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Articles

Case Comment

Recent Decisions

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Vulture Funds: The Reason Why Congolese Debt May Force a Revision of the Foreign Sovereign Immunities Act

Jonathan C. Lippert*

I. Introduction

A party who wishes to sue a foreign country in the United States courts must do so pursuant to the provisions of the Foreign Sovereign Immunities Act of 1976 (FSIA).[1] Prior to the passage of the FSIA, it was virtually impossible for an injured party to sue a sovereign nation.[2] While all countries have a legitimate interest in protecting their government from frivolous lawsuits,[3] certain countries were invoking their sovereign immunity to prevent suits against them that were based on purely commercial grounds.[4] For example, if a sovereign state signed a business contract with an American company to build a highway and then failed to pay for the completed construction, the American business would have no recourse. As such, the FSIA was passed, in part, to provide a forum for the resolution of such disputes in an effort to facilitate international business and protect injured parties in commercial dealings with sovereign states.[5] Still, the standards for bringing suit under the FSIA are rigorous, and sovereign states retain much of their immunity.[6]

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1. 28 U.S.C. §§ 1330, 1332, 1441, 1602–1611 (2006).

2. *See* Bradford R. Clark, *Domesticating Sole Executive Agreements*, 93 VA. L. REV. 1573, 1618 (2007) (noting that prior to the FSIA, foreign countries had absolute immunity from suits in U.S. courts).

3. *See generally* Rodolphe J.A. De Seife, *The King Is Dead, Long Live the King! The Court-Created American Concept of Immunity: The Negation of Equality and Accountability Under Law*, 24 HOFSTRA L. REV. 981, 1042 (1996) (asserting sovereign immunity is preferred to public officials fearing retaliatory suits).

4. *See* Michael L. Morkin, Ethan A. Berghoff & Richard S. Pike, *Doing Business with Foreign Sovereign Entities*, 17 BUS. L. TODAY 43, 44 (2007) (explaining that sovereign immunity precluded aggrieved private parties in commercial ventures from seeking judicial remedies). *See generally* Noah Benjamin Novogrodsky, *Immunity for Torture: Lessons from Bouzari v. Iran*, 18 EUR. J. INT'L L. 939, 939 (2007) (admitting immunity more often than not leads to impunity).

5. *See* 44B AM. JUR. 2D INT'L L. § 95 (2007) (explaining that sovereign immunity does not apply to private or commercial acts); *see also* James E. Pfander, *Protective Jurisdiction, Aggregate Litigation, and the Limits of Article III*, 95 CAL. L. REV. 1423, 1423 (2007) (explaining the FSIA provides that foreign nations can be sued in U.S. courts when their commercial activities impact the United States).

6. *See* Morkin et al., *supra* note 4, at 44 (recognizing that a foreign state can be sued in U.S. courts only if it falls within one of the FSIA exceptions). *But see* Andrea K. Bjorklund, *Private Rights and Public International Law: Why Competition Among International Economic Law Tribunals Is Not Working*, 59 HASTINGS L.J. 241, 253 (2007) (stressing that breaking sovereign immunity is not insurmountable).

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Recently, several new cases in U.S. Courts have generated a reason to consider revising the language of the FSIA. Companies participating in an investment scheme called "vulture funds" have purchased millions of dollars of defaulted debt from the creditors of impoverished countries at bargain basement prices.[7] The countries that owe the debt will never be able to repay that debt. However, many of these third world countries are sites of considerable oil deposits and demand royalty payments from foreign oil companies (some of them American) in exchange for exploration and drilling rights.[8] Vulture funds, circumventing traditional debt collection structures procedures established by the World Bank and the International Monetary Fund (IMF),[9] have attempted to collect on the debt owed by these nations by suing the foreign oil companies in U.S. courts for attachment of the royalties the oil companies agreed to pay in exchange for their oil rights.[10] If the vulture funds succeed, they will reap extraordinary profits at the expense of U.S. companies, the U.S. economy and U.S. foreign relations.[11]

The FSIA governs these lawsuits and, to date, not many vulture funds have been successful in U.S. courts.[12] However, careful analysis of the application of the current language of the FSIA in these cases reveals that if the correct set of circumstances were present, a vulture fund could succeed in attaching millions of dollars in payments intended as royalties to debt-laden

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7. Vulture funds are companies that purchase the debt of poorer nations at reduced rates then sue that nation for the full value of the debt plus interest. *See Zambia Loses "Vulture Fund" Case*, BBC NEWS, Feb. 15, 2007, *available at* http://news.bbc.co.uk/2/hi/business/6365433.stm; Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1044 (2004) (explaining how vulture funds purchase the debt of countries that are financially distressed); Suniati Yap, *Investing in Chapter 11 Companies: Vultures or White Knights?*, 2 SW. J.L. & TRADE AM. 153, 153 (1995) (stating the purpose of vulture funds is to invest in distressed companies).

8. *See* Harry G. Broadman & Joy Dunkerley, *The Drilling Gap in Non-OPEC Developing Countries: The Role of Contractual & Fiscal Arrangements*, 25 NAT. RESOURCES J. 415, 423 (1985) (illustrating that royalty payments are used as a tool for risk allocation).

9. *See* Christopher C. Wheeler & Amir Attaran, *Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT'L L. 253, 263 n.53 (2003). *See generally* Jean-Marc Gollier, *Monetary Institutions in an Evolving World*, 55 BUFF. L. REV. 613, 614 (2007) (describing that vulture funds target other globalization efforts).

10. *See* Donovan Picard, *Proceedings of the Ninety-Ninth Annual Meeting of the American Society of International Law: New World Order or a World of Disorder? Testing the Limits of International Law International Claims Litigation I: Is Rough Justice Too Rough?*, 99 AM. SOC'Y INT'L L. PROC. 84, 85 (2005) (discussing foreign oil suits in U.S. courts); *see also* Wheeler & Attaran, *supra* note 9, at 284 (highlighting the discretion exercisable by U.S. courts in determining whether to allow vulture funds to file suits therein).

11. *See infra*, Part V.

12. *See* Pravin Banker Assocs. v. Banco Popular del Peru, 109 F.3d 850, 854 (2d Cir. 1996) (stressing U.S. courts ordinarily refuse to review decisions of foreign countries); *see also* Adam Brenneman, Comment, *Gone Broke: Sovereign Debt, Personal Bankruptcy, and a Comprehensive Contractual Solution*, 154 U. PA. L. REV. 649, 665 (2006) (stating U.S. courts generally defer to foreign rulings).

third world governments.[13] Consequently, the FSIA should be revised in order to prevent U.S. Courts from being used as debt collection agencies.[14]

While vulture funds have targeted a number of highly indebted nations, this article will focus on the Republic of the Congo. To most effectively illustrate the need for revisions in the FSIA, this comment will: 1) present a brief history of the Congolese debt; 2) analyze two important vulture fund cases and the likelihood that a vulture fund could be successful in the future; 3) describe the negative effects that would occur domestically and internationally if vulture fund tactics were successful; and 4) provide suggestions for a revision of the FSIA to protect U.S. courts and businesses against vulture funds abuses.

