (June 12, 2007), [http://www.chinalawblog.com/2007/06/chinas\\_new\\_bankruptcy\\_law\\_firs.html](http://www.chinalawblog.com/2007/06/chinas_new_bankruptcy_law_firs.html).

166. See Enoch Yiu, *Liquidation Specialist Warns of Mainland Risks*, S. CHINA MORNING POST, Oct. 24 2011, at B3, available at 2011 WLNR 21764870.

167. See Wolff 2004, *supra* note 163, at 100-281.

168. *Id.*

169. PRC Enterprise Insolvency Law art. VII.

170. See *id.* art. V.

171. See *id.*; Wolff 2004, *supra* note 163, at 281-620.

172. *Id.*

173. See MCGREGOR, *supra* note 133, at 116 ("When Iraq couldn't raise the money it owed for arms bought during the Iran-Iraq war, it paid in kind in 1996 by offering PetroChina a \$1.2 billion oil concession in tandem with Norinco, the state weapons manufacturer . . . . Likewise, Chinese investment in oilfields in Sudan was done in parallel with arms sales by a state-owned weapons firm to the Khartoum regime."); *Obey the Rules, New Zambia Leader Tells China*, REUTERS (Sept. 26, 2011, 12:24 PM), <http://af.reuters.com/article/topNews/idAFJJOE78P0EZ20110926>; see also Toh Han Shih, *Controversial Chinese Projects in Cambodia Bow to Public Pressure*, S. CHINA MORNING POST, Sept. 3, 2011, at B1-2, available at 2011 WLNR 17432751.

174. See *supra* Part II.

175. See Woo, Moller & Chan, *supra* note 3.

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to be changing<sup>176</sup> with Chinese investments now specifically targeting companies with advanced technology,<sup>177</sup> global brands, and trade names.<sup>178</sup>

According to official Chinese sources, Chinese overseas investments are industry oriented, *i.e.*, they are focused on those countries where the conditions for a particular type of investment or investments in a particular industry are the best.<sup>179</sup> In contrast, some foreign commentators have identified strategic interests behind many of China's investment projects overseas. In particular, it has been noted that China must secure its supplies with natural resources, energy, and rare earths<sup>180</sup> to fuel its economic growth.<sup>181</sup> Indeed, between 2004 and 2009 almost fifty percent of the acquisitions of Chinese investors overseas worth more than fifty million U.S.D. were aimed at targets in the natural resource and energy sectors.<sup>182</sup> According to UNCTAD, in recent years more than twenty percent of China's total overseas investment volume was in the extractive industries.<sup>183</sup>

Others have suggested that China's overseas investments may be driven by attempts to "buy" United Nations voting power through investments in developing countries, in particular in Africa and Latin America.<sup>184</sup> According to another viewpoint, China simply invests where other countries have yet to invest, *i.e.*, China is picking up what has not been targeted by non-Chinese.<sup>185</sup> Finally, there have been reports that Chinese entities have often found it difficult to adjust to the Western cultural environment.<sup>186</sup> This could ex-

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176. See Flanigan, *supra* note 30, at 54 (North America); O'Neill, *supra* note 14, at 16-17 (Europe); Woo, Moller & Chan, *supra* note 3, at 57-58 (North America).

177. See ECONOMIST INTELLIGENCE UNIT, *supra* note 14, at 8; Kevin Nie, *Chinese Automakers' Overseas M&A—From the Perspective of IPR*, CHINA INTELL. PROP., Apr. 2010, at 42-43, available at <http://www.chinaipmagazine.com/en/journal-show.asp?id=591>; Woo, Moller & Chan, *supra* note 3, at 55.

178. See Doris Li, *Beijing Automobile Speeds Up Brand Development By M&A*, CHINA INTELL. PROP., Apr. 2010, at 35-37, available at <http://www.chinaipmagazine.com/en/journal-show.asp?id=589>; Nie, *supra* note 177, at 42-43; Woo, Moller & Chan, *supra* note 3, at 55.

179. See Murphy, *supra* note 12, at 7-10; WOLFF, CHINA OUTBOUND INVESTMENTS, *supra* note 5, at 3.

180. See Ed Zhang & Toh Han Shih, *China Pays for Risky African Ventures*, S. CHINA MORNING POST, Feb. 25, 2011, at A1, A6, available at 2011 WLNR 3689812; Woo, Moller & Chan, *supra* note 3, at 55.

181. MCGREGOR, *supra* note 133, at 115 (stating that in 1993 "China became a net oil importer" and "China's reliance on oil imports, which had been growing every year since, marked a turning point for its economy and redefined its broader security interests for ever as well."); Woo, Moller & Chan, *supra* note 3, at 55; see also Simon Parry, *Chilly Reception for Icelandic Venture*, S. CHINA MORNING POST, Sept. 13, 2011, at A4 ("the response to the idea of a Chinese multimillionaire buying up what amounts to 0.3 per cent of Iceland has been decidedly chilly in parts of Reykjavik, where suspicions are rife that the project is in fact a cover for Chinese strategic development . . . part of a bigger move by Beijing to get access to the trans-Arctic shipping lanes that could open as polar ice caps melt."); the investment proposal has in the meantime been rejected by the Internal Affairs Ministry of Iceland on the basis of various legal issues, see Stephen Chan, *Nordic Ventures far from Finished*, S. CHINA MORNING POST, Nov. 28 2011, at A4.

182. ECONOMIST INTELLIGENCE UNIT, *supra* note 14, at 13.

183. UNCTAD *World Investment Report 2011*, *supra* note 19, at 47.

184. See Susan Stumme, *Leaked US Cable Says China Has "No Morals" in Africa*, AGENCE FR. PRESSE (Dec. 8, 2010), <http://www.google.com/hostednews/afp/article/ALeqM5gNV4PQJy0-vBVobjbRuITqI21wcA?docId=CNG.c41db06392485b1ac24c577f6d55fb67.441>; Prak Chan Thul, *Analysis: China Pumps Up Cambodia Economy, But At What Cost?*, REUTERS (Apr. 5, 2011, 3:01 AM), <http://www.reuters.com/article/2011/04/05/businesspro-us-cambodia-china-idUSTRE73412E20110405>; *Beijing's Aid "A Double-Edged Sword"*, S. CHINA MORNING POST, Apr. 7, 2011, at A14 (discussing soft loans provided through a foreign aid programme offered by China).

185. My colleague, Professor Yu Xingzhong, brought this point to my attention.

186. See Hannah Seligson, *For American Workers in China, a Culture Clash*, N.Y. TIMES, Dec. 24, 2009, at B1 (N.Y. edition), available at <http://www.nytimes.com/2009/12/24/business/global/24chinawork.html>.

plain why Chinese enterprises prefer to invest in Asia rather than in Western countries.<sup>187</sup> Adding to the difficulties of Chinese overseas investors in Western markets could be the reluctance to take advantage of high quality but expensive legal, financial, and industry-related consultancy services when setting up and developing business abroad.<sup>188</sup>

All the above reasons sound plausible and may have their own justifications. In other words, different Chinese overseas investment projects in different geographical regions may be based on different rationales. In this regard it must also be acknowledged that it would be surprising if the Chinese government did not to take strategic aspects into account. Governments of other countries must do exactly the same.

## V. Final Remarks

The world order is currently undergoing fundamental changes, and it remains to be seen where China will stand upon completion of the ongoing reshuffle. It is clear, however, that China is a strong newcomer in the international investment arena while, at the same time, other countries have lost much of their former power in recent years. Successful newcomers are always eyed with suspicion.<sup>189</sup> This may explain the common reluctance to accept China's increasing overseas investment volume as what it is, namely evidence of the globalization efforts of multi-national enterprises located in a country which has or is about to become a political and economic mega-power.

Overseas investments of Chinese enterprises are developing rapidly despite a rather strict domestic outward investment regime. The increasing volume of Chinese outward investments creates chances and risks not only for Chinese, but also for foreign parties. Future developments must be monitored closely because China's overseas investment strategies have the potential to destabilize the world, whether they fail or succeed.<sup>190</sup>

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187. See WOLFF, *MERGERS & ACQUISITIONS IN CHINA*, *supra* note 7, at 3.

188. Dr. Markus Ederer, EU Ambassador to China, has kindly drawn my attention to this aspect.

189. See MCGREGOR, *supra* note 133, at 272.

190. *Id.*

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## A Comparative Analysis of Secretariats Created Under Select Treaty Regimes

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### I. Introduction

The administrative structure of most international organisations includes a secretariat that plays an important role in the functioning of the entire regime. Secretariats act as the backbone of the organisations and mainly perform administrative functions. Secretariats originated with the League of Nations<sup>1</sup> and continued with the United Nations (UN) Secretariat, which has provided administrative support since 1945.<sup>2</sup> Various secretariats may perform common or specific functions depending on the aims of the treaty.<sup>3</sup>

What is a secretariat? There are many definitions. An opinion of the UN Office of Legal Affairs of November 4, 1993 states, with respect to the Climate Change Convention, that a secretariat is a supportive structure.<sup>4</sup> According to James R. Fox, it is a bureaucracy.<sup>5</sup> Loveday compares them with national ministries; of course, international organisations or Multilateral Environmental Agreements (MEAs) have less power than national governments.<sup>6</sup> According to Sandford, secretariats are executive support systems of treaties<sup>7</sup> or international organisations created by the treaty parties to aid the management and implementation of the treaty.<sup>8</sup> Per-Olof Busch states with regard to the Climate Change Secretariat that a secretariat is an “intergovernmental bureaucracy that

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1. Thomas G. Weiss, *International Bureaucracy: The Myth and Reality of the International Civil Service*, 58 INT'L AFF. 287, 289 (1982).

2. UN Charter, Ch. XV, art. 97.

3. PHILIPPE SANDS & PIERRE KLEIN, *BOWETT'S LAW OF INTERNATIONAL INSTITUTIONS* 297-98 (5th ed. 2001).

4. Robin R. Churchill & Geir Ulfstein, *Autonomous Institutional Arrangements in Multilateral Environmental Agreements: A Little-Noticed Phenomenon in International Law*, 94 AM. J. OF INT'L LAW 623, 647 (2000).

5. JAMES R. FOX, *DICTIONARY OF INTERNATIONAL AND COMPARATIVE LAW* 285, 358 (1997).

6. PARRY AND GRANT *ENCYCLOPAEDIC DICTIONARY OF INTERNATIONAL LAW* 455 (John P. Grant and J. Craig Barker eds., 2004).

7. Rosemary Sandford, *International Environmental Treaty Secretariats: A Case of Neglected Potential*, 16 ENVTL. IMPACT ASSESSMENT REVIEW 3, 3 (1996).

8. ROSEMARY SANDFORD, *International Environmental Treaty Secretariats: Stage-Hands or Actors?*, in *GREEN GLOBE YEARBOOK OF INTERNATIONAL CO-OPERATION ON ENVIRONMENT AND DEVELOPMENT*, 17 (1994).

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states created to assist them in their cooperative struggle to confront climate change.”<sup>9</sup> For Andresen and Skjaereth, “A secretariat is an international organization established by the relevant parties to assist them in fulfilling the goal(s) of the treaty.”<sup>10</sup> “Such environmental treaty secretariats generally take shape as small intergovernmental bureaucracies that are run by international civil servants under the formal control of predefined multilateral governmental mechanisms.”<sup>11</sup>

The role of secretariats has long been overlooked because secretariats are not perceived as a significant feature of the institutional setup of treaties. The main actors are the nation states—and the secretariats are merely at their service. Recently, however, there has been some research on secretariats in the field of international relations. Secretariats are capable of influencing treaty negotiation and implementation. In fact, treaty secretariats are set up precisely for this purpose – to administer negotiations and to help parties in implementing MEAs.<sup>12</sup> When a treaty is created, it involves many actors such as subsidiary bodies, nation states, and other stakeholders such as communities and non-governmental organisations (NGOs). Secretariats provide the link between these actors and aid their efforts to address the policy challenge in question. Therefore, they have an important role to play.

Sandford has divided environmental history into three parts.<sup>13</sup> First, there are conventions such as the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES),<sup>14</sup> signed in the 1970s in the aftermath of the United Nations Conference on the Human Environment held in Stockholm in 1972. Second, there are conventions such as the Vienna Convention for the Protection of the Ozone Layer (Vienna Convention)<sup>15</sup> and its Montreal Protocol on Substances that Deplete the Ozone Layer (Montreal Protocol)<sup>16</sup> signed in the 1980s that came into being due to the United Nations Environment Programme (UNEP). Finally, there are conventions such as the Convention on Biological Diversity (CBD),<sup>17</sup> the United Nations Framework Convention on Climate Change (UNFCCC),<sup>18</sup> and the United Nations Convention to Combat Desertification in Those Countries Experiencing Serious Drought and/or Desertification, Particularly in Africa (UNCCD),<sup>19</sup> signed in 1992 in the aftermath of the United Nations Conference on Environment and Development held in Rio de Janeiro. This article exam-

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9. Per-Olof Busch, *The Secretariat of the Climate Convention: Make a Living in a Straitjacket* 1 (Global Governance Working Paper No. 22, 2006), available at <http://www.glogov.org/images/doc/wp22.pdf>.

10. International Conference on Synergies and Co-ordination between Multilateral Environmental Agreements, Tokyo, Japan, July, 14-16 (1999).

11. STEFFEN BAUER, *The United Nations and the Fight against Desertification: What Role for the UNCCD Secretariat?*, in GOVERNING GLOBAL DESERTIFICATION. LINKING ENVIRONMENTAL DEGRADATION, POVERTY, AND PARTICIPATION 73 (2006).

12. Steffen Bauer, *Does Bureaucracy Really Matter? The Authority of Intergovernmental Treaty Secretariats* 21 (Paper presented at the 45th Annual Convention of the International Studies Association, Montreal, Can., Mar. 17-20, 2004), available at <http://www.ppl.nl/ebooks/files/C08-0052-Bauer-Bureaucracy.pdf>.

13. SANDFORD, *supra* note 8, at 18.

14. CITES, Mar. 3, 1973, 993 U.N.T.S. 244.

15. Vienna Convention, Mar. 22, 1985, 1513 U.N.T.S. 324.

16. MONTREAL PROTOCOL, Sept. 16, 1987, 1522 U.N.T.S. 29.

17. CBD, June 5, 1992, 1760 U.N.T.S. 143.

18. UNFCCC, May 9, 1992, 1771 U.N.T.S. 165.

19. UNCCD, June 17, 1994, 1954 U.N.T.S. 108.

ines the secretariats of these five MEAs which were chosen because of their near-universal membership.

## II. Features of Environmental Secretariats

- Secretariats are central organs in an international organisation and are the functional arm of the Conference of the Parties (COP) (or Meeting of the Parties (MOP) in the case of Protocols) and of the MEA. Their single most important characteristic is their international character because the secretariat staff does not owe allegiance to national governments; it does not receive instructions from any particular government but instead owes allegiance to the treaty, which leads to impartiality.<sup>20</sup> Despite this independence, a secretariat's freedom to act is largely dependent on the will of the parties, frequently nation states.<sup>21</sup> Secretariats actually have two masters – the treaty and the parties. There may, at times, be a conflict between the duty to obey the parties and the duty to uphold the objectives of the treaty. Because the parties may not always follow the treaty, the secretariats' task is even more difficult. For instance, the UNFCCC Secretariat has been accused of bias by certain Parties because it supported the Kyoto Protocol, which is a legal instrument of the Climate Change regime.<sup>22</sup>
- Secretariats function under a veil of legitimacy. This means that they do their work and make proposals under the responsibility of the presiding officers/chairpersons who have been elected by the parties. Because secretariats possess expert knowledge of the regimes they serve and chairpersons have political authority to make use of that knowledge, the actors have a complementary relationship: the secretariats being subservient to the chairpersons.<sup>23</sup> Thus, secretariats' activities are carried out under a veil of legitimacy and approved by the presiding officers. Though the presiding officers have the final say on the proposals to put forward, this veil is indispensable for the functioning of secretariats, as they cannot openly assume the role of a leader.<sup>24</sup>
- They are modelled on the secretariats of the UN system. Their administrative processes such as recruitment of personnel are also close to those of the UN.<sup>25</sup> For example, they try to maintain geographical balance while recruiting personnel.
- They are smaller than other secretariats; for example, the World Trade Organization (WTO) and United Nations Conference on Trade and Development (UNCTAD) Secretariats have about 640 and 400 employees respectively, whereas the Ozone and CBD Secretariats have about 17 and 117 employees respectively.<sup>26</sup>

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20. Grant & Barker, *supra* note 6, at 455.