II. West Africa: The Next Frontier in Oil Exploration and Exploitation

A. The Roots of Debt in the Congo

In a world of ever-increasing oil demand, West Africa has emerged as an important supplier to the global market.[15] The Republic of the Congo (the Congo)[16] is one of the key players. The Congo began oil production in 1957.[17] Today, oil receipts account for 70 percent of the Congo's income and 90 to 95 percent of its exports.[18] The Congo has estimated reserves of

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13. *See* Elliott Assocs. v. Banco de la Nacion, 194 F.3d 363, 366 (2d Cir. 1999) (awarding a vulture fund a $57 million judgment); *see also* William W. Bratton, *Pari Passu and a Distressed Sovereign's Rational Choices*, 53 EMORY L.J. 823, 823–24 (2004) (highlighting that a vulture fund obtained a judgment for $55,660,831.56 from the Southern District of New York).

14. *See* Jennifer L. Davis, *Jurisdiction—The Foreign Sovereign Immunities Act—Commercial Activity Exception Does Not Confer Jurisdiction over Foreign Sovereign*, 18 SUFFOLK TRANSNAT'L L. REV. 417, 425 (1993) (emphasizing Congress should revise the commercial activity exception to the FSIA). *But see* Todd Connors, *The Foreign Sovereign Immunities Act: Using Separation of Powers Analysis to Guide Judicial Decision-Making*, 26 LAW & POL'Y INT'L BUS. 203, 216–17 (1994) (explaining that it is unlikely Congress will amend the FSIA in the near future).

15. *See* Jacqueline Lang Weaver, *The Traditional Petroleum-Based Economy: An "Eventful" Future*, 36 CUMB. L. REV. 505, 543 (2005–2006) (explaining that West Africa, Russia, and the Middle East supply most of the world's oil); ENERGY INFORMATION ADMINISTRATION: INTERNATIONAL ENERGY OUTLOOK 2007, CHAPTER 3: WORLD OIL MARKETS, http://www.eia.doe.gov/oiaf/ieo/oil.html [hereinafter OUTLOOK 2007] (last visited Feb. 24, 2008) (noting that West Africa is one of the main global oil suppliers).

16. Two countries in sub-Saharan Africa use "Congo" in their name: the Republic of the Congo (also known as Congo-Brazzaville) and the Democratic Republic of the Congo (formerly Zaire). For purposes of this article, "the Congo" and "Congolese" will be referring to the Republic of the Congo. *See* Adam Burton, *A Grave and Gathering Threat: Business and Security Implications of the AIDS Epidemic and a Critical Evaluation of the Bush Administration's Response*, 35 GEO. J. INT'L L. 433, 440 (2004) (identifying the Congo as one of the most oil rich sub-Saharan nations); Miriam Grunstein et al., *Energy and Natural Resources*, 41 INT'L L. 491, 492 (2006) (stating the Congo plays a large role in global oil sales).

17. *See* MATTHIAS BASEDAU & ANDREAS MEHLER, RESOURCE POLITICS IN SUB-SAHARAN AFRICA 129 (2005) (explaining that although commercial oil production started in the Congo in 1957, major offshore deposit development did not start until the 1960s); *see also* AN MBENDI PROFILE: CONGO—OIL AND GAS INDUSTRY: EXPLORATION & PRODUCTION—PRODUCTION AND EXPLORATION, http://www.mbendi.co.za/indy/oilg/ogus/af/co/p0005.htm (last visited Mar. 24, 2008) (discussing the start of Congo's oil production in 1957 and the increase in crude oil production over the years).

18. GLOBAL WITNESS, TIME FOR TRANSPARENCY: COMING CLEAN ON OIL, MINING AND GAS REVENUES 18 (2004), *available at* http://www.justiceinitiative.org/db/resource2/fs/?file_id=15679 [hereinafter TRANSPARENCY].

1.5 billion barrels of oil and produces almost 300,000 barrels per day.[19] With constant exploration, these numbers are expected to rise.[20]

Unfortunately, the Congo's oil supply has created more problems than it has solved for the third world country. Billions of dollars of debt from oil-backed loans[21] have left the Congo in a volatile and poverty-stricken state.[22] In fact, the IMF recently stated that the Congo has the highest per capita debt in the world at $6.4 billion, or over twice the country's GDP.[23]

The current state of the Congolese economy can be linked to years of financial mismanagement and corruption. Shortly after oil was discovered in the Congo, foreign oil companies began making secret payments to Congolese officials for preferential treatment.[24] While these secret payments were an indication of the corrupt nature of the government, the biggest problem for the Congo was the temptation to secure billions of dollars in loans with its oil.[25] The first known oil-backed loan occurred after dictator Denis Sassou-Nguesso took control in 1979.[26] He demanded an immediate cash advance on future oil production from French oil

19. *See* OUTLOOK 2007, *supra* note 15. Despite the fact that the Congo's main source of income is oil, their total output of approximately 300,000 barrels per day is comparable to the output of Louisiana. *See* Jim Landers, *Operators in Congo Squeezed by Debt-Laden Nation, Vulture Funds*, DALLAS MORNING NEWS, May 5, 2006. For comparison's sake, Saudi Arabia produces approximately 10.9 million barrels of oil per day. *See* Energy Information Administration, Country Analysis Briefs: Saudi Arabia (Aug. 2005), http://www.eia.doe.gov/emeu/cabs/saudi.html; OUTLOOK 2007, *supra* note 15.

20. *See* OUTLOOK 2007, *supra* note 15.

21. *See* Landers, *supra* note 19 (stating that as a result of the oil-backed loans, the Congo owes more than $9 billion). The Congo has been using oil-backed loans since 1979 as a way to pump quick infusions of cash into the country in order to pay civil servants and preserve the peace. However, these loans have created "an extraordinary paradox . . . [in which they] ended up indebting the nation and reducing the government's control of revenues to the extent that unrest was virtually assured." TRANSPARENCY, *supra* note 18, at 21.

22. *See* Emeka Duruigbo, *The World Bank, Multinational Oil Corporations, and the Resource Curse in Africa*, 26 U. PA. J. INT'L ECON. L. 1, 25 (2005) (asserting the correlation between the government's debt in the Congo and the increase in poverty)*; see also* ENERGY INFORMATION ADMINISTRATION, CONGO-BRAZZAVILLE, para. 3 (2002), *available at* http://www.eia.doe.gov/emeu/cabs/congo2.html (providing that despite their oil wealth, the Congo has experienced economic difficulties).

23. *See* Transparency, *supra* note 18, at 18. *See generally* CENTRAL INTELLIGENCE AGENCY, THE WORLD FACTBOOK—CONGO, REPUBLIC OF THE (2008), https://www.cia.gov/library/publications/the-world-factbook/geos/cf.html (estimating the Congo's external debt in 2000 to be $5 billion).

24. *See* Transparency, *supra* note 18, at 19–20 (revealing the secret payments made by Congolese officials to Elf Aquitaine). *See generally* MARK GRADSTEIN & KAI A. KONRAD, INSTITUTION AND NORMS IN ECONOMIC DEVELOPMENT 126 (2007) (discussing the audit that exposed the corruption existing in the Congo's national oil company).

25. *See* Landers, *supra* note 19 (commenting that various regimes have mortgaged oil revenues for loans); *see also* TRANSPARENCY, *supra* note 18, at 30–31 (critiquing the decision of the Congo's government to borrow against oil revenues, despite multiple promises to the IMF to refrain from doing so). *See generally* Duruigbo, supra note 22, at 25 (noting the Congo's "huge" amount of oil-backed debt).