21. Steffen Bauer, Per-Olof Busch & Bernd Siebenhüner, *Administering International Governance: What Role for Treaty Secretariats?* 2 (Global Governance Working Paper No 29, 2007), available at <http://www.glo.gov.org/images/doc/WP29.pdf>.

22. JOANNA DEPLEDGE, *THE ORGANIZATION OF GLOBAL NEGOTIATIONS: CONSTRUCTING THE CLIMATE CHANGE REGIME* 65-66 (2005).

23. Joanna Depledge, *A Special Relationship: Chairpersons and the Secretariat in the Climate Change Negotiations*, 7 *GLOBAL ENVTL. POL.* 45, 57 (2007).

24. DEPLEDGE, *supra* note 22, at 66-67.

25. SANDFORD, *supra* note 8, at 17, 19.

26. WTO, *Annual Report 2011*, [http://www.wto.org/english/res\\_e/booksp\\_e/anrep\\_e/anrep11\\_chap7\\_e.pdf](http://www.wto.org/english/res_e/booksp_e/anrep_e/anrep11_chap7_e.pdf); UNCTAD, *The UNCTAD Secretariat*, <http://www.unctad.org/Templates/Page.asp?intItemID=1931&>

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- They may be activist or passive, the former being in a position to affect treaty outcomes.<sup>27</sup> In reality, no secretariat is passive; they only prefer to remain in the background instead of in the limelight. Thus even passive secretariats can be very active behind the scenes.<sup>28</sup>
- Secretariats are stable elements in a changing international system, providing an element of permanence. This is a very important feature because national governments come and go, but MEAs have long-term goals and so continuity in secretariats is important. They are the only active actors between sessions of the COP and subsidiary bodies. The continuity of their staff builds institutional expertise and memory. In fact, this is the reason why parties establish secretariats.<sup>29</sup>
- Secretariats may be created by the MEA such as in the case of CITES (article XII(1)) or by the COP. In the latter case, the MEA may establish an interim secretariat and the COP may be required to establish the permanent secretariat. Examples are the Vienna Convention (article 7(2)), the CBD (article 24(2)), the UNCCD (article 23(3)), and the UNFCCC (article 8(3)). Permanent secretariats are more active than interim ones because the institutional status of the former is assured.<sup>30</sup>
- MEAs may also make use of secretariats of existing organisations; for example, the CBD and Ozone Secretariats are hosted by the UNEP.<sup>31</sup> Since having their own secretariat requires more resources, the use of established secretariats may reduce these expenses. Also, UNEP provides an established administrative structure. Though the Ozone Secretariat is housed within the UNEP headquarters, it is not a necessary condition that secretariats be located physically within the premises of the host organisation. In the case of the UNFCCC, the interim Secretariat from which the permanent Secretariat was derived was provided by the UN Secretariat following UN rules and using UN resources. Given these advantages, the COP, while considering the permanent Secretariat, agreed on a formal institutional linkage with the UN. This linkage extends to administrative regulations on personnel and financial matters such as staff entitlements and financing of Convention conferences by the UN. Also, the Secretariat is encouraged to cooperate with other relevant agencies at the national and international level.<sup>32</sup> Since the UNFCCC and UNCCD Secretariats serve autonomous UN Conventions, their Executive Secretaries are ex officio Assistant Secretary-Generals to the UN, whereas the Executive Secretaries of the CBD and Ozone Secretariats report to the UN through the Executive Director of the UNEP. According to Churchill and Ulfstein, it is possible that there may be a conflict between the host organisation such as UNEP and the COP of a MEA such as the Vienna Convention in regard to the work of the MEA's secretariat. But this is largely theoretical, as the host organisation cannot interfere in the functioning of the MEA.

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lang=1; UNEP Ozone Secretariat, *About the Secretariat*, [http://ozone.unep.org/new\\_site/en/about\\_the\\_secretariat.php](http://ozone.unep.org/new_site/en/about_the_secretariat.php); CBD, *The CBD Secretariat, Staff List*, <http://www.cbd.int/secretariat/staff>.

27. ROSEMARY SANDFORD, *Secretariats and International Environmental Negotiations: Two New Models*, in INTERNATIONAL ENVIRONMENTAL TREATY MAKING 27 (1992).

28. Depledge, *supra* note 23, at 54.

29. SANDFORD, *supra* note 8, at 17, 19.

30. *Id.* at 19.

31. Vienna Convention, Mar. 22, 1985, 1513 U.N.T.S. 324, art. 7(2).

32. *Administrative and Financial Matters Institutional Linkage of the Convention Secretariat to the United Nations*, ¶¶ 5, 7-8, 10, UN Doc. FCCC/SBI/1999/7 (Apr. 16, 1999).

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The UNEP emphasises its importance in relation to the Ozone Secretariat, but the latter is a distinct intergovernmental secretariat,<sup>33</sup> and the UNEP can only intervene in its administrative matters. In fact, the COP confers certain powers on the UNEP because it hosts the MEA secretariats, but the UNEP follows the UN rules in administering the secretariats.<sup>34</sup> In the case of the UNFCCC, this distinction is quite clear (i.e., the Secretariat reports to the COP for MEA work and to the UN for staff matters).<sup>35</sup> Moreover, in the case of the CITES Secretariat administered by UNEP, its conflicts with the UNEP relate to staff and budget matters.<sup>36</sup>

### III. Legal Personality of Environmental Secretariats

Before examining the legal status of secretariats, it is worthwhile to define the components of legal status. The legal status of an entity may be characterised by the following attributes: (1) it should have rights and privileges of a binding nature; (2) no party should be able to alter the position of the entity in any manner or take any decision contrary to the rights or interests of the entity without its consent; and (3) it should have the capacity to enter into agreements or contracts with other parties.

The question of international legal personality of secretariats will benefit from a discussion of two Advisory Opinions of the International Court of Justice (ICJ). In the Advisory Opinion of April 11, 1949, on Reparation for Injuries Suffered in the Service of the United Nations,<sup>37</sup> the ICJ stated that in case an agent of the UN suffered injury while performing his duties, the UN as an organisation had the capacity to bring an international claim against the government of the state responsible for the injury in order to obtain reparation for damages caused to the UN and to the victim. This would apply in the case of a member and non-member state that has breached its obligations towards the UN because the members of the UN created an entity whose international legal personality is objective and therefore recognised by non-members as well.<sup>38</sup> According to the ICJ, the capacity to bring a claim vests with states and if organisations can bring claims, it would mean they have international personality. The ICJ did not say that a forum where a claim can be brought is required to confer international legal personality on the organisation. The Court further stated that because the UN Charter conferred rights and obligations on the UN, the latter had legal personality.

Additionally, according to the ICJ in its Advisory Opinion of December 20, 1980 on the question of the Interpretation of the Agreement of 25 March 1951 between the World

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33. Bauer, *supra* note 12, at 17.

34. UNEP, *The Relationship between the Executive Director of UNEP and the Conventions Regarding the Administration of Their Secretariats*, Fourth Meeting on Coordination of Secretariats of Environmental Conventions, UN Doc. UNEP/DEP/Coord.4/3/COR.1 1-7 at 2, 3 (Jan. 4, 1996), in BHARAT H. DESAI, *INSTITUTIONALIZING INTERNATIONAL ENVIRONMENTAL LAW* 210 (2004).

35. See Churchill & Ulfstein, *supra* note 4, at 628, 635.

36. See Rosemary Sandford, *Secretariats as Catalysts: A Comparative Study of the Influence of Global Environmental Treaty Secretariats on Treaty Implementation* (June 1998) (unpublished Ph.D. dissertation, Massachusetts Institute of Technology) at 234-35, <http://hdl.handle.net/1721.1/28197>.

37. See *Reparation for Injuries Suffered in the Service of the United Nations*, Advisory Opinion: I.C.J. Reports 1949, p. 174.

38. See *id.* at 185, 187.

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Health Organization (WHO) and Egypt,<sup>39</sup> a contractual legal regime was created between Egypt and the WHO when they entered into an agreement on March 25, 1951. This agreement had a legally binding character and the WHO was able to ask for an Advisory Opinion concerning this agreement. Could the fact that the WHO was able to enter into an agreement with legally binding character mean that the WHO has international legal personality? Even if the secretariat of a MEA has rights that can be enforced against parties there may be no forum where these can be enforced. That does not mean, however, that the secretariat does not possess legal personality. Applying the Reparations Advisory Opinion, one could say an environmental secretariat can bring a claim against a state, but in which forum? MEAs do not contain dispute redressal forums<sup>40</sup> such as in the WTO. Even if they did, it is not known if a secretariat could bring a claim against the parties in such a forum given that these forums are generally established to resolve disputes between parties to the organisation, as is the case of the WTO. In case the secretariat wanted to bring a claim against a non-party in a case similar to the Reparations Opinion, where would it do so? Even if one does not apply the two Advisory Opinions in the case of secretariats because they relate to organisations and not secretariats, the fact remains that a secretariat has rights. The question is whether these rights are sufficient to confer international legal personality on the secretariat. Applying the Reparations Opinion, the fact that the MEA confers rights and obligations on the secretariat may indicate that it has international legal personality.

Another aspect of the legal personality issue is that environmental secretariats are frequently linked to the UN. Would they, as a consequence, have legal personality because the UN has it? For example, the Climate Change Convention Secretariat is institutionally linked to the UN while not being fully integrated in the work programme and management structure of any particular department or programme.<sup>41</sup> The meaning of "institutionally" is not relevant because the legal regime enjoyed by the UN cannot be automatically extended to the UNFCCC Secretariat.<sup>42</sup> For the Secretariat to have legal personality, the COP would have to confer it by means of a decision.<sup>43</sup> But the COP still has to consider whether the Secretariat should be given international legal personality.<sup>44</sup> On the other hand, the host organisation, the UN in this case, may commit a breach of its obligations if it does not provide resources to the Secretariat for its functions.<sup>45</sup> This would mean that the Secretariat has international legal personality. Regarding other MEAs, the UNEP administers the CITES Secretariat and hosts the Ozone and CBD Secretariats (CITES, the Vienna Convention, and the Montreal Protocol were "negoti-

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39. See Interpretation of the Agreement of 25 March 1951 between the WHO and Egypt, Advisory Opinion, I.C.J. Reports 1980, p. 73.

40. The UNFCCC, the Vienna Convention, and the CBD all state that disputes can be referred to the ICJ, which means that the Convention itself does not have a dispute redressal forum. See UNFCCC, May 9, 1992, 1771 U.N.T.S. 165, art. 14(2)(a); Vienna Convention, Mar. 22, 1985, 1513 U.N.T.S. 324, art. 11(3)(b); CBD, June 5, 1992, 1760 U.N.T.S. 143, art. 27(3)(b).

41. Institutional Linkage of the Convention Secretariat to the United Nations, Climate Change COP Decision 14/CP.1, UN Doc. FCCC/CP/1995/7/Add.1, at 42, ¶ 2.

42. Institutional and Budgetary Matters: Arrangements for Relocation of the Convention Secretariat to Bonn, UN Doc. FCCC/SBI/1996/7, ¶ 7.

43. See *id.* ¶ 11(5).

44. Agreement Concerning the Headquarters of the Convention Secretariat, Climate Change COP Decision 15/CP.2, UN Doc. FCCC/CP/1996/15/Add.1, at 63, ¶ 2.

45. See Churchill & Ulfstein, *supra* note 4, at 635.

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ated under the auspices of UNEP").<sup>46</sup> The same question regarding legal personality would arise in the case of these secretariats as well.

It is also possible to look at the Headquarters agreement to locate the secretariat in a particular country. For example, the Headquarters agreement between the UNFCCC Secretariat, the UN, and the Republic of Germany to locate the Secretariat in Germany states that the Secretariat shall have legal capacity in Germany.<sup>47</sup> The COP has approved this agreement.<sup>48</sup> The Secretariat's authority to enter into such an agreement derives from the request of the Subsidiary Body for Implementation<sup>49</sup> and is not conclusive of the Secretariat's international legal personality. Article 6(3) of the Headquarters agreement requires twelve months' notice in order for the agreement to be terminated.<sup>50</sup> Does this mean that if this provision is not honoured, the injured party is entitled to bring a claim? If the answer is in the affirmative, the Secretariat would have international legal personality. But again the question arises, in which forum would the claim be settled? Moreover, article 6(4) of the Headquarters agreement states that disputes are to be settled in accordance with article 26(2) of the United Nations Volunteers Programme Headquarters Agreement which provides that disputes are to be resolved on the basis of international law.<sup>51</sup> Article 6(6) of the Headquarters agreement stipulates that the agreement enters into force after notification from Parties.<sup>52</sup> Would this suffice to provide international legal personality to the Secretariat which is party to the Headquarters agreement? However, the UN Office of Legal Affairs has stated that the Secretariat is not *de jure* a UN subsidiary organ.<sup>53</sup> In the case of the CBD, the Headquarters agreement is between Canada and the UNEP; the Secretariat is not a party.<sup>54</sup> If the Secretariat is not even involved, the question of its international legal personality likely does not arise.

Article 24(1)(d) of the CBD, article 8(2)(f) of the UNFCCC, article 23(2)(e) of the UNCCD, and article 7(1)(e) of the Vienna Convention state that Secretariats shall ensure necessary coordination with other international bodies and enter into such administrative and contractual arrangements as may be required for the effective discharge of their functions.<sup>55</sup> These articles are not limited to domestic arrangements.<sup>56</sup> Can this be construed as authorising these Secretariats to enter into binding international agreements? Accord-

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46. *Id.* at 630.

47. *Administrative and Financial Matters Establishment of the Permanent Secretariat and Arrangements for its Functioning*, UN Doc. FCCC/CP/1996/MISC.1, art. 4(1).

48. Agreement Concerning the Headquarters of the Convention Secretariat, Climate Change COP Decision 15/CP.2, UN Doc. FCCC/CP/1996/15/Add.1, at 63, ¶ 1.

49. Report of the Subsidiary Body for Implementation on the Work of its Second Session, held at Geneva from 27 February to 8 March 1996, UN Doc. FCCC/SBI/1996/9, ¶ 66(c).

50. *Administrative and Financial Matters Establishment of the Permanent Secretariat and Arrangements for its Functioning*, UN Doc. FCCC/CP/1996/MISC.1, art. 6(3).

51. *Id.* at art. 6(4).

52. *Id.* at art. 6(6).

53. *Institutional and Budgetary Matters: Arrangements for Relocation of the Convention Secretariat to Bonn*, UN Doc. FCCC/SBI/1996/7 *supra* note, at ¶ 11(2).

54. *Location of the Secretariat*, CBD COP Decision II/19, ¶ 5, available at <http://www.cbd.int/decision/cop/?id=7092>.

55. See CBD, June 5, 1992, 1760 U.N.T.S. 143, art. 24(1)(d); UNFCCC, May 9, 1992, 1771 U.N.T.S. 165, art. 8(2)(f); UNCCD, June 17, 1994, 1954 U.N.T.S. 108, art. 23(2)(e); Vienna Convention, Mar. 22, 1985, 1513 U.N.T.S. 324, art. 7(1)(e).

56. Churchill & Ulfstein, *supra* note 4, at 649.

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ing to the Handbook of the Convention on Biological Diversity Including its Cartagena Protocol on Biosafety, a liaison group of the Secretariats of the three Rio conventions (CBD, UNFCCC and UNCCD) has been established to promote complementarities amongst the Secretariats without compromising their independent legal status.<sup>57</sup> Does this legal status refer only to the authority required to form such a group? In other words, is this an example of the aforementioned secretarial function? Or can it be interpreted to mean a status beyond that? Given that one secretariat can enter into an agreement with another one, it may seem plausible to conclude that secretariats have legal personality on the international plane. But in the case of the UNFCCC Secretariat, the COP still has to consider the question of legal personality.

The CITES Secretariat has entered into memoranda of understanding with various secretariats, government departments, universities, and others.<sup>58</sup> The CBD Secretariat has also entered into memoranda of cooperation with various other secretariats.<sup>59</sup> One such memorandum with the Secretariat of the Convention on Wetlands of International Importance Especially as Waterfowl Habitat (Ramsar Secretariat) is termed an “agreement” and requires a year’s notice for termination.<sup>60</sup> The legal personality of the Secretariats would depend on whether they can bring a claim in case the provision is not complied with. In other words did the parties create a binding agreement? The use of exhortatory language in the memoranda indicates that they are not intended to be binding.<sup>61</sup> This can be distinguished from the case of the WHO Advisory Opinion wherein the agreement between Egypt and WHO had a legally binding character.

#### IV. Functions of Environmental Secretariats

- All the secretariats examined here perform certain common functions. These are generally of an administrative nature because the work of the secretariat is to provide services to the treaty regime. Such functions may be (1) arranging and servicing the sessions of COP, MOP, and subsidiary bodies; (2) preparing and transmitting reports based on information received; (3) assisting developing country parties in compiling and transmitting requisite information; (4) preparing activity reports for the COP; (5) coordination with secretariats of other international bodies; (6) entering into arrangements with external entities for its proper functioning; and (7) performing residual functions as required by the Convention/Protocol or COP/MOP. Since the advent of the internet, secretariats also maintain the websites of MEAs.

Basically, secretariats are responsible for efficient conduct of the work of the treaty, their main task being to ensure the smooth functioning of meetings and conferences organised under the aegis of the MEA.<sup>62</sup> They may also prepare the provisional agenda,

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57. SECRETARIAT OF THE CONVENTION ON BIOLOGICAL DIVERSITY, HANDBOOK OF THE CONVENTION ON BIOLOGICAL DIVERSITY INCLUDING ITS CARTAGENA PROTOCOL ON BIOSAFETY, at xxxiii (3rd ed. 2005).

58. See CITES, *Cooperation and Partnerships*, <http://www.cites.org/eng/disc/coop.php> (last visited Nov. 18, 2011).

59. See Churchill & Ulfstein, *supra* note 4, at 654.

60. *Id.*

61. *Id.*

62. See Volker Röben, *Institutional Developments under Modern International Environmental Agreements*, 4 MAX PLANCK YEARBOOK OF UNITED NATIONS LAW 363, 423-24 (2000), available at [http://www.mpil.de/shared/data/pdf/pdfmpunyb/roeben\\_4.pdf](http://www.mpil.de/shared/data/pdf/pdfmpunyb/roeben_4.pdf).

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undertake studies, give advice on legal, technical, and procedural matters, inform the parties of the meetings, and facilitate the process as a whole.<sup>63</sup> Rule 9 of the UNFCCC Rules of Procedure states that the Secretariat shall draft the provisional agenda of the COP sessions in agreement with the President.<sup>64</sup> The Climate Change and CBD Secretariats also organise technical workshops to advance discussions in subsidiary bodies and then summarise the results.<sup>65</sup> Secretariats also present introductory notes on submissions of working groups or parties.<sup>66</sup> Given that secretariats prepare the provisional agenda and do the preparatory work, they are “able to pre-structure the political process at the meetings”<sup>67</sup> and thus exercise some influence in the political decision-making process. However, secretariats do not generally submit proposals in the form of recommendations to the parties unless mandated by the latter to do so.<sup>68</sup>

Even though it is not very frequent, secretariats may provide an opinion on the interpretation and application of the MEA. For instance, the CITES Secretariat clearly termed a COP decision as incompatible with the treaty because it did not follow the specified procedure for the transfer of a species from one Appendix to another.<sup>69</sup>

The nature of functions performed by secretariats also depends on the aims of the MEA. Some secretariats perform certain specific tasks related to the aforementioned functions. The Ozone Secretariat notifies Parties of requests for technical assistance and informs non-Party observers as well, leading to more transparency.<sup>70</sup> It also encourages non-Parties to attend sessions of MOP as observers.<sup>71</sup> The UNCCD Secretariat assists developing members, particularly in Africa, in compiling and communicating requisite information to the COP, thus helping them to meet the requirements of the Convention.<sup>72</sup> The CBD Secretariat organises all meetings under the Convention, prepares documents, facilitates the flow of information, represents the Convention externally, and promotes public awareness activities in pursuance of article 13 of the Convention.<sup>73</sup> It also assists the Parties to the Cartagena Protocol on Biosafety (Cartagena Protocol),<sup>74</sup> and if the costs of the Secretariat services for this Protocol are distinct, the costs are met by the Parties to the Protocol (article 31(3) of the Cartagena Protocol).<sup>75</sup> This is a unique provision and is not provided for in the Kyoto and Montreal Protocols. The CITES Secretariat publishes and distributes to the parties current editions of Appendices containing lists of species.<sup>76</sup> The secretariats also play a role in the compliance/implementation procedure of the treaties.

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63. *See id.* at 424, n.197.

64. *See id.* at 424.

65. *See id.*

66. *See id.*

67. *See id.*

68. *See id.* at 424-25.

69. *See id.* at 431, n. 212.

70. *See* MONTREAL PROTOCOL, Sept. 16, 1987, 1522 U.N.T.S. 29, art. 12(d), (f).

71. *See id.* at art. 12(e)-(f).

72. *See* UNCCD, June 17, 1994, 1954 U.N.T.S. 108, art. 23(2)(c).

73. *See* CBD, THE CBD SECRETARIAT, ROLE, <http://www.cbd.int/secretariat/role.shtml> (last visited July 10, 2011).

74. CARTAGENA PROTOCOL ON BIOSAFETY TO THE CONVENTION ON BIOLOGICAL DIVERSITY, JAN. 29, 2000, 2226 U.N.T.S. 257.

75. *See id.* at art. 31(3).

76. *See* CITES, Mar. 3, 1973, 993 U.N.T.S. 244, art. XII(2)(f).

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**V. Role of Secretariats in Compliance/Implementation of the Treaty**

The idea of negotiating a MEA is to attain the objective of protecting certain environmental resources. The parties to the MEA are required to comply with the treaty. The secretariats directly administer the MEA by administering the compliance and implementation mechanisms. Indirectly, secretariats help in compliance, mainly by assisting developing parties if they so request, in compiling and communicating information required under the conventions (article 8(2)(c) of the UNFCCC and article 23(2)(c) of the UNCCD) and by disseminating information relating to technologies.<sup>77</sup> Thus, this secretarial function effectively has two aspects to it: compliance monitoring and implementation.

**A. ROLE OF SECRETARIATS IN MONITORING OF COMPLIANCE**

Generally, all the secretariats in the sample receive factual information on compliance from the parties and forward it to the organ that assesses and evaluates this information. Secretariats play a bigger role in MEAs whose implementing mechanism consists of lists of species, substances or areas controlled because parties are required to provide information regarding regulatory action taken in respect of such lists to the secretariat to be updated or maintained by the latter.<sup>78</sup> For example, in the case of the Montreal Protocol and the CITES, secretariats can trigger the non-compliance procedure.<sup>79</sup>

According to article 12(1), (2), (3) of the UNFCCC, Parties are required to communicate to the Secretariat steps taken and policies and measures adopted or envisaged for implementation of the Convention and other relevant information such as the effects of the measures.<sup>80</sup> The Secretariat transmits such information to the COP and subsidiary bodies (article 12(6)).<sup>81</sup> In the case of the Kyoto Protocol, the UNFCCC Secretariat transmits the reports prepared by the Expert Review Teams to all the Parties to the Convention.<sup>82</sup> It also lists for further consideration by the MOP any questions of implementation mentioned in these reports. These reports contain not only an assessment of the implementation of the commitments of Parties but also potential problems and factors influencing compliance (article 8(3)).<sup>83</sup> What is important is that the Secretariat does not by itself initiate the procedure, but only transmits the reports. Thus it facilitates flow of information that supports the compliance regime of the Kyoto Protocol and helps in monitoring implementation of the Convention.

Under article 9(1) of the UNCCD, the Secretariat receives notifications of national action plans for implementation by the Parties.<sup>84</sup> Article 26(1) requires the Parties to provide to the Secretariat reports on measures taken for the implementation of the Convention. The Parties also provide information on the implementation of strategies and

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77. See UNFCCC, May 9, 1992, 1771 U.N.T.S. 165, art. 8(2)(c); UNCCD, June 17, 1994, 1954 U.N.T.S. 108, art. 23(2)(c).

78. Röben, *supra* note 62, at 427.

79. See *id.* at 430-31.

80. UNFCCC, May 9, 1992, 1771 U.N.T.S. 165, art. 12(1)-(3).

81. See *id.* at art. 12(6).

82. See Kyoto Protocol to the UNFCCC, Dec. 11, 1997, 2303 U.N.T.S. 214, art. 8(3).

83. *Id.*

84. UNCCD, June 17, 1994, 1954 U.N.T.S. 108, art. 9(1).

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programmes and may make a submission on measures taken at subregional/regional levels as part of action programmes (article 26(2), (3), (4)).<sup>85</sup> The Secretariat is required to communicate such information to the COP and subsidiary bodies (article 26(6)).<sup>86</sup> Appended to the Convention are four regional implementation annexes by region of the world viz. Africa, Asia, Latin America and the Caribbean, and Northern Mediterranean.<sup>87</sup> In the case of the first three regions, the Secretariat may facilitate consultative processes or coordination meetings for implementation if so desired by the Parties by way of providing advice on the organisation of effective consultative/coordination arrangements, providing information to bilateral and multilateral agencies concerning consultative/coordination meetings or processes to encourage their active involvement, and providing other relevant information to establish or improve consultative/coordination arrangements/processes.<sup>88</sup> This indicates that the functions of the Secretariat of the UNCCD have a strong developing country focus. But otherwise, the powers of the Secretariat in regard to implementation do not amount to much and can be said to be on par with those of the UNFCCC Secretariat. Despite this, the Secretariat has played an important role in interpreting the meaning of “implementation” and acting accordingly as we will see further on in this article.

According to the CBD Secretariat, it plays an important role in assisting the implementation of the Convention.<sup>89</sup> It compiles national reports on compliance by domestic authorities, synthesises these reports and information on implementation, and then forwards the resulting synthesis to the COP.<sup>90</sup> So the Secretariat compiles the report on compliance, unlike the UNFCCC Secretariat which transmits to the Parties reports prepared by the Expert Review Teams and the UNCCD Secretariat which transmits to the COP information obtained from the Parties.<sup>91</sup>

According to article 5 of the Vienna Convention, the Secretariat receives information from the Parties on measures adopted to implement the objectives of the Convention and Protocols and transmits it to the COP.<sup>92</sup> Here, the Ozone Secretariat acts in a manner similar to the UNCCD Secretariat.

The Montreal Protocol has a separate non-compliance procedure giving enhanced powers to the Secretariat.<sup>93</sup> The Ozone Secretariat coordinates the flow of information between the Parties and the Implementation Committee.<sup>94</sup> Any Party can make a submission regarding its reservations as to the implementation of the Montreal Protocol by another Party and the Secretariat will transmit this submission to the Party concerned who

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85. *Id.* at art. 26(2)-(4).

86. *Id.* at art. 26(6).

87. *See id.* at Annexes I-IV.

88. *See id.* at Annex I, art. 18(4); Annex II, art. 8(3); Annex III, art. 7(2).

89. *See* CBD, THE CBD SECRETARIAT, ROLE, <http://www.cbd.int/secretariat/role.shtml> (last visited July 10, 2011).

90. *See id.*

91. *See* Kyoto Protocol to the UNFCCC, Dec. 11, 1997, 2303 U.N.T.S. 214, art. 8(3); UNCCD, June 17, 1994, 1954 U.N.T.S. 108, art. 26(6).

92. *See* Vienna Convention, Mar. 22, 1985, 1513 U.N.T.S. 324, art. 5.

93. *See* Montreal Protocol, *Report of the Fourth Meeting of the Parties to the Montreal Protocol on Substances that Deplete the Ozone Layer*, Nov. 25, 1992, U.N. Doc. UNEP/OzL.Pro.4/15, Annex IV.

94. *See id.* at Annex IV, ¶ 2.

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has to file a reply and substantiating information to the Secretariat and the Parties.<sup>95</sup> The Secretariat sends these documents together with the submission to the Implementation Committee.<sup>96</sup> If the Secretariat becomes aware of possible non-compliance by a Party who does or does not provide information on request, the Secretariat shall inform the MOP and the Implementation Committee.<sup>97</sup> The Secretariat transmits to the MOP information received from Parties relating to results of non-compliance proceedings under article 11 of the Vienna Convention.<sup>98</sup> The Secretariat also transmits to the Implementation Committee any explanation provided by any Party as to the reasons for non-compliance.<sup>99</sup> The Implementation Committee can also request information from the Secretariat.<sup>100</sup> With respect to the Montreal Protocol, the Secretariat also receives statistical data from Parties regarding the production, import, and export of controlled substances (article 7 of the Montreal Protocol).<sup>101</sup> The Parties are also required to report to the Secretariat every two years on the research and exchange of information they have engaged in to promote awareness regarding the substances that deplete the Ozone layer (article 9 of the Montreal Protocol).<sup>102</sup> It then prepares and distributes to the Parties reports based on this technical information (article 12(c) of the Montreal Protocol), thus providing the informational basis for legislative decision-making by the latter.<sup>103</sup> Given that the Secretariat receives this information from the Parties, it is in a position to know about possible non-compliance and can initiate the procedure. This is unlike the UNFCCC Secretariat in the case of the Kyoto Protocol and the UNCCD and CBD Secretariats that do not inform the Implementation Committee of non-compliance and so do not initiate the procedure.

Under article VIII(4)(c) of the CITES, if a living specimen is confiscated, the Management Authority may consult the Secretariat to decide the future course of action.<sup>104</sup> This may include returning the specimen to the state or putting it in a rescue centre or other appropriate place.<sup>105</sup> Article VIII(7) requires Parties to transmit to the Secretariat reports on implementation of the Convention containing details of trade in designated species as well as legislative, administrative, and regulatory measures taken to enforce the Convention.<sup>106</sup> The Secretariat can ask the Parties to supply further information required for the implementation of the Convention (article XII(2)(d)) and files reports to the Parties on the implementation of the Convention (article XII(2)(g)).<sup>107</sup> It also undertakes technical studies on issues concerning implementation of the Convention (article XII(2)(c)) and is the only secretariat that makes recommendations regarding implementation (article XII(2)(h)).<sup>108</sup> The CITES Secretariat can be said to act like the Ozone Secretariat, be-

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95. *See id.* at Annex IV, ¶¶ 1, 2.

96. *See id.* ¶ 2.

97. *See id.* at Annex IV, ¶ 3.

98. *See id.* at Annex IV, ¶ 12.

99. *See id.* at Annex IV, ¶ 4.

100. *See id.* at Annex IV, ¶ 7(c).

101. *See* MONTREAL PROTOCOL, Sept. 16, 1987, 1522 U.N.T.S. 29, art 7.

102. *See id.* at art. 9.

103. *See id.* at art. 12(c).

104. *See* CITES, Mar. 3, 1973, 993 U.N.T.S. 244, art. VIII(4)(c).

105. *See id.* at art. VIII(4)(b).

106. *See id.* at art. VIII(7).

107. *See id.* at art. XII(2)(d), (g).