26. *See* ENCYCLOPEADIA BRITANNICA, CONGO 20 (2008) (discussing Sassou Nguesso's role in setting up the Congo's oil subsidization); *see also* Transparency, *supra* note 18, at 21 (describing the Congo's first oil-backed loan demanded by Sassou Nguesso). *See generally* Alain Lallemand, *The Field Marshall,* THE CENTER FOR PUBLIC INTEGRITY, Nov. 15, 2002, *available at* http://www.publicintegrity.org/bow/report.aspx?aid=155 (remarking that Jack Sigolet of Elf Aquitaine pioneered the concept of oil-backed loans).

company Elf,[27] because of a sudden destabilization of the world oil market.[28] Since then, the Congo has used oil-backed loans to fund elections, pay Congolese civil servants, and even finance military operations.[29]

Foreign oil companies with operations in the Congo were able to take advantage of the Congo's frequent demands for quick cash.[30] Not only did they profit from Congolese oil production; they also profited as financiers to the Congolese government.[31] For example, in the 1970s, Elf devised a system that created huge profits from oil-backed loans.[32] Elf would first set up a company in Switzerland,[33] then Elf would lend the company large sums of money at a very low interest rate.[34] The Swiss company would then turn around and lend the money to

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27. Elf Aquitaine originated as a state-owned French oil company in the 1960s. In 1996, the French government sold its stake in the company and in 2000 Elf Aquitaine merged with Italian oil company Total Fina to form TotalFinaElf, which changed its name to Total in 2003. In 2003, a number of top Elf executives with close ties to the French government were jailed after being convicted of misappropriating millions of euros of Elf revenue. *See* Jon Henley, *Gigantic Sleaze Scandal Winds Up as Former Elf Oil Chiefs Are Jailed*, GUARDIAN UNLIMITED (UK), Nov. 13, 2003, *available at* http://www.guardian.co.uk/france/story/0,11882,1083784,00.html. Much of this revenue originated in Elf's operation in Western Africa. *Id.*

28. *See* TRANSPARENCY, *supra* note 18, at 21.

29. *See id.* at 21–23 (analyzing the various areas in which the Congo has loan money); *see also* Lallemand, *supra* note 26 (discussing the Congo's 1997 military expenditures which were paid for with oil-backed loans from Elf).

30. *See id*. at 21 (discussing the Congo's need of quick money into the country); *see also Revenue Transparency: A Priority for Good Governance and Energy Security,* MINES & COMMUNITIES, Mar. 24, 2004, http://www.minesandcommunities.org/Action/press308.htm (arguing Elf took advantage of the Congo in its economic dealings with the country). *Cf.* George Koomson, *Governments and Mining Companies Must Come Clean on Revenue,* AFRICAN AGENDA, 2004, *available at* http://groups.yahoo.com/group/GreenLeft_discussion/message/18800 (noting the substantial percentage of oil extraction that the Congo has mortgaged for loans).

31. *See* ENERGY INFORMATION ADMINISTRATION, *supra* note 22, at para. 3 (elaborating on the Congo's "production sharing agreements" in which foreign companies finance oil exploration activities); *see also* TRANSPARENCY, *supra* note 18, at 20 (outlining Elf's lending methods that resulted in very high interest rates imposed on the Congo). *See generally* Charlotte Denny, *Oil Firms Secretly Finance Crooked Regimes*, GUARDIAN (UK), Mar. 24, 2004 (remarking that profits from Congolese oil are being appropriated by the already rich and powerful).

32. *See* TRANSPARENCY, *supra* note 18, at 20 (discussing Elf employee Jack Sigolet's development of the oil-backed loan). *Cf.* Koomson, *supra* note 30 (suggesting the oil-backed loans were devised in such a way so the Congolese could not comprehend how the lending system operated).

33. *See* Hugh Schofield, *Elf Trial Reveals Moral Vacuum*, BBC NEWS, Apr. 24, 2003 (noting the Elf money passed through a system of interlocking bank accounts in Switzerland); *see also* TRANSPARENCY, *supra* note 18, at 20 (recounting the methods Elf used to capitalize on the Congo's indebtedness); John Tagliabue, *At a French Trial, a Tale Unfolds of Graft on High*, N.Y. TIMES, Apr. 18, 2003 (describing Elf's complex scheme which encompassed the halls of power in Paris and bank accounts in Switzerland, Liechtenstein, and former French colonies).

34. *See* TRANSPARENCY, *supra* note 18, at 20 (relating the process by which Elf would lend money to its own company); POWYS ENVIRONMENT AND DEVELOPMENT EDUCATION CENTRE, ETHICAL TRADE CURRENTS 6 (2004), *available at* http://www.cyfanfyd.org.uk/resources/pdf/Ethical%20Currents%20%20Summer%202004.pdf (noting Elf's Swiss company would loan money at low interest rates or even guarantee a loan to it from another source).

several banks at a higher interest rate.[35] Finally, these banks would lend it at an even higher interest rate to the Congo and secure the loans with future Congolese oil proceeds.[36] The Congo dealt only with the lending bank and had no idea of the circuitous route by which the money traveled.[37] Thus, Elf created a vicious cycle in which the money earned by Elf from Congolese oil was lent back to the Congo at artificially high interest rates, effectively ensuring that the Congo would not be able to repay the loans unless it floated even more loans.[38]

By the late 1990s the Congo was deeply in debt and engaged in a violent civil war.[39] The oil-backed loans had created an unexpected paradox in which "a system dreamed up as a way to pump quick infusions of cash into the country, in order to pay civil servants and preserve the peace, ended up indebting the nation and reducing the government's control of revenues to the extent that unrest was virtually assured."[40]

Oil-backed debt is a major hurdle in the Congo's attempts to achieve solvency.[41] "In recent years 'one-fourth to one-third of [the Congo's] oil revenue has been automatically trans-

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35. *See* TRANSPARENCY, *supra* note 18, at 20 (concluding this plot created by Elf allowed it to profit from the difference between the interest rates it was charging and it was receiving); *see also* POWYS ENVIRONMENT AND DEVELOPMENT EDUCATION CENTRE, *supra* note 34, at 6 (describing the way the Congolese government would remain indebted under Elf's direction).

36. *See* TRANSPARENCY, *supra* note 18, at 20 (quoting an Elf executive's testimony that part of its system of exploitation was to loan money at very high interest rates through other banks to the Congo); *see also* John Clark, *Petro-Politics in Congo,* 8 J. OF DEMOCRACY 62, 72–73 (1997) (concluding that one effect of Elf's loans to the Congolese government is that large portions of the Congo's future oil revenues are "mortgaged" into the next century).

37. *See* TRANSPARENCY, *supra* note 18, at 20 (admitting that Elf designed the entire system so that the Congo was aware of only the official lending bank).

38. *See id.* (explaining that in addition to the debt accumulated from the inflated interest rates, a portion of each loan was subject to syndication right, which was "free cash" for Elf). *See generally* BASEDAU & MEHLER, *supra* note 17, at 131 (describing how the cycle of rising and falling petroleum prices led lenders to freely issue loans to the Congo).

39. From 1979 to 1991, President Denis Sassou Nguesso ruled the Congo under a one-party system. (*See* GlobalSecurity.org, Republic of The Congo Civil War, http://www.globalsecurity.org/military/world/war/congo-b.htm (last visited Feb. 26, 2008) (detailing the battle for power that occurred between Sassou Nguesso and Pascal Lissouba against the backdrop of growing debt and severe administrative mismanagement).) In 1992 Pascal Lissouba was democratically elected. *Id.* Over the next five years, a growing debt from oil-backed loans, coupled with severe mismanagement by President Lissouba's administration, led to recurring clashes among militia forces loyal to the Congo's major political leaders. *Id.* In 1997 former president Nguesso seized power with the help of Angolan troops. *Id.* The civil war resulted in more than 10,000 deaths in Brazzaville alone. *Id.* While the war technically ended in 1997, economic progress was badly stunted by slumping oil prices and the resumption of armed conflict in December 1998. CENTRAL INTELLIGENCE AGENCY, THE WORLD FACTBOOK: CONGO, THE REPUBLIC OF (2008), https://www.cia.gov/cia/publications/factbook/geos/cf.html. Sassou Nguesso is currently the president, presiding over an uneasy internal peace and facing difficult economic challenges of stimulating economic recovery and reducing poverty. *Id. See generally* OLI BROWN, TRADE, AID AND SECURITY: AN AGENDA FOR PEACE AND DEVELOPMENT 98 (2007) (emphasizing Elf's role in exacerbating the Congo's civil war by funding both sides).

40. TRANSPARENCY, *supra* note 18, at 21.

41. *See* BRUCE W. JENTLESON, PREVENTIVE DIPLOMACY IN THE POST–COLD WAR WORLD 269 (2000) (explaining because Elf nearly controlled the Congo's economy through its high level of investment in Congolese oil, it was difficult to get rid of the country's growing debt); *see also* Business Africa, *Country Watchlist: Congo (Brazzaville)*, BUS. AFRICA, Sept. 16, 2005 (describing the Congo's external debt burden as "unsustainable").

ferred to offshore accounts held by creditors.'"[42] Consequently, the Congo has taken great pains to hide large portions of its oil revenues.[43] In 1998, the Congo established a state oil company, the Société Nationale des Pétroles du Congo (SNPC),[44] explaining that it needed an instrument to buy and sell oil in order to protect itself from the predatory methods of the foreign oil companies.[45] While the SNPC has been successful in taking control of the Congolese oil industry, it has been accused of funneling millions of dollars of oil revenues into autonomous companies in the Cayman Islands to prevent creditors from attaching the funds of the SNPC or the Congolese government.[46]

B. The New Player: Vulture Funds

Throughout its history, the Congolese oil industry has been a platform for opportunism and corruption.[47] On the one hand, the Congo has been the victim of foreign oil companies' secretive financial exploits.[48] On the other hand, Congolese officials have accepted countless

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42. TRANSPARENCY, *supra* note 18, at 26.

43. *See id.* at 29 (suggesting the Société Nationale des Pétroles du Congo is hiding portions of its revenue not only from its creditors but even its own citizens); *see also* John Donnelly, *In Oil-Rich Nation, Charges of Skimming*, BOSTON GLOBE, Nov. 25, 2005 (discussing the Congo's transactions with companies in the British Virgin Islands that allowed corporations to keep their ownership secret); Sebastian Mallaby, *A Corrupt French Connection*, WASH. POST, Mar. 13, 2006, at A15 (reporting charges that BNP Paribas, a major French bank, has been colluding with Congolese officials to hide oil revenue).

44. *See* TRANSPARENCY, *supra* note 18, at 29 (noting that while the SNPC was created to protect Congo from the backroom deals with foreign oil companies, its lack of transparency makes its success unclear); *see also* ENERGY INFORMATION ADMINISTRATION, *supra* note 22 (affirming when SNPC was created in April 1998, it assumed all the upstream functions of the prior state-owned oil firm, Hydro-Congo).

45. *See* TRANSPARENCY, *supra* note 18, at 29 (explaining the SNPC allowed the Congo to protect itself by developing a national capacity for exploration and selling); *see also* GLOBAL WITNESS, THE RIDDLE OF THE SPHYNX: WHERE HAS CONGO'S OIL MONEY GONE? 2–3, Dec. 2005, http://www.osisa.org/files/transparency_cd/global%20witness/The_Riddle_of_the_Sphynx.pdf (asserting SNPC is being used to prevent loan proceeds or oil serving as collateral from being seized by aggressive creditors).

46. *See* TRANSPARENCY, *supra* note 18, at 31 (reasoning that SNPC's use of autonomous entities allowed it to keep government funds from creditors); *see also Congo-Brazzaville Leaders Use Transfer Pricing via Shell Companies to Steal Oil Revenue*, http://www.taxjustice-usa.org/index.php?option=com_content&task=view&id=105&Itemid=30 (last visited Feb. 27, 2008) (detailing the Congo's efforts to keep its oil income from creditors by directing state petroleum revenues through shell companies in tax havens). *But see* PIERRE ENGLEBERT & JAMES RON, PRIMARY COMMODITIES AND WAR: CONGO-BRAZZAVILLE'S AMBIVALENT RESOURCE CURSE, *available at* http://www.internal-displacement.org/8025708F004CE90B/(httpDocuments)/880182BC59072882802570B70059F600/ $file/englebertron.pdf (last visited Feb. 26, 2008) (arguing the SNPC is a means for the government to "loot" the Congo's oil).

47. *See* Landers, *supra* note 19 (calling vulture funds the new means for foreign companies to exploit theCongo's oil).

48. *See UN Condemns Congo "Exploitation*," BBC NEWS, Nov. 20, 2001, *available at* http://news.bbc.co.uk /2/hi/business/1666751.stm (concluding the Congo's huge natural resources are being looted wholesale by both the government's allies and opponents); *see also DR Congo "Looters" Condemned*, BBC NEWS, Nov. 20, 2001, *available at* http://news.bbc.co.uk/2/hi/Africa/1665952.stm (stating the Congo's neighbors tended to perpetuate the civil war to exploit the country's resources).

millions of dollars in bribes and bonuses and are currently employing elaborate schemes to hide and protect oil revenues from attachment.[49]

The Congolese style of Machiavellian business techniques does not end there. Vulture funds[50] are the newest players in the ongoing Congolese saga.[51] The Congo is so deeply in debt that no realistic businessperson actually believes it will ever be able to pay off its loans.[52] As a result, these vulture funds are able to buy defaulted Congolese debt for pennies on the dollar from its creditors.[53] The vulture funds realize that it would be a futile effort to try to collect directly from the Congo—there are billions of dollars in oil-secured debt that has priority over most of these claims.[54] Instead, the vulture funds are attempting to collect from foreign oil companies that operate in the Congo.[55] Foreign oil companies are required to pay royalties to the Congo for exploration and drilling rights.[56] Therefore, the vulture funds have sued some of

49. *See* GLOBAL WITNESS, *supra* note 45, at 2–3 (discussing a judgment that shed light on the schemes of Congolese officials to keep oil revenues from their creditors); *see also* BOSTON GLOBE, *Congo Holds 2 Activists Who Assailed Oil Deals,* Apr. 7 2006 (citing Congolese officials' oil sale schemes as the reason the World Bank denied Congo's application for debt relief); Mallaby, *supra* note 43, at A15 (describing the role of a French bank in the alleged plot to hide oil money from creditors).