108. *See id.* at art. XII(2)(c), (h).



cause it has the authority to take action on its own and inform the Management Authority of a Party in case a species is adversely affected by trade or the Convention is not being implemented (article XIII(1)).<sup>109</sup> In such a case, the Party concerned has to reply to the Secretariat and propose remedial action (article XIII(2)).<sup>110</sup> So the role of the CITES Secretariat is more advanced than that of the UNFCCC, UNCCD, and CBD Secretariats because it goes beyond merely transmitting information. Like the Ozone Secretariat, the CITES Secretariat can ask the Parties for more information and even go further as it can make recommendations.

The CITES COP has recognised the important role played by the Secretariat in the enforcement process. In 2000, the CITES COP urged the Parties and external actors to provide additional funds to the Secretariat to reinforce the enforcement mechanism.<sup>111</sup> These funds were to be used to appoint additional officers in the Secretariat to work on enforcement-related issues, to assist in the drafting and implementation of regional enforcement agreements, and to provide training and technical assistance to the Parties. The Secretariat had also been allowed to take measures with the International Criminal Police Organization (ICPO-Interpol) and the World Customs Organization to facilitate the exchange of information.<sup>112</sup> The COP also directed the Secretariat to work closely not only with the aforementioned actors but also with the Convention's institutions, national enforcement agencies, and existing intergovernmental bodies such as the UN Office on Drugs and Crime and submit a report on enforcement matters at each meeting of the COP.<sup>113</sup>

Moreover, its many recommendations gave the Secretariat a larger role in the enforcement procedure. These recommendations included asking the Parties to provide further information to the Secretariat within a time limit, authorising the Secretariat to report implementation problems to the Standing Committee in case they remain unsolved even after provision of technical assistance to the Party concerned, and the establishment of enforcement task forces by the Secretariat.<sup>114</sup>

The process of receiving reports and commencement of the non-compliance procedure by the secretariats is very significant because parties are not willing to initiate such procedures against each other. Not many secretariats have been entrusted with the function of triggering the non-compliance procedure with most being relegated to a fact-gathering role.

#### B. SECRETARIAL ASSISTANCE IN IMPLEMENTATION

Secretariats assist parties in implementing the MEA, thus complying with international obligations. Because secretariats receive national reports, they are in a position to know implementation difficulties faced by members and, consequently, to know their needs. Secretariats use their contacts and expertise to provide assistance such as legal and policy

109. *See id.* at art. XIII(1).

110. *See id.* at art. XIII(2).

111. *See* CITES COP, 11th Sess. (Apr. 10-20, 2000), Resolution Conf. 11.3 (Rev. CoP15) Compliance and enforcement, *available at* <http://www.cites.org/eng/res/11/11-03R15.php>.

112. *See id.*

113. *See id.*

114. *See id.*

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advice as well as access to external funds.<sup>115</sup> This kind of assistance is useful for the country and also for the secretariat because it enhances its credibility and influence.

The UNFCCC Secretariat is not mandated to do much in the field of implementation. It does not disburse funds or implement projects. It does not favour adoption of any particular policies nor can it take decisions or impose sanctions on Parties to make them comply. The Secretariat only collects and processes information and coordinates reviews of data communicated by Parties.<sup>116</sup> However, the Secretariat tries to ensure that developed countries are mindful of the concerns of the Association of Small Island States when they take decisions.<sup>117</sup> In fact, this reticent attitude may be the result of the Secretariat's narrow mandate and the fact that Parties guard their sovereignty zealously. Even if the Secretariat makes an objective suggestion in favour of implementation of the treaty, it could be misinterpreted by the Parties.

The UNCCD Secretariat has, by way of institutionalisation of the Convention, helped in its implementation.<sup>118</sup> It does not have the resources to fund projects but indirectly helps capacity development within the jurisdiction of members.<sup>119</sup> It provides documentation on the Convention in UN languages and prepares informational kits for elementary schools.<sup>120</sup> It also helps in establishing National Action Programmes (NAPs) in affected countries.<sup>121</sup> It prepares the national focal points to deal with international partners and helps international donors identify people who need training to implement the Convention locally.<sup>122</sup> The Secretariat staff also assists the national focal points of developing members by advising them on how to fulfil the requirements of the COP.<sup>123</sup> The staff sometimes holds workshops and sensitises the national focal points of the funding opportunities available but such workshops are rather rare due to a shortage of resources.<sup>124</sup>

The CBD Secretariat provides skills-oriented capacity building.<sup>125</sup> It does this by organising courses, compiling and publishing guidelines and administrative practices, and responding to requests on how to build capacity for implementation of the Convention.<sup>126</sup> Practitioners in member states find these activities useful.<sup>127</sup> These efforts are commendable because capacity building is not in the mandate of the Secretariat nor does it have the resources to fund projects.<sup>128</sup> However, the Secretariat has not been very successful in fulfilling the monitoring obligation because states do not want to be controlled by it. For instance, the Secretariat developed a scheme to include quantifiable measures in national reports filed by states to the Secretariat, but the scheme was not adopted by the Parties.<sup>129</sup>

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115. See Sandford, *supra* note 36, at 122.

116. See Busch, *supra* note 9, at 7-8, 10.

117. See Sandford, *supra* note 36, at 123.

118. Bauer, Busch, & Siebenhüner, *supra* note 21, at 18.

119. BAUER, *supra* note 11, at 80-81.

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.*

125. Bernd Siebenhüner, *Administrator of Global Biodiversity: The Secretariat of the Convention on Biological Diversity*, 16 BIODIVERSITY & CONSERVATION 259, 266 (2007).

126. *Id.*

127. *Id.*

128. *Id.* at 265-66.

129. *Id.* at 269.

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In fact, the Parties frequently do not even provide the reports to the Secretariat, and it has to ask for them.<sup>130</sup>

The Ozone Secretariat is not mandated to build technical and financial capacity.<sup>131</sup> Instead, it has created a very efficient communication network with the National Ozone Units and advises national bureaucrats on request.<sup>132</sup> It also holds workshops in developing countries to prepare the staff of the National Ozone Units for sessions of MOP who then prepare their delegates.<sup>133</sup> This helps them link their work at the local level with the ozone discourse at the international level.<sup>134</sup> This is useful for developing members as it helps them in fulfilling the implementation objectives of the regime. This provision of advice on implementation-related matters has an impact on the management of compliance issues at the national level.<sup>135</sup> Because the delegates of the National Ozone Units are better informed, they can contribute better to international cooperation. The Secretariat also administers the reporting requirements of members, which is a complex function because the number of members in the Convention, Protocol, and its amendments is not the same.<sup>136</sup>

The CITES Secretariat helps developing members access international scientific and financial resources such as the CITES Trust Fund, which helps them fulfil their reporting and performance obligations.<sup>137</sup> The CITES Trust Fund is a financial mechanism of the Convention itself.<sup>138</sup> It matches external donors with a needy country to develop national legislation and strengthen implementation of the Convention.<sup>139</sup> The Secretariat's close links with NGOs help in capacity building activities such as training and technology transfer.<sup>140</sup> It holds extensive regional training programmes as part of its regional and national capacity building initiatives.<sup>141</sup> The CITES Secretariat and World Wide Fund for Nature/Trade Records Analysis of Flora and Fauna in Commerce collaborate to oversee international trade records and bring to light illegal trafficking in prohibited species.<sup>142</sup> This collaboration takes the form of statistical correlation of trade reports and field work by the NGO.<sup>143</sup>

These activities show the significant role played by secretariats in implementation. Not all secretariats have been granted the same powers, nor do all of them play equally important roles (for example, the UNFCCC Secretariat has not been mandated to do much, and as a result, does not do much). Nevertheless, they are indispensable as "subjects of coordi-

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130. *Id.*

131. Steffen Bauer, *The Ozone Secretariat: Administering the Vienna Convention and the Montreal Protocol on Substances that Deplete the Ozone Layer* 8 (Global Governance Working Paper No 28, 2007), available at [www.glogov.org](http://www.glogov.org). <http://www.glogov.org/images/doc/WP28.pdf>.

132. *Id.*

133. *Id.*

134. *Id.* at 8-9.

135. Bauer, *supra* note 12, at 18.

136. Bauer, Busch, & Siebenhüner, *supra* note 21, at 24.

137. Sandford, *supra* note 36, at 117.

138. *Id.* at 120.

139. *Id.* at 119.

140. *Id.* at 127.

141. *Id.* at 232.

142. *Id.* at 111.

143. *Id.* at 126.

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nation” because they transfer information between different actors of their respective regimes, which finally leads to the fulfilment of the treaty objectives.

## VI. Comparative Assessment of the Actual Functioning of Secretariats

Now that we have seen the important role played by secretariats in an international treaty system, it is worthwhile to shed light on the effects of their functions. What has been the impact of secretarial functions? This is the subject to which the article now turns.

The effects of the functions performed by secretariats can be divided into two categories: cognitive, and normative.<sup>144</sup> Cognitive effects include processing and distributing data to stakeholders.<sup>145</sup> In fact, dissemination of information is a key function of secretariats.<sup>146</sup> This may affect the knowledge or belief systems of the actors because political activity is dependent on the information received by the parties from the secretariat.<sup>147</sup> Normative effects include norm-building processes that can also influence political activity aimed at international cooperation.<sup>148</sup> For example, secretariats play a role at the time of treaty negotiation and its amendment by way of protocols.<sup>149</sup> They frame the agenda and procedures in negotiations, thus exercising a certain amount of influence on norm setting.<sup>150</sup> This influence can be used by the secretariat to further the institutionalisation and implementation of the treaty.<sup>151</sup>

### A. COGNITIVE EFFECTS

Although the UNFCCC Secretariat does not really generate new knowledge, it does process factual and descriptive information used by stakeholders, thus contributing to public discourse.<sup>152</sup> Different stakeholders—such as policy makers, negotiators, civil society, and the media—interpret the information provided by the Secretariat.<sup>153</sup> The documentation provided by the Secretariat is in great demand and a large number of visitors visit its website frequently.<sup>154</sup> Moreover, Parties have also requested information in languages other than English.<sup>155</sup> But the Secretariat’s compiling and disseminating activity is dependent on the data provided by the Parties.<sup>156</sup> Thus, even though the Secretariat coordinates the reporting obligations of the Parties, it cannot critically evaluate the data provided by them because the Parties may perceive it as a political assessment.<sup>157</sup> In fact,

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144. Bauer, Busch, & Siebenhüner, *supra* note 21, at 1.

145. *Id.* at 3.

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.*

151. Busch, *supra* note 9, at 2.

152. Bauer, Busch, & Siebenhüner, *supra* note 21, at 9.

153. *Id.* at 10

154. *Id.*

155. *Id.*

156. *Id.* at 13.

157. *Id.*

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the job of the Secretariat is to remove all politically-inclined information from the documents it prepares.<sup>158</sup>

The UNCCD Secretariat has been more visible in its cognitive effects. It has, for example, deliberately maintained the use of the expression “desertification” as opposed to “land degradation,” because the former has a political appeal and affects the perception of the problem by non-experts.<sup>159</sup> The Secretariat has also succeeded in making the desertification problem appear global instead of regional.<sup>160</sup> This has had a significant consequence because the UNCCD projects are now eligible for funding from the Global Environment Facility (GEF).<sup>161</sup> The Secretariat has always lobbied for developing countries and kept the issue alive at the GEF Council.<sup>162</sup> The Secretariat staff acknowledges its role in obtaining such funding and states that because the UNCCD does not have its own finances, funding from the GEF is necessary to implement its objectives.<sup>163</sup>

The Secretariat also prepares documents on request by the Parties and makes them available on its website. As provided by its mandate, the UNCCD Secretariat has established good contacts with NGOs to promote regional action plans.<sup>164</sup> This cooperation is a continuation of the negotiation phase of the treaty in which NGOs were very closely involved.<sup>165</sup> The Secretariat has also been accused of controversial financial support to select NGOs that has led to a review of its activities by the Parties.<sup>166</sup>

The CBD Secretariat, which is also the outcome of the Rio Summit like the two previous Secretariats, has been successful in its cognitive effects even though they are not very remarkable.<sup>167</sup> In fact, its mandate does not prescribe scientific research.<sup>168</sup> Despite this, it has been quite active in bringing together and diffusing scientific knowledge.<sup>169</sup> For this purpose, it maintains close contact with the scientific community.<sup>170</sup> The Secretariat mainly collects scientific information on different ecosystems and processes it for the member states.<sup>171</sup> For this, it maintains a scientific and technical division.<sup>172</sup> The Secretariat prepares documents, reports, handbooks, and newsletters in addition to providing information on its website.<sup>173</sup> It also publishes the Global Biodiversity Outlook, a report on the measures to implement the objectives of the Convention.<sup>174</sup> Therefore, the Secretariat has extensive expertise on biodiversity-related matters and functions as an informa-

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158. Busch, *supra* note 9, at 3.

159. BAUER, *supra* note 11, at 78-79.

160. *Id.* at 79.

161. *Id.*

162. *Id.*

163. *Id.*

164. Bauer, *supra* note 12, at 24.

165. *Id.*

166. *Id.* at 25.

167. Bauer, Busch, & Siebenhüner, *supra* note 21, at 18.

168. *Id.*

169. *Id.* at 18-19.

170. *Id.* at 18.

171. *Id.* at 18-19.

172. CBD, The CBD Secretariat, Divisions, <http://www.cbd.int/secretariat/divisions/> (last visited Nov. 16, 2011).

173. Bauer, Busch, & Siebenhüner, *supra* note 21, at 19.

174. *Id.*

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tion hub.<sup>175</sup> It is also involved in a review mechanism supported by governments and NGOs.<sup>176</sup> But the information supplied by the Secretariat is primarily used by member states and NGOs and not generally used by the scientific and business communities.<sup>177</sup> The Secretariat has not been able to influence public discourse in its field.<sup>178</sup> Its activities do not garner much attention from the media either.<sup>179</sup> This is despite the fact that the information it provides is viewed as credible by various stakeholders that make use of it.<sup>180</sup> Nevertheless, this credibility coupled with the fact that the Secretariat is viewed as politically neutral leads to a relationship of trust between the Parties and the Secretariat.<sup>181</sup>

One reason for the limited (but successful) cognitive effects of the CBD Secretariat is that biodiversity loss does not generate public interest.<sup>182</sup> For example, the loss of species of insects does not lead to natural disasters and therefore its redressal is not a priority for the public.<sup>183</sup> Hence, the activities of the Secretariat cannot generate enough public opinion to impact the actions of the member states. It has only had a limited influence on public awareness of biodiversity but has still helped in the identification of new environmental issues in national jurisdictions.<sup>184</sup> Consequently, the Secretariat has responded by coming up with a communication strategy to reach a wider public.<sup>185</sup> Its aim is to educate the media, students, governments, etc. of biodiversity conservation.<sup>186</sup> Another reason for the CBD Secretariat's limited cognitive effects is that biodiversity conservation measures involving rights of land owners are politically sensitive and therefore the Secretariat cannot do much.<sup>187</sup> Additionally, the objectives of the Convention are vague and do not include any specific quantifiable targets to be achieved by member states.<sup>188</sup> In such a situation, the effects of the Secretariat may actually be considered remarkable.

The Ozone Secretariat, which, like the other two Secretariats in the sample, serves a Protocol also, has had significant cognitive effects.<sup>189</sup> This is despite the fact that it did not develop from the UNEP Ozone Unit until after the adoption of the Montreal Protocol in 1987.<sup>190</sup> It plays an important role in highlighting unsolved issues in the ozone regime.<sup>191</sup> Because the Montreal Protocol is considered one of the most effective environmental treaties, governments are lackadaisical in their attitude towards it, which leads to the exploitation of unregulated ozone depleting substances by the private sector.<sup>192</sup> It is precisely in this area that the Secretariat has a role to play, because it must inform the

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175. *Id.* at 21.

176. *Id.* at 19.

177. *Id.*

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.* at 20.

183. *Id.* at 20-21.

184. Siebenhüner, *supra* note 125, at 265.

185. *Id.*

186. *Id.*

187. *Id.* at 271.

188. *Id.*

189. Bauer, Busch, & Siebenhüner, *supra* note 21, at 22.

190. *Id.*

191. *Id.*

192. *Id.* at 22-23.

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Parties of what is going on.<sup>193</sup> For creating awareness, it uses such means as information kits and slide projections.<sup>194</sup> The Secretariat also processes knowledge and feeds it into the negotiation process.<sup>195</sup> In fact, even the UNEP Ozone Unit was involved in knowledge dissemination to all the stakeholders during the negotiation of the Vienna Convention.<sup>196</sup>

The CITES Secretariat has expertise that it uses on various occasions, such as changes of governments.<sup>197</sup> It holds (re)training programmes for national officers every time a government changes, especially in Africa and Latin America.<sup>198</sup> Because formal communications can be difficult at such a time, the Secretariat uses means such as fax and telephone to keep in touch with the state and non-state actors.<sup>199</sup> Thus, the Secretariat has the infrastructure and knowledge to guide new officials.<sup>200</sup> Furthermore, it has regional centres employing specialists who can disseminate expert knowledge.<sup>201</sup> It has also recommended to governments not to change the head of the CITES Management Authority as s/he has invaluable expertise<sup>202</sup> that could impact the actions of stakeholders. The Secretariat also uses its technical expertise to conduct analyses of national reports to advise and recommend actions to be taken.<sup>203</sup>

The CITES Secretariat must also convince members of the importance of conservation, which is difficult in the case of developing countries.<sup>204</sup> In this case, it uses an anthropocentric approach,<sup>205</sup> helping the countries to develop alternatives to wildlife trading for their locals.<sup>206</sup> The Humane Society, an NGO, termed the CITES Secretariat as very influential because it provides reliable data, detects infractions, and advises Parties.<sup>207</sup> Generally, the recommendations made by the Secretariat are not ignored by the Parties. In fact, the Secretariat enjoys authority due to its professional expertise and experience.

**B. NORMATIVE EFFECTS**

The UNFCCC Secretariat has not exercised much visible influence on the political outcome of negotiations or on the adoption of specific measures by Parties.<sup>208</sup> It did not have much influence on the direction and content of the negotiations leading to the adoption of the Kyoto Protocol either. Despite this, one can say that the Secretariat exercised indirect influence because it facilitated the negotiations leading to a successful outcome by

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193. *Id.* at 23.

194. *Id.*

195. *Id.*

196. *Id.*

197. See Sandford, *supra* note 36, at 232-33.

198. *Id.* at 232.

199. *Id.* n. 13.

200. *Id.* at 233.

201. *Id.* at 253.

202. *Id.* at 232.

203. *Id.* at 118.

204. *Id.* at 239.

205. *Id.*

206. *Id.* at 245.

207. *Id.* at 239.

208. Bauer, Busch, & Siebenhüner, *supra* note 21, at 10.

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providing strategic advice to the COP President and respective Chairs and officers.<sup>209</sup> This was particularly evident at the resumed COP 6 in Bonn in July 2001, where the Secretariat drafted a text that assisted the Parties in deciding on the technical features of the Kyoto mechanisms and then adopting the Marrakech Accords at COP 7 in Marrakech in November 2001.<sup>210</sup> The Secretariat did not lean one way or the other, politically, in the text but instead it merely removed incoherence in the previous texts and provided technical solutions.<sup>211</sup> The Secretariat can only step in once the Parties are in political agreement and cannot push forward questions on which Parties are in disagreement.<sup>212</sup> This kind of support for negotiations and technical advice is highly appreciated by the Parties.<sup>213</sup>

One of the reasons why secretariats might have a limited influence is because of the high costs of regulation in domestic economies and the high political stakes.<sup>214</sup> In such a case parties monitor the activities of the secretariat to make sure they are not acting against parties' respective interests and are reluctant to give any latitude to the secretariat to act.<sup>215</sup> The Climate Secretariat, for instance, cannot take a stand in the documentation it prepares and must reflect the positions of all Parties.<sup>216</sup> The Secretariat can only make technical propositions and cannot comment on politically sensitive issues.<sup>217</sup> Even though this may be called an exercise in impartiality, taking a stand does not necessarily amount to partiality.

This does not mean that the Secretariat does not exercise any influence, however; as this article has noted, its influence is limited but it does exist.<sup>218</sup> The source of its influence is its political and technical expertise on climate change issues and its ability to provide input in a timely manner. For example, the Secretariat prepares technical papers for subsidiary bodies. Given that it is an authority on the climate regime, it can come up with the requisite analysis of issues critical to the negotiations.<sup>219</sup> Thus the Secretariat possesses expertise unmatched in national jurisdictions and prepares its documents in a politically neutral way so that such documents are acceptable to the Parties when negotiating.<sup>220</sup> It prepares, on request, drafts and proposals for the presiding officers that contain options for agreement amongst Parties, advice on the conduct of negotiations, possible outcomes, negotiating arena, procedural obstacles, and ways to overcome them.<sup>221</sup> In fact, the COP at The Hague failed largely due to lack of secretarial advice.<sup>222</sup> This shows the significance of the Secretariat's advisory function. The Secretariat also

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209. *Id.* at 11.

210. *Id.*

211. *Id.*

212. *Id.* at 11-12.

213. *Id.* at 11.

214. *Id.* at 12.

215. *Id.*

216. *Id.*

217. *Id.* at 12.

218. *Id.* at 14.

219. FARHANA YAMIN & JOANNA DEPLEGE, *THE INTERNATIONAL CLIMATE CHANGE REGIME: A GUIDE TO RULES, INSTITUTIONS AND PROCEDURES* 484-85 (2004).

220. Bauer, Busch, & Siebenhüner, *supra* note 21, at 14.

221. Busch, *supra* note 8, at 5-6.

222. *Id.* at 5.



provides the logistics *in the form of organising* negotiations.<sup>223</sup> This is a very important function because climate change negotiations involve a large number of participants.<sup>224</sup> According to a staff member, “[n]o meeting ever succeeded because the logistics were great. But if the logistics are bad, the negotiations can fail.”<sup>225</sup>

In the case of the UNCCD Secretariat, its staff members were involved in the negotiations of the Convention, especially the former Executive Secretary, Hama Arba Diallo, who led the interim Secretariat.<sup>226</sup> The continuity of their presence contributed to the institutionalisation and implementation of the Convention. Because the Convention itself contains regional annexes, the Secretariat’s efforts, through its Regional Action Facilitators, are oriented towards Africa, Asia, and Latin America, the affected regions.<sup>227</sup> The Secretariat has aimed to improve cooperation between regions through Regional Co-ordination Units (RCUs) to implement regional action plans.<sup>228</sup> The affected countries were receptive to the idea of institutionalisation of the Convention but donor countries were sceptical about it.<sup>229</sup> Another example of institutionalisation of the Convention by the Secretariat is the creation of the Committee for the Review of the Implementation of the Convention (CRIC).<sup>230</sup> This idea originated from within the Secretariat just like the idea to set up RCUs.<sup>231</sup> The creation of the CRIC was not looked upon favourably by the donor countries, similar to the case of the formation of RCUs.<sup>232</sup> Additionally, there were some irregularities regarding the election of CRIC officials, which affected the reputation of the Secretariat.<sup>233</sup> When the CRIC held its meetings, however, this scepticism partially evaporated because it helped to implement the Convention’s objectives.<sup>234</sup>

Not satisfied with its previous efforts towards the institutionalisation of the Convention, the Secretariat continued in the same direction by organising a High Level Segment of Heads of State and Government at the Havana COP to get public attention for the Convention.<sup>235</sup> It invited Heads of State of developing countries such as Fidel Castro, Robert Mugabe, and Hugo Chávez.<sup>236</sup> In contrast, it did not invite any Heads of State from developed countries.<sup>237</sup> This Segment even resulted in a Havana Declaration of Heads of States and Governments.<sup>238</sup> All these activities show the Secretariat’s consistent support for the developing world. The developed countries expressed their displeasure at the activities of the Secretariat.<sup>239</sup> Developing countries, being at the mercy of rich donor countries, also criticised the Secretariat for holding the Segment. This led to the Parties

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223. *Id.* at 6.

224. *Id.* at 6-7.

225. DEPLEDGE, *supra* note 22, at 71.

226. BAUER, *supra* note 12, at 22-23.

227. BAUER, *supra* note 11, at 79-80.

228. *Id.* at 80.

229. *Id.*

230. *Id.*

231. *Id.*

232. *Id.*

233. BAUER, *supra* note 12, at 25.

234. BAUER, *supra* note 11, at 80.

235. BAUER, BUSCH, & SIEBENHÜNER, *supra* note 21, at 16.

236. *Id.* at 17, n. 42.

237. *Id.*

238. *Id.* at 16.

239. *Id.* at 17.

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exercising greater control over the activities and resources of the Secretariat.<sup>240</sup> However, the very fact that the Segment ignited so much controversy shows the important role secretariats are capable of playing in the sphere of intergovernmental diplomacy.

Since the UNCCD negotiations began at the Rio de Janeiro Summit in 1992, the Convention has been framed as a sustainable development convention aimed at alleviating poverty, a point highlighted by the Secretariat and developing members.<sup>241</sup> Given that it is supposed to be a desertification convention, this framing leads to a certain amount of ambiguity in its objectives.<sup>242</sup> This ambiguity gives a lot of liberty to the Secretariat, which prefers a broad interpretation of the Convention.<sup>243</sup> In fact, this ambiguity helped the Secretariat to shape the current Convention process.<sup>244</sup> Given that desertification affects developing countries much more than developed countries, the Convention is not of much interest to the latter. Therefore, the developing countries perceive the Secretariat's support as a positive factor.<sup>245</sup> On the one hand, the Secretariat could be said to be faithful to the objectives of the treaty, but on the other hand, this pro-developing country attitude may put a question mark on the impartial character of the Secretariat. This is a case of the Secretariat deciding which of the two masters it wants to serve—the treaty (since the title of the convention refers to Africa) or the parties or both.

The CBD Secretariat has generated substantial normative effects compared with other secretariats.<sup>246</sup> Its effects result from international cooperation and assistance in negotiations.<sup>247</sup> In fact, because the Secretariat has expert knowledge of the biodiversity regime (as we have seen in addressing its cognitive effects) and is neutral, it is able to generate normative effects beyond its mandate.<sup>248</sup> For example, the Secretariat held dialogues on the issue of biosafety and encouraged Parties to participate in the negotiations<sup>249</sup> despite their conflicting priorities. As a result, a lot of countries participated in the negotiations on the Cartagena Protocol on Biosafety, leading to its successful adoption.<sup>250</sup> Also, the Convention has an inclusive approach towards non-state actors unlike other conventions.<sup>251</sup> This inclusive approach is also the result of the efforts of the Secretariat, which supported the inclusion of indigenous and local communities in the working group on traditional knowledge.<sup>252</sup> The Secretariat's role in encouraging NGO participation in the regime has been highlighted by a majority of stakeholders.<sup>253</sup> Additionally, the Secretariat prepares background documents for the meetings of the COP and other subsidiary bodies and organises the meetings.<sup>254</sup> It also prepares COP decisions, in which passages relating

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240. *Id.*

241. *Id.*

242. *Id.*

243. *Id.*

244. *Id.*

245. *Id.*

246. *Id.* at 18.

247. *Id.* at 19.

248. *Id.* at 21.

249. *Id.* at 19.

250. *Id.*

251. *Id.* at 20.

252. *Id.*

253. Siebenhüner, *supra* note 125, at 266.

254. Bauer, Busch, & Siebenhüner, *supra* note 21, at 20-21.

to technical assessments have been adopted without any changes.<sup>255</sup> Of course, drafts prepared by the Secretariat are frequently amended when the issue in question is politically sensitive.<sup>256</sup> On the whole, it is clear that the Secretariat exercises bureaucratic authority and is able to bring about a change in the activities of the different stakeholders.<sup>257</sup>

The Ozone Secretariat, like the Climate Secretariat, drafts reports and decisions to be adopted by the MOP.<sup>258</sup> Though the Executive Secretary attached little importance to the Secretariat's drafts, the staff admits that its legal and technical expertise helps it to indirectly influence the members' decisions because members view the drafts as reliable.<sup>259</sup> Secretariat staff rephrases potentially controversial parts in drafts to make them acceptable to delegates.<sup>260</sup> This expertise, which results from a highly qualified, sincere, and professional staff, allows the Secretariat to command considerable authority.<sup>261</sup> Apart from the preparation of drafts, the Secretariat has also come up with solutions in case of collapse of negotiations due to politically sensitive issues.<sup>262</sup> The Secretariat also tries to convince Parties to ratify amendments to the Montreal Protocol as the number of members to the Convention, the Protocol, and its amendments are different thus increasing the work of the Secretariat.<sup>263</sup> Its mandate allows it to invite non-members to meetings.<sup>264</sup> It also communicates to the Parties any proposed Protocol to be adopted, at least six months before the COP meeting for its adoption (article 8(2) of the Vienna Convention).<sup>265</sup> It is also required to communicate proposed amendments to the Convention or Protocol to the Parties at least six months before the COP or MOP meeting for its adoption. The Secretariat shall also communicate proposed amendments to the signatories to this Convention for information (article 9(2) of the Vienna Convention).<sup>266</sup> Thus, the Secretariat plays an important role in improvements and advances in the treaty, be it the Vienna Convention or the Montreal Protocol. Moreover, the Secretariat is known to be impartial and transparent and has been able to create good relations with developing and developed members.<sup>267</sup> This certainly helps in furthering the treaty regime.

The CITES Secretariat has had diverse normative effects. It receives proposed amendments to the Appendices from the Parties 150 days before the meeting to discuss them. It is then required to consult the Parties and intergovernmental bodies on the issue and forward the response to the other Parties with its own findings and recommendations (article XV(1)(a) and (2)(b),(c),(e)). This is unlike the Ozone Secretariat that only communicates the proposed amendments to the Convention or Protocol. In case of Parties' replies or objections, the Secretariat shall communicate them to the other Parties (article

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255. *Id.* at 20.

256. *Id.*

257. *Id.* at 19-21.

258. Bauer, *supra* note 131, at 12.

259. Bauer, Busch, & Siebenhüner, *supra* note 21, at 23.

260. Bauer, *supra* note 131, at 12.

261. Bauer, Busch, & Siebenhüner, *supra* note 21, at 25-26.

262. *Id.* at 23.

263. *Id.* at 24.

264. *Id.* at 23-24.

265. Vienna Convention, Mar. 22, 1985, 1513 U.N.T.S. 324, art. 8(2).

266. *Id.* at art. 9(2).

267. Bauer, Busch, & Siebenhüner, *supra* note 21, at 25.

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XV(2)(h)). The Secretariat is also required to notify the Parties of the result of the vote on the proposed amendment (article XV(2)(k)). Thus it plays a role in treaty-making.