50. *See* Alon Seveg, *Investment: When Countries Go Bust: Proposals for Debtor and Creditor Resolution*, 3 ASPER REV. INT'L BUS. & TRADE L. 25, 38–39 (2003) (putting forth an example of a New York Fund's use of a vulture fund to buy Peruvian debt and collect on it at a later date).

51. *See* Landers, *supra* note 19 (describing the emerging role of vulture funds in Congolese debt saga); Kevin Bogardus, *Vulture Funds Targeted*, THE HILL, Nov. 1, 2007, http://thehill.com/leading-the-news/vulture-funds-targeted-2007-11-01.html (detailing recent vulture fund activity that is burdening the effort to eliminate African debt).

52. *See* Landers, *supra* note 19 (listing the various financial obstacles that will prohibit Congo from paying off its huge loans); *see also* Emmanuel O. Iheukwumere & Chukwuemeka A. Iheukwumere, *Colonial Rapacity and Political Corruption: Roots of African Underdevelopment and Misery,* 3 J. INT'L & COMP. L. 4, ¶ 17 n.92 (2003) (explaining the specific historic episode in which the Congolese began to dig themselves into great debt).

53. *See* Wheeler & Attaran, *supra* note 9, at 263 n.53 (commenting that the reason for the debt's low purchase price is nobody expects the debts to be fully repaid); *see also* Landers, *supra* note 19 (emphasizing the rock-bottom price that vulture funds pay for Congolese debt before they try to collect through litigation); Felix Salmon, *How Litigation Became a Priceless Commodity,* EUROMONEY.COM, Sept. 4, 2006, http://www.euromoney.com/Print.aspx?ArticleID =1079173 (pointing out the windfall vulture funds receive when they sue to collect on the debt for which they paid very little).

54. *See* Landers, *supra* note 19 (attributing the difficulty of collecting on Congolese debts to its hidden oil revenues); *see also* Andrew Leonard, *In Defense of Vulture Funds?*, HOW THE WORLD WORKS, SALON.COM, Feb. 27, 2007, http://www.salon.com/tech/htww/2007/02/27/vulture_funds_2/index.html (explaining the vulture funds rarely collect on the debt from the Congo).

55. *See* Paula Dittrick, *U.S. Operators Ensnared in Tussle Over Host-Country Debt*, REDORBIT.COM, May 25, 2006, http://www.redorbit.com/news/business/516706/us_operators_ensnared_in_tussle_over_hostcountry_debt/index.html (noting that most of the money that vulture funds collect is through U.S. courts and not directly from the Congo); *see also* Leonard, *supra* note 54 (pointing out the increasingly popular practice of vulture funds collecting on the Congolese debt from Western oil companies).

56. *See* Alfredo C. Gurmendi, *The Mineral Industry of Congo*, *available at* minerals.usgs.gov/minerals/pubs/country/1996/9207096.pdf (noting the royalties the Congolese government charges for drilling and exploration).

these oil companies in an attempt to garnish the royalty payments.[57] If the vulture funds are successful, this garnishment scheme could have an enormous impact on how foreign oil companies conduct business in sub-Saharan Africa.[58] The oil companies would effectively have to pay double because the Congo would not surrender the royalties as a source of income.[59]

Two cases will have a major impact on the ability of the vulture funds to attach these royalties, *Af-Cap, Inc. v. The Republic of Congo*[60] *and FG Hemisphere Assocs. v. La République du Congo*.[61] In both of these cases, a vulture fund sued the Congo, as well as American oil company CMS Nomeco, in an American court attempting to garnish the royalties.[62] The litigation of these cases is a complicated exercise in international law. It required a novel application of the FSIA, posing the question: Do these vulture funds have the jurisdiction to collect defaulted Congolese debts by suing foreign oil companies?[63] In order to proceed further with an analysis of these cases, it is necessary to explore the complicated details of the FSIA.

III. The Foreign Sovereign Immunities Act of 1976

A. History

Should a plaintiff wish to sue a sovereign state in a United States court, the plaintiff must abide by the rules laid out in the FSIA. As international trade has grown and the lines have been blurred between private and state-owned companies, the FSIA has become increasingly important.[64] Despite the fact that the FSIA is a commonly used statute, it is extremely complicated in its different applications and it continuously poses problems for courts.[65] Both Af-Cap

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57. *See, e.g.,* Af-Cap, Inc. v. The Republic of Congo, 462 F.3d 417, 421 (5th Cir. 2006); FG Hemisphere Assocs. v. The Republique du Congo, 455 F.3d 575, 580 (5th Cir. 2006). Sources close to the case estimated that the debt involved could be as high as $65 million and the projected value of the property to be attached was $20 to 30 million. *See* Gary Taylor, *US Companies Ordered to Cover Congo Debt: Judge Seeks Garnishment of Royalty Payments*, PLATTS OILGRAM NEWS, Apr. 7, 2006, at 2 *available at* http://tkges.net/resources/documents/Platts%20Article.pdf (reviewing court holdings regarding vulture funds' lawsuits against oil companies).

58. *See* Landers, *supra* note 19 (shedding light on the huge impact that a successful ruling for vulture funds would have); *see also* Dittrick, *supra* note 55 (discussing two ways oil companies will be disadvantaged if vulture funds are successful in litigation).

59. *See* Andrew Derman & Andrew Melsheimer, RECENT DEVELOPMENTS IN FOREIGN SOVEREIGN IMMUNITY AND TEXAS GARNISHMENT LAW: A NEW THREAT FACING U.S. OIL AND GAS COMPANIES (2006), http://www.entrepreneur.com/tradejournals/article/163153336.html; *see also* Landers, *supra* note 19 (highlighting the Congo's retainment of royalties in addition to any recovery in a lawsuit).

60. 462 F.3d 417 (*Af-Cap II)*.

61. 455 F.3d 575.

62. *See Af-Cap*, 462 F.3d at 421; *FG Hemisphere*, 455 F.3d at 580.

63. *See Af-Cap*, 462 F.3d at 426 (admitting *Af-Cap* sets forth a new justification for jurisdiction); *FG Hemisphere*, 455 F.3d at 584 (emphasizing the court's need to address whether subject matter jurisdiction exists).

64. Sarah Schano, *The Scattered Remains of Sovereign Immunity for Foreign States After Republic of Argentina v. Weltover, Inc.—Due Process Protection or Nothing?* 27 VAND. J. TRANSNAT'L L. 673, 676 (1994).