In case of conflicts among members, the CITES Secretariat being activist sees them as an opportunity to make use of its conflict management skills, thus enhancing its credibility and reputation as an impartial secretariat.<sup>268</sup> Of course the resolution of the conflict must also result in advancing the objectives of the Convention.<sup>269</sup> The Secretariat's expertise in resolving conflicts is well known because it is called upon to resolve conflicts between member states and NGOs, for example, during the negotiation of the Lusaka Agreement which led to a successful outcome.<sup>270</sup> However Parties do not really acknowledge the contribution of the Secretariat in resolving conflicts relating to the implementation of the treaty.<sup>271</sup>

The question of ivory trade has caused much tension between the Parties and the Secretariat because the latter advised the parties to enter a reservation on protection of elephants until they were in a position to be protected.<sup>272</sup> The Secretariat knew this recommendation would be problematic because Parties do not appreciate this recommendation-making power as they feel that the Secretariat has too much liberty to make recommendations.<sup>273</sup> So the unique power to make recommendations does not always work in favour of the Secretariat.<sup>274</sup> However, when the Secretariat recommended to the Standing Committee to take action against Italy for violation of CITES regulations, the members actually imposed trade bans on Italy, making it comply.<sup>275</sup> In case of trade in endangered species in Thailand, the Secretariat recommended more time for implementation. Thailand worked with the Secretariat and thus avoided sanctions.<sup>276</sup> Thus, the CITES Secretariat is not just a servant of the Parties. It also helps in fulfilling the objectives of the Convention. These three examples make it clear the CITES Secretariat is quite activist even though it may not always succeed in its efforts. But this activism is actually the result of a formal mandate to make recommendations. Moreover, the Secretariat prepares projects on Parties' request and makes recommendations to the Standing Committee about which of these should be funded and has also recommended the use of trade bans against defaulting members.<sup>277</sup>

Relations between the Secretariat and NGOs deteriorated in the 1980s when the latter accused the Secretary General of favouring ivory trade.<sup>278</sup> The Secretariat reacted in a very mature way. It did not stop communicating with the NGOs. This has an impact on the achievement of the goals of the treaty. This also explains why the Secretariat is good at handling conflicts that ultimately leads to furthering the Convention. The fact that these efforts of the Secretariat bear fruit is proof of its commitment to the Convention.

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268. See Sandford, *supra* note 36, at 165.

269. *Id.*

270. *Id.* at 167, 261.

271. *Id.* at 376.

272. *Id.* at 227.

273. *Id.* at 228.

274. *Id.*

275. *Id.* at 229.

276. Sandford, *supra* note 7, at 16.

277. Sandford, *supra* note 36, at 225, 244.

278. *Id.* at 167.

The number of Parties to the CITES was twenty-one in 1973 and 134 in 1996.<sup>279</sup> This increase was due to the activism of the CITES Secretariat that made efforts to convince developing and developed countries to become members of the treaty.<sup>280</sup> These efforts have continued and the number of Parties currently is 175.<sup>281</sup> Additionally, the Secretariat has made efforts to include plants under regulated species as the Convention is seen as one that is too focussed on animals.<sup>282</sup> This is a very significant contribution to the advancement of the Convention. The Secretariat is also respected by all for being impartial.

There are many factors that affect the performance of secretariats, such as cooperation with other entities, finances, and leadership, to name a few. For example, if the cost of alleviating the problem is very high or the time span between the cause and effect of the problem is too long, governments may try to reduce the role of treaty secretariats.<sup>283</sup> However, the authority exercised by secretariats by virtue of their institutional memory, varied knowledge base, professional diversity, and leadership allows them to play a role in the functioning of the treaty.<sup>284</sup> One of the most important factors affecting the role of secretariats is their leadership.

## VII. Leadership

Leadership is a phenomenon that elicits divergent opinions. On the one hand, scholars like Thomas G. Weiss feel that the role of leadership in international organisations is exaggerated because leaders function within an inherently complex structure and are not always free to make decisions.<sup>285</sup> On the other hand, there are scholars like Oran R. Young who feel that the success or failure of institutional bargaining in international organisations depends on the leadership.<sup>286</sup> He defines leadership as “the actions of individuals who endeavour to solve or circumvent the collective action problems that plague the efforts of parties seeking to reap joint gains in processes of institutional bargaining.”<sup>287</sup> It is thus clear that leaders, in isolation, cannot determine the success of institutional bargaining but good leadership can go a long way in achieving success.<sup>288</sup> This article subscribes to Oran R. Young’s view about the importance of the role of leadership.

The functions and impacts of secretariats are greatly determined by their leaders. The main actors in secretariats are the top executives, especially the head of the organisation who guides the staff. Skilful leadership allows the secretariat to have more impact. The personality and abilities of the head are very important when forging relationships with the parties and other intergovernmental organisations. S/he must maintain informal ties with the relevant persons without sacrificing the impartiality of the secretariat. The point of view of the leader regarding the role of the secretariat in treaty implementation deter-

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279. *Id.* at 224.

280. *Id.*

281. CITES, Member Countries, available at <http://www.cites.org/eng/disc/parties/index.php>.

282. Sandford, *supra* note 36, at 230.

283. Bauer, Busch, & Siebenhüner, *supra* note 21, at 4.

284. *Id.* at 3-7.

285. See Weiss, *supra* note 1, at 299.

286. Oran R. Young, *Political Leadership and Regime Formation: On the Development of Institutions in International Society*, 45 INT’L ORG. 281 (1991).

287. *Id.* at 285.

288. *Id.*

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mines the role the secretariat will play in the treaty regime. The leadership determines the performance of the secretariat and how it is perceived by the stakeholders. In fact, the behaviour of the head can have an impact on the behaviour of the stakeholders in the entire regime.

The UNFCCC Secretariat does not project itself as the leader. Even though the Executive Secretary can provide some sort of “inspirational leadership,”<sup>289</sup> the first Executive Secretary of the Climate Change Secretariat, Michael Zammit Cutajar, did not want overt involvement of the Secretariat staff in the climate regime.<sup>290</sup> The staff does not make any effort to influence the political activity and is aware that this would contradict its mandate.<sup>291</sup> Thus, the Secretariat does not exercise proactive leadership. Staff members stay impartial by following the instructions of the Parties and this in turn helps the Secretariat influence the regime.<sup>292</sup> The Secretariat enjoys the trust of the Parties. This is due to Michael Zammit Cutajar, who having worked in the UNCTAD previously<sup>293</sup> had good knowledge of UN procedures and of developing country concerns. He served for over a decade as Executive Secretary,<sup>294</sup> gaining the confidence of Parties through his good relations. He was known to be efficient, objective, intelligent, committed, professional, and affable. The next Executive Secretary, Joke Waller Hunter followed in his footsteps, i.e. she managed to keep the trust of the Parties.

The UNCCD Secretariat’s leadership has been instrumental in bringing about institutionalisation and implementation of the Convention. The former Executive Secretary Hama Arba Diallo from Burkina Faso was head of the Secretariat of the Intergovernmental Negotiating Committee on Desertification and of the interim Secretariat. He was popular with developing countries.<sup>295</sup> He played an important role in the negotiation of the Convention and was known to take a stand against developed members.<sup>296</sup> The current Executive Secretary is Luc Gnacadja from Benin.<sup>297</sup> This could be symbolic as desertification mainly affects Africa.<sup>298</sup> This may also show the preference for an Executive Secretary who comes from the affected region and so has a good grasp of the problem.

The effects of the CBD Secretariat can be explained by the functioning of its leadership. For example, the Executive Secretary proposed a Staff Development Policy adopted by the COP in 2002 which encourages staff to improve and evaluate its competencies.<sup>299</sup> This obviously helps in better functioning of the Secretariat and thus of the treaty regime. The first Executive Secretary of the CBD Secretariat, Calestous Juma, had frequent conflicts with the UNEP because he wanted more autonomy for the Secretariat.<sup>300</sup> Since the

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289. Depledge, *supra* note 23, at 54.

290. *Id.* at 63.

291. Busch, *supra* note 9, at 12.

292. *Id.* at 12-13.

293. Depledge, *supra* note 23, at 63.

294. *Id.*

295. Bauer, Busch, & Siebenhüner, *supra* note 21, at 18.

296. *Id.*

297. UNCCD, Secretariat, <http://www.unccd.int/secretariat/menu.php?newch=l2> (last visited Jan. 20, 2012).

298. UNCCD, Fact Sheet 11, Combating Desertification in Africa, [http://www.unccd.int/publicinfo/fact\\_sheets/showFS.php?number=11](http://www.unccd.int/publicinfo/fact_sheets/showFS.php?number=11) (last visited Dec. 12, 2011).

299. Siebenhüner, *supra* note 125, at 270.

300. *Id.*

CBD Secretariat is hosted by the UNEP, any attempt to break away does not make sense. As long as the Secretariat can fulfil its mandate, whether or not it is autonomous is not really the question. But these efforts at autonomy did bear fruit because the next Executive Secretary, Hamdallah Zedan, who was from the UNEP itself, took the reins of a rather independent Secretariat.<sup>301</sup> Moreover, he did not let UNEP exercise any further control on the Secretariat and instead favoured more autonomy.<sup>302</sup> He also favoured consulting his staff when taking decisions, thus bringing about a change in the centralised decision-making procedure that existed earlier.<sup>303</sup> The current Executive Secretary Ahmed Djoghlaif has emphasised capacity building and implementation as areas requiring further action.<sup>304</sup> Thus, it is clear that the leadership has contributed to the useful effects of the Secretariat.

Despite the fact that all the Executive Secretaries of the UNCCD and CBD Secretariats have been from developing countries, the difference in the stand of the two Secretariats is obvious. The UNCCD Secretariat is manifestly pro-developing countries whereas the CBD Secretariat is impartial.

The role played by the Ozone Secretariat is reinforced by its leadership. Mustafa Tolba, Executive Director of UNEP, was very overtly involved in the ozone negotiations and is respected for having furthered the formation of the ozone regime.<sup>305</sup> All the stakeholders, including staff and delegates, are unanimously appreciative of his leadership capabilities. His successor, Madhava Sarma, the first Executive Secretary of the Ozone Secretariat, was also respected by all the parties.<sup>306</sup> Like Mustafa Tolba, who played an important role in the Vienna Convention and Montreal Protocol negotiations, Sarma also played a significant role in resolving impasses at the sessions of the MOP to amend the Montreal Protocol.<sup>307</sup> Both would consult informally with Parties before the beginning of formal negotiations to achieve consensus.<sup>308</sup> Marco Gonzalez, the current Executive Secretary, is more prudent in his approach to the Parties<sup>309</sup> but understands fully well the consequences of Parties not willing to commit in negotiations. According to him, even though the Secretariat is meant to serve the Parties, it also reminds them of their responsibilities.<sup>310</sup> Also, the fact that the Ozone Secretariat processes knowledge that is used in informal meetings of the Parties shows not only its expertise but also the dynamism of its leadership. The role of the personnel and the leadership is commendable given the limited autonomy of the Secretariat being part of the UNEP. Additionally, the Executive Secretary has to make do with a very small staff.<sup>311</sup>

The leadership of the CITES Secretariat has had a turbulent history. The achievements of the Secretariat, however, are a testimony of its commitment to the Convention. In 1989, American NGOs accused the Secretariat of supporting ivory trade and its Secre-

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301. *Id.*

302. *Id.*

303. *Id.*

304. *Id.*

305. Depledge, *supra* note 23, at 63.

306. Bauer, *supra* note 131, at 14.

307. *Id.*

308. *Id.* at 13.

309. *Id.* at 14.

310. *Id.* at 13.

311. *Id.* at 10.

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tary General, Eugène Lapointe, of receiving payments from ivory traders, because of which he was dismissed by Mustafa Tolba, the then Executive Director of UNEP.<sup>312</sup> The Secretariat staff is sympathetic to Lapointe and are now cautious in their relations with NGOs. In 1998, Izgrev Topkov, the then Secretary General, was also removed from his post, along with two other officers, for awarding permits to organisations that wanted to trade in banned plants and animals. This was the result of an inquiry by Klaus Tpfer, Executive Director of UNEP.

The Secretariat has also had many problems with the UNEP over common services and costs of being located in Geneva.<sup>313</sup> In 1995, the Secretary-General Izgrev Topkov suggested that the International Union for Conservation of Nature (IUCN) that was acting as the CITES Secretariat had not put in enough effort to make their alliance work, because of which the parties decided to move it to the UNEP.<sup>314</sup> But there were problems with the UNEP too and according to Topkov, since the Secretariat had been through this with IUCN, it knew that bowing to UNEP would spell the end of its autonomy.<sup>315</sup> Thus, he could be said to be like Calestous Juma, the first Executive Secretary of the CBD Secretariat, who was very concerned about the independence of his Secretariat. Given the strong personality of its head, it is not surprising that the CITES Secretariat is quite active. Furthermore, Topkov realised that employees were underpaid and on short-term contracts.<sup>316</sup> He therefore secured them longer contracts.<sup>317</sup> He believed that he could not win the loyalty of the staff if he did not take care of it. It is curious that the CITES Secretariat has such a bad relationship with UNEP, unlike the Ozone Secretariat. And Mustafa Tolba buckled under U.S. pressure to dismiss Lapointe. Perhaps, this is just one reason explaining the bad relationship between the UNEP and the CITES Secretariat. What is really surprising is that the Secretariat is so active despite its controversial leadership.

Lapointe's generation was dedicated to the protection of the environment. The new generation of leaders is more concerned about the efficiency of the Secretariat,<sup>318</sup> as is clear by Topkov's attitude. But this attitude cannot be criticised *per se* because it must be judged by what it achieves in terms of the Convention's objectives. The Secretariat has played a role in resolving conflicts amongst members, as mentioned earlier. Its senior officers, such as the Secretary General, Deputy Secretary-General, and the Scientific Officer have facilitated negotiations among members.<sup>319</sup> Therefore, they are highly regarded by all the stakeholders.<sup>320</sup> Additionally, the Secretary General is also responsible for the budget of the Secretariat.<sup>321</sup>

This overview proves that leaders of environmental secretariats have made a significant contribution to the functioning of secretariats and, as a result, on the impact of secretariats on the treaty regime.

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312. Sandford, *supra* note 36, at 213, 228, 254.

313. *Id.* at 235.

314. *Id.*

315. *Id.* at 235-36.

316. *Id.* at 248.

317. *Id.* at 248, n. 19.

318. *Id.* at 255.

319. *Id.* at 257.

320. *Id.* at 391.

321. *Id.* at 242.



### VIII. Problems Faced by Environmental Secretariats

One problem faced by secretariats is the issue of sovereignty, i.e. the parties and not the secretariats are the decision-makers.<sup>322</sup> Parties can do anything in the name of sovereignty. Also, different departments or ministries of the government have different priorities so secretariats get different signals from the same government.<sup>323</sup> For example, the Ministry of Trade will promote trade, whereas the Ministry of Forests will promote conservation.<sup>324</sup> Moreover, changes in national governments mean changes in national priorities and new government officials must be briefed every time.<sup>325</sup> If a new government changes its priority from environment to education, the secretariat can only advance the goal of the treaty within this change in priority. Within this constraint, the secretariat has to try to achieve the treaty objectives so it constantly communicates with parties' governments, providing relevant information, etc. The secretariat may also cooperate with NGOs as they can mobilise opinion that may influence the implementation of the convention by a party. This is certainly useful if the convention is not a priority for the new government. Secretariats may also build contacts with the media for this purpose.

Another problem is finances. With the passage of time, the number of parties to treaties has gone up, thus increasing the workload and financial needs of secretariats. When parties want to restrain the expansion of secretariats, they may use budget constraints.<sup>326</sup> This may be the case if parties do not want the secretariat to play a role in compliance monitoring, for example, by travelling and verifying implementation by parties. Moreover, parties are reluctant to provide funds for implementation problems as that would amount to admitting their existence.<sup>327</sup> Therefore, secretariats are hesitant to ask for funds. The CITES Secretariat faced this problem and had to ask for funds stating that they were for the performance of substantive tasks.<sup>328</sup> Also, parties may not pay their contributions in a timely manner, forcing the secretariat to do fund-raising from their parent organisation or external sources such as NGOs, which is time consuming and may put its neutrality at risk. But this is not a substitute for parties' contributions. Additionally, lack of funds may not let the secretariat employ quality staff.<sup>329</sup> In this case the work is outsourced to consultants or even NGOs. But in the face of changing governments, continuity is required in the secretariat staff. Therefore, secretariats try to obtain contributions from important members first and then persuade other members to pay.