65. *See* Karen Halverson, *Is a Foreign State a Person? Does it Matter?: Personal Jurisdiction, Due Process, and the Foreign Sovereign Immunities Act*, 34 N.Y.U. J. INT'L L. & POL. 115, 120 (1990) (characterizing the FSIA as a complicated statute); Joseph F. Morrissey, *Simplifying the Foreign Sovereign Immunities Act: If a Sovereign Acts Like a Private Party, Treat It Like One*, 5 CHI. J. INT'L L. 675, 703 (2005) (commenting that the special framework created by FSIA is confusing and has caused split decisions in federal courts).

and FG Hemisphere are subject to the FSIA because both plaintiffs have attempted to sue a foreign state for the satisfaction of a defaulted debt.[66]

The requirements to bring suit against a sovereign state in U.S. courts have evolved over time. In *Schooner Exchange v. McFaddon,*[67] Justice Marshall held that sovereign states have absolute immunity.[68] This precedent stood for the next 150 years. After World War II, however, absolute sovereign immunity came under intense criticism.[69] More and more, sovereign states would engage in purely commercial activities, but then claim sovereign immunity if they became liable for a tort or a breach of contract.[70] In 1952, the U.S. government responded with the issuance of a State Department opinion known as the Tate Letter.[71] The Tate Letter adopted a restrictive view[72] of sovereign immunity, stating: "the Department feels that the widespread and increasing practice of governments of engaging in commercial activities makes necessary a practice which will enable persons doing business with them to have their rights determined in courts."[73]

The Tate Letter was a large shift away from absolute sovereign immunity,[74] but because of several of its provisions, U.S. citizens were still largely unable to sue sovereign states.[75] First, presumably for political and diplomatic reasons, the State Department reviewed each claim

66. *See Af-Cap*, 462 F.3d at 421; *FG Hemisphere*, 455 F.3d at 580.

67. 11 U.S. 116 (1812).

68. *Id.* at 144.

69. DAVID J. BEDERMAN, INTERNATIONAL LAW FRAMEWORKS 198 (2006).

70. BEDERMAN, *supra* note 69, at 198 (revealing the many lucrative commercial operations of foreign sovereigns); *see also* John Martinez, *Hurry Up and Wait: Negative Statutes of Limitations in the Government Tort Liability Setting,* 19 St. John's J. Legal Comment. 259, 268, (2005) (noting that even where a government undoubtedly caused harm, sovereign immunity bars recovery); Morrissey, *supra* note 65, at 680 (explaining that as governments' participation in commerce grew, it became increasingly unfair to grant them absolute sovereign immunity).

71. *See* Letter from Jack B. Tate, Acting Legal Adviser, U.S. Dept. of State, to Acting U.S. Attorney General Philip B. Perlman, May 19, 1952, in 26 Dept. State Bull. 984–85 (1952), *available at* http://www.law.berkeley.edu/faculty/ddcaron/Documents/US_Statutes/1952_Tate_%20Letter_Restrictive_Sov_Immunity.doc (hereinafter Tate Letter). *See generally* Ruth Donner, *The Tate Letter Revisited*, 9 WILLAMETTE J. INT'L L. & DISP. RESOL. 27, 29–30 (2001) (distinguishing the Tate Letter as one of the first times a major government official spoke out against full sovereign immunity).

72. The restrictive theory of sovereign immunity confines immunity to suits involving the foreign sovereign's public acts and does not extend to purely commercial actions by the sovereign. *See* Austria v. Altmann, 541 U.S. 677, 709 (2004); *see also* Michael D. Murray, *Stolen Art and Sovereign Immunity: The Case of Altmann v. Austria*, 27 COLUM. J.L. & ARTS 301, 307 (2004) (recognizing while FSIA codified the restrictive view of sovereign immunity, it did not create it).

73. Tate Letter, *supra* note 71, at 984–85.

74. *See* James Chung, *Republic of Austria v. Altmann: A Flawed Attempt to Apply Retroactively the Foreign Sovereign Immunities Act of 1976*, 20 TEMP. INT'L & COMP. L.J. 163, 178 (2006) (highlighting the Tate Letter's restrictive view of sovereign immunity); *see also* Morrissey, *supra* note 65, at 680 (outlining the reasons for a restrictive view).

75. *See* BEDERMAN, *supra* note 69, at 199; Daveed Gardenstein-Ross, *A Critique of the Terrorism Exception to the Foreign Sovereign Immunities Act*, 34 N.Y.U. J. INT'L L. & POL. 887, 889–90 (2002); *see also* Alison Elizabeth Chase, *Legal Mechanisms of the International Community and the United States Concerning State Sponsorship of Terrorism*, 45 VA. J. INT'L L. 41, 64 (2004) (naming one possible reason that suing sovereign nations was difficult post–Tate Letter).

before a case could be brought against a sovereign state.[76] This provision eliminated many cases before they even started. Second, the Tate Letter required that any case against a sovereign state be based on a "commercial activity."[77] Unfortunately, the Letter did not define "commercial activity."[78] Therefore, for many potential plaintiffs it was unclear whether their case qualified or not.[79] Finally, the Tate letter was only applicable to obtain jurisdiction to sue a sovereign state.[80] Without a method of executing on a potential judgment against the defendant, jurisdiction was useless. As a result, Congress decided to codify the requirements to sue a sovereign state and, in 1976, passed the FSIA.[81]

B. Applying the FSIA

The FSIA created two hurdles that United States or foreign plaintiffs[82] must clear in order to successfully litigate and then execute on a judgment against a foreign sovereign in a U.S. court. First, the plaintiff must establish that the U.S. court has jurisdiction over the sovereign state.[83] If the plaintiff is successful in establishing jurisdiction, then the trial proceeds.[84] If the plaintiff is granted a favorable judgment, the plaintiff then has the task of executing the judg-

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76. *See* BEDERMAN, *supra* note 69, at 199; *see also* Stella Havkin, *The Foreign Sovereign Immunities Act: The Relationship Between the Commercial Activity Exception and the Noncommercial Tort Exception in Light of De Sanchez v. Banco Central de Nicaragua*, 10 HASTINGS INT'L & COMP. L. REV. 455, 462 (1987) (stressing the State Department's discretion in choosing whether to allow a suit against a sovereign government); *see also* David Todd Pendergast, *Strangers in a Strange Land: Personal Jurisdiction Analysis Under the Foreign Sovereign Immunities Act*, 47 WASH. & LEE L. REV. 1159, 1162 (1990) (noting State Department approval is required to sue a foreign sovereign).

77. *See* Michael G. Cosby, *Commercial Activity Under the Foreign Sovereign Immunities Act of 1976: Toward A More Practical Definition*, 34 BAYLOR L. REV. 295, 296 (1982).

78. *See* Tate Letter, *supra* note 71, at 984–85; *see also* Havkin, *supra* note 76, at 460; Eric D. Suben, *Contrasting Judicial Approaches to Seamen's Claims Under the Foreign Sovereign Immunities Act*, 18 TUL. MAR. L.J. 231, 239 (1994) (explaining the Tate Letter mandated public acts, such as commercial activity, to be the basis for a suit against a foreign sovereign).

79. *See generally* BEDERMAN, *supra* note 69, at 199 (explaining pre-FSIA, sovereign immunity was a political, rather than a judicial matter).

80. *See* Marla Goodman, *The Destruction of International Notions of Power and Sovereignty: The Supreme Court's Misguided Application of Retroactivity Doctrine to the Foreign Sovereign Immunities Act in Republic of Austria v. Altmann*, 93 GEO. L.J. 1117, 1222 (2005) (explaining that, at the time, the Tate Letter guidelines were the accepted methods used by courts to grant jurisdiction over foreign sovereigns); *see also* Kelley Abbott Howes, *Civil Procedure-Foreign Sovereign Immunities Act—Application to Individuals Acting in Official Capacity, Chuidian v. Philippine National Bank*, 15 SUFFOLK TRANSNAT'L L.J. 305, 309 (1991) (recognizing that, before FSIA, the Tate Letter controlled the scope of jurisdiction over foreign sovereigns).