Some parties may feel the secretariat is too active and may try to restrain its activities. But in fact, the secretariats do not overstep their limits as they have their survival in mind. Anyway, staff cannot be hired without COP approval. Also, the parties are sometimes suspicious of the activities of the secretariat. For example, the parties to the UNFCCC never analysed the financial activities of the Secretariat, but have started doing so now.<sup>330</sup> Additionally, the programme budget decision for 2004-2005 requested the Executive Sec-

322. Bauer, Busch, & Siebenhüner, *supra* note 21, at 5.

323. Sandford, *supra* note 36, at 135.

324. *Id.* at 241.

325. *Id.* at 135-36.

326. *Id.* at 142-143.

327. *Id.* at 376.

328. *Id.*

329. *Id.* at 140-42.

330. YAMIN & DEPLEDGE, *supra* note 219, at 502-03.

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retary to specify how COP decisions on article 4(8) of the UNFCCC<sup>331</sup> are reflected in the work programme and to conduct an evaluation of the Secretariat's activities and report to the COP 11. Moreover, Saudi Arabia, speaking for G77 and China, asked for a continuing review of the functions and operations of the Secretariat. This close supervision of the Secretariat may be useful if it is not done for political purposes.<sup>332</sup>

Parties do not appreciate the presence of NGOs in their jurisdictions.<sup>333</sup> For example, there are northern NGOs which monitor trade in Asia and Africa and report to the CITES Secretariat to identify infractions.<sup>334</sup> Frequently, the NGOs are more interested in making money and have little understanding of the problem or culture of the issue in question.<sup>335</sup> Moreover, developing countries do not always have the resources to put into practice all the rules of the Conventions, and NGOs do not understand this.<sup>336</sup> Therefore, secretariats play a role in improving relations between the stakeholders. But, because secretariats are dependent on NGOs for fieldwork, their dislike by the parties may not allow the secretariat to fulfil its monitoring obligation.

National governments try to exert pressure on their nationals to influence the course of action in the secretariats.<sup>337</sup> This means that geographical quotas may lead to international civil servants promoting national interests within the international secretariat.<sup>338</sup> In fact, the very concept of geographical quotas supports the idea of national loyalties and may lead to the non-fulfilment of the international objectives of the MEA.<sup>339</sup> Thus, these quotas should be eliminated. Instead, they could be based on gender, age, length of service, etc., or a mix of these criteria.<sup>340</sup> Or recruitment could be done in such a way that it is representative of all stakeholders, for example indigenous peoples, involved in the management of the resource to be protected.<sup>341</sup> An example of geographical quotas not serving their purpose is provided by the UNFCCC Secretariat, where developing country nationals are under-represented in the top management.<sup>342</sup> As a result, China and G77 have questioned this and asked for equity in allocation of resources between developed and developing members.<sup>343</sup> If the principle of geographical quotas were not followed, this question would not have arisen.

Secretariats may also face problems with respect to their parent organisation, like the CITES Secretariat has had problems with UNEP. But this conflict related to the field of activity of the Secretariat under the purview the UNEP, i.e. administrative matters, and

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331. Article 4(8) reads as follows, "In the implementation of the commitments in this Article, the Parties shall give full consideration to what actions are necessary under the Convention, including actions related to funding, insurance and the transfer of technology, to meet the specific needs and concerns of developing country Parties arising from the adverse effects of climate change and/or the impact of the implementation of response measures . . . ." UNFCCC, May 9, 1992, 1771 U.N.T.S. 165, art. 4(8).

332. YAMIN & DEPLEDGE, *supra* note 219, at 502-03.

333. Sandford, *supra* note 36, at 237-38.

334. *Id.* at 238.

335. *Id.*

336. *Id.*

337. *Id.* at 160.

338. Weiss, *supra* note 1, at 293.

339. *See id.* at 302-03.

340. *Id.* at 304.

341. SANDFORD, *supra* note 27, at 36-37.

342. *See* DEPLEDGE, *supra* note 22, at 70.

343. *Id.*

not to the field of substantive operations of the Secretariat that are the domain of the COP. Despite this, the secretariat has to spend time dealing with it.

The location of the secretariat can also create problems. For example, the CITES Secretariat may conduct activities such as training programmes in developing countries.<sup>344</sup> But it is located in Geneva and it may be difficult to coordinate from there. It has regional centres<sup>345</sup> but this is not the case with all secretariats. The Ozone Secretariat is located in a developing country but then far away from the UN in Geneva or New York, so coordination is again a problem.<sup>346</sup> Also, developing countries do not always have missions in another developing country so they cannot send delegates, especially on short notice. On the other hand, they have missions in UN centres so they can attend meetings easily. Given that most secretariats are in the North, it may be a good idea to decentralise activities by having regional centres where representatives of various secretariats may participate. Because environmental problems are linked, a forum is needed where all the environmental secretariats can interact, which would be beneficial to the attainment of the goals of the various treaties involved. Regional centres make the secretariat more accessible to stakeholders and help the secretariat to monitor compliance. Furthermore, decentralisation would make their operations more flexible and decisions could be taken faster without the need for consulting the entire management. In addition, decentralised offices, being in the field, understand the problem better and can initiate useful projects that would fulfill the aims of the MEA. Of course, decentralisation leads to higher costs but has many advantages too.<sup>347</sup> The decentralised units can continue to be financed by the main office or may generate their own finances also. Another possibility may be to locate secretariats, whether or not by rotation, in places where the problem to be addressed is most acute because people there have greater understanding of the issue and need more help.<sup>348</sup>

## IX. Conclusion

This analysis of secretariats shows that they do play an important role in the treaty regime. Despite the fact that they lack formal power, they help in ensuring the success of the treaty and can have a significant impact on the international environmental policy outcomes. They do so by impacting the behaviour of states and non-state actors. For example, despite criticism and accusations of lack of transparency, the UNCCD Secretariat has emerged as an active player in the regime. Of course, secretariats cannot be held responsible for the failure or success of the regimes as they are but secretariats. They are not the decision-makers. But they can lead to unpredictable results that impact the implementation of the MEA. The principal role is played by the nation states, but secretariats are fast becoming quite influential even if such influence is not laid down in their mandate. States frequently react to secretariats' actions, as in the case of the UNCCD Secretariat. As a result, it is clear that secretariats exercise bureaucratic authority. But, this authority should be exercised judiciously. For example, the blatant support of developing

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344. Sandford, *supra* note 36, at 22.

345. *Id.* at 252.

346. SANDFORD, *supra* note 8, at 22-27.

347. Weiss, *supra* note 1, at 302, n. 36.

348. SANDFORD, *supra* note 27, at 41, 45.

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members by the UNCCD Secretariat has proved counterproductive by offending powerful donor countries.

Secretariats offset their little formal power by acting as the information hub and providing the link between states and non-state actors. Moreover, the influence of secretariats is also dependent on their leadership. Being the institutional memory of the regime and the main expert on technical, scientific, legal, and political matters, secretariats are actually indispensable. Parties' appreciation of their work is proof of this fact.

The most important function of secretariats is actually acting as the facilitator and mediator, especially the latter. This means that the most important function is the one that is not really defined in its mandate. This once again proves their importance. Of course, the other functions are equally indispensable, but the effects of acting as a mediator can be quite spectacular; for example, the adoption of the Convention or Protocol.

If secretariats are to continue their important work, their problems need to be solved. They need to be provided with funds and basic autonomy so that they do not spend their time searching for either or both.

## The Indian Microfinance Institutions (Development and Regulation) Bill of 2011: Microfinance Beginnings and Crisis and How the Indian Government is Trying to Protect Its People

LAMAR DOWLING\*

### I. Introduction

The recent microfinance crisis in the southern Indian state of Andhra Pradesh caught the world's attention and caused many to wonder who was to blame. Sensationalized newspaper accounts of suicides among over-indebted clients of microfinance institutions (MFIs) brought to light the increasing debt stress across tens of thousands of clients, exacerbated by explosive growth of these MFIs in southern India.<sup>1</sup> In light of these events, India's Ministry of Finance released a draft of the Microfinance Institutions (Development and Regulation) Bill 2011 (MFI Bill) to address the oversight of MFIs and establish more control over this vastly growing sector of the Indian economy. This article will begin by addressing the beginnings of microfinance in India and then explain the crisis in Andhra Pradesh and its causes. Ultimately, the Microfinance Bill will be explained and analyzed to determine the effects it might have on Indian MFIs and the Indian people as a whole.

### II. The Beginnings of Microfinance in India

Microfinance as we know it today can be defined as "the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their micro enterprises."<sup>2</sup> Historically, unethical moneylenders with extremely high interest rates have been the poor's only access to capi-

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1. Elisabeth Rhyne, *On Microfinance: Who's to Blame for the Crisis in Andhra Pradesh?*, HUFFINGTON POST, Nov. 2, 2010, [http://www.huffingtonpost.com/elisabeth-rhyne/on-microfinance-whos-to-b\\_b\\_777911.html](http://www.huffingtonpost.com/elisabeth-rhyne/on-microfinance-whos-to-b_b_777911.html).

2. Md. Waliul Baten, *Vision of Micro Financing in Bangladesh: Success and Challenges* 29 (Oct. 21, 2009) (unpublished Master's thesis, Copenhagen Business School), available at [http://studenttheses.cbs.dk/bitstream/handle/10417/796/waliul\\_baten.pdf](http://studenttheses.cbs.dk/bitstream/handle/10417/796/waliul_baten.pdf).

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tal because of larger formal banking institutions' unwillingness to lend without some sort of collateral backing their loans. Thus, microfinance has sought to "bridge the gap between formal institutions and the poor by providing some intermediary mechanisms of transaction aggregation and rationalizing transaction costs."<sup>3</sup>

Microfinance is not necessarily a new idea. "In the mid 1800s, individualist anarchist Lysander Spooner wrote about the benefits of numerous small loans for entrepreneurial activities to the poor as a way to alleviate poverty."<sup>4</sup> However, it was not until the end of World War II with the Marshall Plan that the idea gained notoriety. Historian Timothy Guinnane began researching Freidrich Wilhelm Raiffeisen's village bank movement in Germany that reached two million rural farmers between 1864 and 1901.<sup>5</sup> Still, the first microfinance and community development bank, Shorebank, was not founded until 1974 in Chicago.<sup>6</sup>

While the true beginnings of microfinance are not traced to India, the popularity and model used today can be attributed to Dr. Muhammad Yunus' Grammen Bank in Bangladesh. Dr. Yunus explained his beginnings as follows:

It has been a long journey for us. It began in 1976 with lending of \$27 to forty-two poor people in a village next to the university campus where I was teaching economics. I had no intention of making a wave. Nor was I planning to create a bank for the poor. I had a very modest goal. I was trying to free forty-two people from the clutches of money-lenders by giving them the money they owed to the moneylenders, in order to repay them and become free from exploitation.<sup>7</sup>

Gradually, Dr. Yunus' model of giving collateral-free tiny loans for income-generating activities of the poor caught on and he founded the formal Grameen Bank in 1983.<sup>8</sup> The idea spread like wildfire across India and the entire world. Today, the Grameen Bank has a portfolio of over \$3 billion and 2.3 million members, dispersing an average of \$170 to each member, which is sixty percent of Bangladesh's per capita GDP.<sup>9</sup> To make these loans, field representatives will form groups of five within the villages and will only continue to make loans to the group if all of the members repay the previous loan. Thus, because the ability to receive future loans and standing within the village creates a huge incentive to repay the loans, Grameen has a ninety-eight percent repayment rate.<sup>10</sup> In 2006, Dr. Yunus was given the Nobel Peace Prize in recognition of his accomplishment in reducing poverty throughout India.<sup>11</sup>

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3. M.S. Sriram, *Information Asymmetry and Trust: A Framework for Studying Microfinance in India*, 30 VIKALPA 4, 78 (Dec. 2005).

4. Adnan Ali & M. Ashan Alam, *Role and Performance of Microcredit 6* (Spring 2010) (unpublished Master's thesis, University West Trollhättan Sweden 2010), available at <http://hv.diva-portal.org/smash/record.jsf?pid=diva2:323460>.

5. Baten, *supra* note 2, at 30.

6. *Id.*

7. Muhammad Yunus, *Grameen Bank, Microcredit and Millennium Development Goals*, 39 ECON. & POL. WKLY. 36, 4077 (Sept. 4, 2004).

8. *Id.*

9. Susan Wolcott, *Microfinance in Colonial India 2* (Binghamton Univ. Dept. of Econ., Working Paper No. 0809, 2008), available at <http://www2.binghamton.edu/economics/research/working-papers/pdfs/wp08/WP0809.pdf>.

10. *Id.*

11. ALEX COUNTS, *SMALL LOANS, BIG DREAMS: HOW NOBEL PRIZE WINNER MUHAMMAD YUNUS AND MICROFINANCE ARE CHANGING THE WORLD 1* (2008).

The success of the Grameen Bank must be attributed partially to the principles on which they were founded. First, Grameen believes that poverty is not created by the poor but by the institutions and policies that surround them, and thus changes are needed.<sup>12</sup> Additionally, they believe that charity is not the answer to poverty and only perpetuates the situation and creates dependency.<sup>13</sup> The Grameen system is also built on the belief that there is no difference in the ability of a poor person and any other person; the poor merely do not get the opportunity to explore their potential.<sup>14</sup> While conventional banks start with the principle that the more you have the more you can get, Grameen's credit principle is the less a person has, the higher the priority he gets.<sup>15</sup> Additionally, a central assumption of the system is that while it may take a poor person longer to pay back the loan due to circumstances beyond his or her control, the poor person will always pay back.<sup>16</sup> Lastly, the Grameen system believes that lending to women brings greater benefits to the family than lending to men because they believe that women have greater long-term vision and are ready to bring about changes in their lives systematically.<sup>17</sup>

With over 1.1 billion people, India constitutes one-sixth of the world's total population and its GDP ranks as the ninth strongest economy in the world.<sup>18</sup> However, 27.5% of its population lives below its poverty level.<sup>19</sup> Thus, India is home to the largest population of poor in the world and consequently has become a natural candidate for experimenting with microfinance as a way to reduce poverty.<sup>20</sup> Studies of microcredit programs have proven that providing "easy and affordable access to credit and other financial services to poor families can have a host of positive impacts on their livelihoods."<sup>21</sup> Moving out of poverty, improved nutrition, better housing and sanitation, lower child mortality rates, and greater empowerment of women are just a few of the proven benefits of microfinance.<sup>22</sup> Indeed, while other factors have attributed to this statistic as well, India's poverty level has continually decreased from 44.5% in 1983 to 27.5% in 2010.<sup>23</sup>

### III. The 2010 Microfinance Crisis in Andhra Pradesh

While microfinance began as a way to reduce poverty, it has recently become a multi-billion dollar industry that has stakeholders in the financial services industry, non-governmental organizations, and global politics.<sup>24</sup> Mexican MFI Banco Compartamos listed eq-

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12. Yunus, *supra* note 7, at 4077-78.

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

18. World Bank Data on India, <http://data.worldbank.org/country/india> (last visited Jan. 4, 2012).

19. *Id.*

20. Rajesh Chakrabarti, *The Indian Microfinance Experience: Accomplishments and Challenges*, in INTEGRATING THE RURAL POOR IN MARKETS 137 (Bibek Debroy & Amir Ullah Khan eds., 2005).

21. Yunus, *supra* note 7, at 4077.

22. *Id.*

23. World Bank Data on India, <http://data.worldbank.org/country/india> (last visited Jan. 4, 2012).

24. Ashley Feasley, *SKS Microfinance and For-Profit MFIs: Unscrupulous Predators or Political Prey? Examining the Microfinance Credit Crunch in Andhra Pradesh and Assessing the Applicability of the UN Global Compact "Protect Respect Remedy" Framework 2* (Cornell Law School Inter-University Graduate Student Conference Papers, Paper 49, 2011), available at [http://scholarship.law.cornell.edu/lps\\_clacp/49/](http://scholarship.law.cornell.edu/lps_clacp/49/).