81. *See* Michael A. Rosenhouse, *Construction and Application of Foreign Sovereign Immunities Act,* 16 A.L.R. 563, 563 (2007) (commenting on the FSIA's codification of sovereign immunity); *see also* BEDERMAN, *supra* note 69, at 200 (discussing Congress's intent in implementing the FSIA).

82. *See* FSIA, 28 U.S.C. § 1602.

83. *See id.* at § 1604.

84. *See* E.H. Schopler, *Modern Status of the Rules as to Immunity of Foreign Sovereign from Suit in Federal or State Courts,* 25 A.L.R 322, § 21 (2007); *see also Republic of Argentina v. Weltover, Inc.,* 504 U.S. 607, 619 (1992) (recognizing the FSIA's jurisdictional standards as one factor that determines whether a plaintiff may sue a foreign sovereign).

ment.[85] Unfortunately for the plaintiff, executing the judgment pursuant to the FSIA is even more difficult than obtaining jurisdiction.[86]

1. Jurisdiction

Under section 1604 of the FSIA, a foreign sovereign is *presumed to be immune* from suit in a U.S. court.[87] "This effectively means that it is the plaintiff in foreign sovereign immunity cases that carries the burden of showing that a U.S. court has jurisdiction over the matter. If this cannot be shown, the case is dismissed."[88] To rebut the presumption of immunity, the plaintiff must prove that the sovereign defendant is subject to one of the exceptions to immunity under section 1605 of the FSIA.[89]

The commercial activity exception, section 1605(a)(2),[90] is the most litigated exception of the FSIA and bears particular importance to the issues at hand in *Af-Cap* and *FG Hemisphere*.[91] There are three prongs to section 1605(a)(2) creating the "nexus requirements"[92] for qualifying under the commercial activities exception:

> [i] the action is based upon a commercial activity carried on in the United States by the foreign state; [ii] or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; [iii] or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.[93]

Courts have drawn a very thin line between what is accepted as a commercial activity exception and what is not. For example, in *Texas Trading & Milling Corp. v. Federal Republic of*

85. *See* FSIA, 28 U.S.C. § 1609.

86. *See id.*; *see also* Gary W. Larson, *Default on Foreign Sovereign Debt: A Question for the Courts?*, 18 IND. L. REV. 959, 979 (1985) (explaining the exceptions to the general provision that confers jurisdiction where assets of a foreign sovereign are immune to attachment); M.P.A. Kindall, *Immunity of States for Noncommercial Torts: A Comparative Analysis of the International Law Commissioner's Draft*, 75 CAL. L. REV. 1849, 1849 (1985) (describing the requirement that plaintiffs suing foreign sovereigns establish a relationship between their claim and the property they seek to attach).

87. FSIA, 28 U.S.C. § 1604; *see, e.g., Arg. Republic v. Amerada Hess Shipping Corp.*, 488 U.S. 428, 428 (1988) (holding that, absent an applicable FSIA exception, a foreign sovereign is immune to jurisdiction in the United States).

88. BEDERMAN, *supra* note 69, at 200.

89. The primary exceptions (listed in order of general importance and as they relate to *Af-Cap* and *FG Hemisphere*) are: i) the commercial exception (section 1605(a)(2); ii) waivers of immunity (section 1605(a)(1); iii) tortious acts (section 1605(a)(5); and iv) the "terrorist states" exception (section 1605(a)(7)). *See* BEDERMAN, *supra* note 69, at 200; *see also Af-Cap,* 462 F.3d 417, 425 (demonstrating the interrelationship of state law and the FSIA in determining jurisdiction); *see also FG Hemisphere*, 455 F.3d 575, 589 (holding property sought to be attached must be located in the United States for a U.S. court to have jurisdiction).

90. FSIA, 28 U.S.C. § 1605(a)(2).

91. *See* BEDERMAN, *supra* note 69, at 200 (asserting § 1605(a)(2) as the most litigated exception in the FSIA).

92. BEDERMAN, *supra* note 69, at 202.

93. FSIA, 28 U.S.C. § 1605(a)(2).

Nigeria,[94] the country of Nigeria ordered a large quantity of cement from the plaintiff.[95] Plaintiff prepared and shipped the order, but before it arrived, Nigeria canceled the order and refused to pay.[96] Plaintiff sued Nigeria under the FSIA.[97] The court held that when Nigeria entered into a contract to purchase cement from Texas Trading and Milling Corp. and then breached the contract, it was a purely commercial activity and thus jurisdiction was allowed.[98] In *International Ass'n of Machinists and Aerospace Workers v. OPEC*,[99] the plaintiff attempted to sue OPEC for illegal price fixing.[100] In this case, however, the court held that "an international cartel's fixing of oil prices was inherently a 'sovereign' activity and thus non-commercial," and jurisdiction was not allowed.[101] While it may appear the sovereign states in both these cases were involved in commercial activities, the courts drew a distinction between a commercial transaction and a political policy implication of international trade.[102] In the end, each application of section 1605(a)(2) is a case and fact-intensive analysis.

While the commercial activity exception is particularly important in *Af-Cap* and *FG Hemisphere*, section 1605(a)(1) also plays an important role.[103] Under section 1605(a)(1) of the FSIA, the court will grant an exception to jurisdictional immunity of a sovereign state if that state has waived its immunity.[104] The sovereign state can waive immunity either explicitly or implicitly.[105] Waiver is ordinarily implied when: "(1) a foreign state agrees to arbitration in another country; (2) the foreign state agrees that a contact is governed by the laws of a particular country; [or] (3) the state files a responsive pleading without raising the immunity defense."[106]

2. Execution

Even if a plaintiff is fortunate enough to obtain jurisdiction and to win its case against a foreign sovereign in a U.S. court, the plaintiff's work has just begun.[107] The plaintiff must still

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94. 647 F.2d 300 (2d Cir. 1981).

95. *Id*. at 303.

96. *Id*. at 302.

97. *Id*.

98. *Id*. at 310.

99. 477 F. Supp. 553 (C.D. Cal. 1979).

100. *Id.* at 558.

101. BEDERMAN, *supra* note 69, at 200 (citing *Int'l Ass'n of Machinists*, 477 F. Supp. 553 (C.D. Cal. 1979)).

102. *Cf. Texas Trading*, 647 F.2d at 310 with *Int'l Ass'n of Machinists*, 477 F. Supp. at 567.

103. *See Af-Cap,* 462 F.3d 417, 427; *FG Hemisphere*, 455 F.3d 575, 582; *see also* Zeynep Gunday, *Abur v. Republic of Sudan: The United States District Court for the District of Columbia Denies Extending Jurisdiction over Claims Brought by Nonresidents Against Foreign Sovereigns* 15 TUL. J. INT'L & COMP. L. 691, 698 (2007) (emphasizing the importance of § 1605(a)(1) in the commercial activity exception).

104. *See* FSIA, 28 U.S.C. § 1605(a)(1).

105. *See id*.