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uity shares worth an estimated \$1.6 billion in 2007 and became the first ever publically traded MFI.<sup>25</sup> Then in August of 2010, Hyderabad-based SKS Microfinance carried out the very successful first IPO by a MFI in India and was reportedly worth \$358 million at listing.<sup>26</sup> Vikram Akula, founder of SKS Microfinance, stated that he wants to “end poverty through profitability.”<sup>27</sup> Many believed the successful IPO of SKS Microfinance marked the beginning of for-profit MFIs leading the way to eradicating poverty in India while also making a very large profit.

While microfinance has seen huge success and growth within India and around the globe, it hit a major roadblock with the microfinance crisis of Andhra Pradesh in October 2010. The Indian state of Andhra Pradesh accounts for almost forty percent of all microfinance activity in India.<sup>28</sup> Andhra Pradesh is called by many “the capital of microfinance in India” and is by far home to the largest number of MFI giants, including SKS Microfinance and Spandana.<sup>29</sup> Events after the SKS Microfinance IPO intensified criticism of for-profit MFIs; some argued that in an effort to sustain profits, for-profit MFIs were making irresponsible investments and were abusing the very poor communities they were supposedly trying to help.<sup>30</sup> Numerous news agencies began running articles on the rise of farmers in Andhra Pradesh committing suicide due to an inability to pay back their high interest loans.<sup>31</sup> Somewhat similar to the U.S. subprime mortgage crisis of 2007-2008, some claimed the for-profit MFIs were extending loans to the poor at extremely high interest rates without regard for their ability to pay due to their pursuit of profits.<sup>32</sup> With news of the sensationalized stories of over seventy suicides, politicians began urging borrowers not to pay back what they owed, and thousands listened. Repayments on \$2 billion worth of loans were halted, and less than ten percent of borrowers made payments.<sup>33</sup> Additionally, the Andhra Pradesh state government created “An Ordinance to Protect the Women Self Help Groups from Exploitation by the Micro Finance Institutions in the State of Andhra Pradesh and for the matters connected therewith or incidental therefore” (AP Ordinance) which soon became the law regulating lending practices of MFIs in Andhra Pradesh.<sup>34</sup>

In passing the AP Ordinance, the government identified the problem as a debt trap and over-borrowing by the poor from multiple, competing MFIs that was resulting in default or near-default situations that were only worsened by aggressive collection practices that helped to possibly lead to the suicides.<sup>35</sup> The AP Ordinance laid down a heavy hand and created many stipulations for MFIs in Andhra Pradesh. First, it requires MFIs to register

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25. Renuka Sane & Susan Thomas, *A Policy Response to the Indian Micro-Finance Crisis* 8 (Indira Gandhi Inst. of Dev. Research, Mumbai, Working Paper No. 2011-007, 2011), available at <http://www.igidr.ac.in/pdf/publication/WP-2011-007.pdf>.

26. *Id.*

27. Rajesh Chakrabarti & Shamika Ravi, *At the Crossroads: Microfinance in India*, ICRA BULLETIN: MONEY & FINANCE 2 (May 2011).

28. *Id.* at 17.

29. *Id.* at 17.

30. Feasley, *supra* note 24, at 2.

31. Lydia Polgreen & Vikas Bajaj, *India Microcredit Faces Collapse from Defaults*, N.Y. TIMES, Nov. 17, 2010, available at <http://www.nytimes.com/2010/11/18/world/asia/18micro.html>.

32. *Id.*

33. *Id.*

34. Feasley, *supra* note 24, at 3.

35. Chakrabarti & Ravi, *supra* note 27, at 20.



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their branches at a district level.<sup>36</sup> As a part of the registration, MFIs are asked to report the effective interest rates they charge, which were found to range between twenty-five and thirty-five percent.<sup>37</sup> Also, any MFI executive who applied or ordered coercive measures against borrowers or their families would be punishable by imprisonment for up to three years.<sup>38</sup> Importantly as well, MFIs were prohibited from charging interest in excess of the principal amount of the loan.

The AP Ordinance drew a great amount of criticism. One critic noted that the AP Ordinance's "largest drawback is that it only regulates the conduct and actions of MFIs and does not attempt to regulate the Self Help Groups, (SHGs) or any other type of microfinance organization operating in India."<sup>39</sup> The critic also noted that the SHGs play a large role in microcredit activities in India and were overlooked because they are promoted by the Indian government and national banking system and are in an intense competition with the MFIs for loan disbursements.<sup>40</sup> Another critic noted, "while there are nuances in whether the Government of Andhra Pradesh has the ability and the inclination to digest the administrative implications of the ordinance, it has once again shown its inability to target the errant microfinance institutions, and has instead come down heavily on the entire market."<sup>41</sup>

The Andhra Pradesh crisis and subsequent AP Ordinance have caused many to seek to understand the underlying causes of the crisis to better understand how to solve the microfinance problems. Many believe that the extremely fast growth of the microfinance sector is at the root of the issue.<sup>42</sup> The strong desire to grow rapidly led many MFIs to streamline their underwriting practices through reducing personal contact with clients and skipping essential background checks that in turn resulted in providing loans to clients who could not repay.<sup>43</sup> Additionally, the massive amounts of new staff MFIs employed were not trained properly and were given responsibilities beyond their capacities, sometimes resulting in unethical collection practices.<sup>44</sup> The extremely fast growth was fueled by many factors. First, MFI growth was exacerbated by the easy access to debt funds, specifically from banks.<sup>45</sup> From the strong competition between banks, to the high repayment rates to MFIs, public and commercial banks saw MFIs as great investments. Also, the lack of governance that surrounded the transition of many non-profit MFIs to for-profit MFIs helped to sustain the high growth rates.<sup>46</sup> With shareholders now influencing decisions, CEOs felt greater pressure to achieve higher margins and increased profits.

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36. Oliver Schmidt, *The Evolution of India's Microfinance Market—Just a Crack in the Glass Ceiling?* 2-3 (Munich Personal RePec Archive, MPRA Paper No. 27142, Dec. 1, 2010), available at <http://mpra.ub.uni-muenchen.de/27142/>.

37. *Id.*

38. *Id.*

39. Feasley, *supra* note 24, at 3.

40. *Id.*

41. M.S. Sriram, *Microfinance: A FairyTale Turns into a Nightmare*, 45 *ECON. & POL. WKLY.* 1, 13 (Oct. 23, 2010).

42. Pete Sparreboom, *The Indian Microfinance Crisis 2010 – Lessons for China* 13 (Working Group on Inclusive Finance in China, China Papers on Inclusiveness No. 4, Apr. 2011), available at <http://www.microfinancegateway.org/gm/document-1.9.52004/The%20Indian%20Microfinance%20Crisis.pdf>.

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.* at 14.

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The national Indian government took note of the crisis and the Reserve Bank of India (RBI) established a committee headed by Y.H. Malegam (Malegam Committee) to review the issues and to recommend regulatory steps that would prevent the Andhra Pradesh crisis from recurring.<sup>47</sup> The first suggestion was to create a new institutional category called NBFC-MFIs that would have a net worth of at least fifteen rupees (Rs.) with a minimum of ninety percent of their assets being “qualified assets;”<sup>48</sup> specifically, the “qualified assets” or non-collateralized micro-loans to households with annual income below Rs. 50,000 and/or total indebtedness not exceeding Rs. 25,000. Additionally, repayment should be within a month or less. In regards to pricing and transparency, the Malegam Committee suggested the MBFC-MIFs observe a margin cap of ten to twenty percent and a pricing cap of twenty-four percent, and all MFIs should provide borrowers with standard loan agreements where prices are prominently displayed.<sup>49</sup> To reduce coercive methods of recovery, it was suggested that MFIs recover loans at the group level at a central place and not at the borrower’s residence or workplace.<sup>50</sup> Additionally, several provisions discouraged over-lending and suggested making it the responsibility of the MFIs to ensure the borrower is not involved in more than one Joint Liability Group (JLG) until another governmental agency can take over those responsibilities.<sup>51</sup>

As with the AP Ordinance, the Malegam Committee recommendations have been met with praise and criticism. Some have noted that the committee rightly recognized the importance of MFIs and the need for more oversight by the RBI.<sup>52</sup> Additionally, they state that the recommendations recognize the need for better information and communication in order to ensure that borrowers are protected and are given transparent information.<sup>53</sup> Critics, however, recognize that those recommendations could likely have unintended consequences that would greatly hurt the MFI sector. They note “the creation of entry and operational barriers through higher net worth, capital adequacy, loan portfolio allocation requirements and interest caps is likely to trigger consolidation within the industry, with a possibility of some banks absorbing some of the MFIs, if facilitated by the RBI.”<sup>54</sup> They also warn “application of interest rate caps, borrower household income caps and reduced loan limits will result in significant exclusion of households in remote areas and poor households whose incomes exceed the income caps but remain unbanked.”<sup>55</sup>

#### **IV. The Microfinance Institutions (Development and Regulation) Bill 2011**

In response to the Malegam Committee recommendations, India’s Ministry of Finance released a draft of the Microfinance Institutions (Development and Regulation) Bill 2011 (MFI Bill) in July of 2011 that will likely reach the Indian Parliament in their coming

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47. Jaideep Singh Panwar, *Microfinance in India: Mission or Misery*, in *ISSUES FOR RESPONSIBLE INVESTORS* 5 (Lucy Carmody ed., 2011).

48. *Id.*

49. Sparreboom, *supra* note 42, at 15.

50. *Id.*

51. Chakrabarti & Ravi, *supra* note 27, at 22.

52. Sparreboom, *supra* note 42, at 16.

53. *Id.*

54. Panwar, *supra* note 47, at 6.

55. *Id.*

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Winter Session.<sup>56</sup> The bill proposes a regulatory framework for the microfinance industry that hopes to protect consumers by making the RBI the sole regulator of the industry.<sup>57</sup> Micro-Credit Ratings International Limited (M-CRIL) noted that the bill “represents a major step forward in the government’s engagement with the microfinance sector.”<sup>58</sup>

The chief features of the bill are that every institution in microfinance should register with the regulator, transform into a company when they attain a significant size, be subject to a variety of prudential and operational guidelines that are introduced by the regulator, provide periodic information to the regulator and face penal action for violation of law or any rules framed.<sup>59</sup> As with any vast changes in the regulation of an extremely large and important sector, the bill has drawn both praise and criticism with its methods of protecting the Indian citizens and economy.

The largest change for the microfinance industry would be the delegation of all regulation powers to the RBI. The bill establishes the supremacy of the RBI as the key regulator in hopes of resolving all political and regulatory ambiguity.<sup>60</sup> The bill seems to dissuade state governments from trying to replicate the AP Ordinance and notes that microfinance will be seen as an extension of the banking sector.<sup>61</sup> Going even farther, the MFI Bill requires that every institution involved in microfinance must register with the RBI to help avoid any confusion that may arise due to multiplicity of regulation.<sup>62</sup> Srinivasan, a foremost scholar on Indian microfinance, argues that state involvement should not be completely taken away.<sup>63</sup> He notes:

The State councils are a good way of involving the state governments. But the councils should be linked to the national council and given a role with content rather than just creating them. Without a significant role and participation in some manner in the activities of the national council, the state councils will become either defunct or deviant.<sup>64</sup>

Alternatively, investors view this aspect of the MFI Bill as a great change. Investors dislike ambiguity and the Andhra Pradesh crisis scared many investors.<sup>65</sup> By creating a sole regulator, ambiguity will be decreased and clarity of rules will be created, enticing many investors to return to the microfinance market.<sup>66</sup> Despite being the sole regulator, M-CRIL also notes that the RBI may, with the previous approval of the Government, delegate any of its powers with respect to any class of MFI to the National Bank for

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56. *Draft Microfinance Bill Gives RBI Total Control and Puts Sector under Strict Watch*, ECON. TIMES, July 7, 2011, [http://articles.economictimes.indiatimes.com/2011-07-07/news/29747758\\_1\\_mfis-coercive-recovery-finance-institutions](http://articles.economictimes.indiatimes.com/2011-07-07/news/29747758_1_mfis-coercive-recovery-finance-institutions).

57. *Id.*

58. *Comments on the Draft Microfinance Bill: A Major Step Forward for Financial Inclusion?*, MICRO CREDIT RATINGS INT’L LTD. 1 (July 7, 2011), <http://www.m-cril.com/BackEnd/ModulesFiles/Publication/M-CRIL's-comments-on-the-draft-Microfinance-Bill-July-2011.pdf>.

59. N. Srinivasan, *India’s Microfinance Bill Answers Most Questions*, CGAP MICROFINANCE BLOG (July 24, 2011), <http://microfinance.cgap.org/2011/07/24/india's-microfinance-bill-answers-most-questions>.

60. Vineet Rai, *India’s Microfinance Bill Offers a Mixed Bag to Investors*, CGAP MICROFINANCE BLOG (Aug. 4, 2011), <http://microfinance.cgap.org/2011/08/04/india's-microfinance-bill-offers-a-mixed-bag-to-investors>.

61. *Id.*

62. *Id.*

63. See Srinivasan, *supra* note 59.

64. *Id.*

65. Rai, *supra* note 60.

66. *Id.*

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Agriculture and Rural Development (NABARD).<sup>67</sup> This of course could create some ambiguity and dissuade investor activity.

The MFI Bill also proposes a margin cap in Section 25 that will supposedly prevent MFIs from profiteering from the poor.<sup>68</sup> This is welcomed by some and not by others. Srinivasan notes that this can be positive in that absolute interest rate caps are “anti-market and introduce rigidities.”<sup>69</sup> However, he also notes that the MFI Bill also gives the RBI the power to impose an APR cap but believes that margin caps will be imposed across the sector and the APR cap will only be used in emergencies.<sup>70</sup> Another also argues that the margin cap could be a blessing in disguise by scaring away short-term, opportunistic investors from the MFI sector and making it easier for long-term investors to find good deals at reasonable prices.<sup>71</sup> While M-CRIL agrees that there should be a limit on loan amounts to define MFIs, they argue that the margin cap is “unnecessary micro-management of a business relationship.”<sup>72</sup> Additionally, it can be argued that a margin cap will take away incentives for MFIs to rework their cost structures and use technology to bring down their costs once they have reached a certain benchmark.<sup>73</sup>

The MFI Bill also tries to protect clients through introducing obligations and establishing extensive monitoring and reporting requirements.<sup>74</sup> Specifically, the MFI Bill creates grievance procedures, mandatory enrollment to credit bureaus, and code of conduct enforcement through industry associations.<sup>75</sup> Requiring all MFIs, regardless of form, to register with the RBI will begin the process of simply gaining more knowledge of the MFI sector in India.<sup>76</sup> While some investors do understand the need to protect vulnerable clients, they also believe that systems for implementation and cost implications have not been taken into account.<sup>77</sup> Nevertheless M-CRIL sees these developments as “inevitable and necessary” in the current situation and “normal in any regulatory regime and beneficial to the sector as a whole.”<sup>78</sup>

## V. Conclusion

While the MFI Bill has drawn criticism and support from different groups throughout India, most everyone agrees that it provides a step in the correct direction in preventing another crisis from occurring like the one in Andhra Pradesh. While it began as a way to bring the poor from the depths of poverty, microfinance’s success has also brought growing pains that have been detrimental to some of those it was trying to help. Through the MFI Bill, the government seems to be striving to protect those that microfinancing was

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67. *Comments on the Draft Microfinance Bill*, *supra* note 58, at 1.

68. See Srinivasan, *supra* note 59.

69. *Id.*

70. *Id.*

71. Rai, *supra* note 60.

72. *Comments on the Draft Microfinance Bill*, *supra* note 58, at 2.

73. Rai, *supra* note 60.

74. *Id.*

75. See Srinivasan, *supra* note 59.

76. *Id.*

77. Rai, *supra* note 60.

78. *Comments on the Draft Microfinance Bill*, *supra* note 58, at 2.

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intended to help in the beginning. The fate of the bill has yet to be determined within the Indian Parliament and only time will be able to determine the final specific steps that will be taken to protect India's poor.

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**ECHR**

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**ECtHR**

*See European Court of Human Rights*

**ECJ**

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