106. Rodriguez v. Transnave, Inc., 8 F.3d 284, 287 (5th Cir. 1993)

107. *See* BEDERMAN, *supra* note 69, at 201 (noting the plaintiff must indicate the connection between the defendant and the exception for immunity); *see also* Pruitt, *supra* note 6, at 1005 (declaring if plaintiffs do not follow the appropriate procedures for enforcing their judgments, foreign countries may refuse to enforce them).

enforce the judgment.[108] There is no international mechanism for enforcing U.S. judgments in other countries.[109] Therefore, unless the United States has a bilateral convention with the foreign sovereign defendant, the plaintiff must enforce the judgment pursuant to FSIA sections 1609–1611.[110] Under the FSIA, the plaintiff may execute against only foreign property located in the United States.[111] However, section 1609 states that "property in the United States of a foreign state shall be immune from attachment arrest and execution," unless it qualifies under an exception.[112] The exceptions appear at section 1610 of the FSIA and require that "(1) only *commercial* property of the foreign sovereign or actual foreign instrumentality that is the defendant in the suit be attached or executed against, and (2) that there must be some link between the property to be attached or executed against and the underlying claim."[113] Much like section 1604, section 1609 creates a default position favoring sovereign immunity, leaving the successful party to prove exceptions in order to execute.[114]

Satisfying the section 1610 exceptions for execution is a very difficult task, especially establishing a link between attachable commercial property and the underlying claim.[115] The Supreme Court has addressed only section 1610 of the FSIA once, in *First National City Bank v. Banco para el Comercio Exterior de Cuba* (*Bancec*).[116] In *Bancec*, the state-owned Cuban bank of the same name brought suit in an American court against Citibank to collect on a letter of credit issued to Citibank by Bancec in 1960.[117] Citibank counterclaimed, arguing losses suffered from the Cuban government's expropriation of Citibank assets exceeded the amount owed on the letter of credit and that Citibank was entitled to a set-off.[118] Upon reaching the Supreme Court, the main issue addressed was whether "a claim of a foreign agency plaintiff was

108. *See generally* Picard, s*upra* note 10.

109. BEDERMAN, *supra* note 69, at 201 (illustrating the plaintiff's duties in enforcing judgments). *See* Jonathan A. Franklin & Roberta J. Morris, *International Jurisdiction and Enforcement of Judgments in the Era of Global Networks: Irrelevance of, Goals for, and Comments on the Current Proposals*, 77 CHI-KENT L. REV. 1213, 1238 (2002) (describing the difficulty plaintiffs encounter when other countries refuse to enforce their judgments); Panagiota Kelali, Comment, *Provisional Relief in Transnational Litigation in the Internet Era: What Is in the US Best Interest?*, J. MARSHALL J. COMPUTER & INFO. L. 263, 291 (2006) (explaining other countries are reluctant to enforce U.S. judgments because they perceive the judgments as excessive).

110. *See* FSIA, 28 U.S.C. § 1609; *see also* John F. Murphy, *Civil Liability for the Commission of International Crimes as an Alternative to Criminal Prosecution*, 12 HARV. HUM. RTS. J. 1, 34 (1999) (claiming that plaintiffs have the burden of showing that their cases fall within an exception to the FSIA to enforce their judgments).

111. See FSIA, 28. U.S.C. § 1609.

112. *Id*.

113. BEDERMAN, *supra* note 69, at 200 (citing Ministry of Def. & Support for the Armed Forces of the Islamic Republic of Iran v. Elahi, 546 U.S. 450, 452 (2006)). *See* FSIA, 28 U.S.C. § 1610.

114. *See* FSIA, 28 U.S.C. §§ 1609–11; *see also Af-Cap*, 462 F.3d 417, 428 (recognizing that section 1609 is the only means for enforcing judgments against foreign sovereigns, but may fail against immunity).

115. *See* FSIA, 28 U.S.C. § 1610(a)(2) (requiring the property be used for the commercial activity the lawsuit concerns); *see also* Joseph W. Dellapenna, *Refining the Foreign Sovereign Immunities Act*, 9 WILLAMETTE INT'L L. & DISP. RESOL. 57, 149 (2001) (asserting it is difficult to understand when commercial property is used for the commercial activity at issue).

116. 462 U.S. 611, 621 n.8 (1983).

117. *See id.* at 611.

118. *See id*.

subject to a set-off for the debts of it parent government."[119] After reviewing the FSIA's legislative history,[120] the court asserted that a government instrumentality should not be liable for the debts of its parent sovereign state if the two can be established as separate juridical entities.[121] However, the court ruled Bancec was so closely related to the Cuban government that the presumption of separateness had been overcome[122] and "Cuba cannot escape liability for acts in violation of international law simply by retransferring the assets to separate juridical entities."[123]

Shortly after *Bancec* was decided, another test of section 1610 came before an American court in *Letelier v. Republic of Chile*.[124] In 1976, Orlando Letelier, a Chilean dissident, was assassinated in Washington, D.C.[125] Letelier's family sued the Chilean government, was granted jurisdiction pursuant to the FSIA, and received a favorable judgment by the Second Circuit Court of Appeals.[126] The only Chilean property that could be found in the United States was a plane owned by the Chilean airline LAN.[127] Relying on *Bancec*, plaintiffs attempted to attach the plane because of its close ties to the Chilean government.[128] After applying FSIA sections 1609–1611, however, the court ruled that the plane could not be executed against because it was not related closely enough to the case.[129]

These two cases appeared to be very similar, but like the application of section 1605(a)(2), the application of section 1610 is a case and fact-intensive analysis. Each of the aforementioned cases, whether there was a jurisdiction issue or an execution issue, illustrates the complexity of

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119. Letelier v. Republic of Chile, 748 F.2d 790, 793 (2d Cir. 1984) (citing First Nat'l City Bank v. Banco para el Comercio Exterior de Cuba, 462 U.S. 611, 611 (1983)).

120. "Section 1610(b) will not permit execution against the property of one agency or instrumentality to satisfy a judgment against another, unrelated agency or instrumentality. There are compelling reasons for this. If U.S. law did not respect the separate juridical identities of different agencies or instrumentalities, it might encourage foreign jurisdictions to disregard the juridical divisions between different U.S. corporations or between a U.S. corporation and its independent subsidiary. However, a court might find that property held by one agency is really the property of another." *First Nat'l City Bank (Bancec)*, 462 U.S. at 627–28 (quoting H.R. REP. NO. 94-1487, at 29–30 (1976), *as reprinted in* 1976 U.S.C.C.A.N. 6604, 6628–29).

121. *First Nat'l City Bank (Bancec)*, 462 U.S. at 627.

122. *Id.* at 632.

123. *Id.* at 632–33.

124. 748 F.2d 790, 793 (2d Cir. 1984).

125. *Id.* at 791.

126. *Id.*

127. *Id.* at 791–92.

128. *Id.* at 794. As evidence that LAN and the Chilean government were not separate juridical entities, plaintiffs pointed out that from January 1975 through January 1979 LAN's assets and facilities were under the direct control of Chile, which had the power to use them. Additionally, Michael Vernon Townley, the assassin, used a LAN airplane to travel to the United States and to transport the explosives used in the crime. *Id.*

129. *Id.* at 799. In making this determination the court held "none of [the] facts showed that Chile ignored LAN's separate status. Instead, they simply demonstrate[d] that Michael Townley was able to enlist the cooperation of certain LAN pilots and officials with whom he had a pre-existing social relationship in pursuing his sinister goal." *Id.* at 794.

the FSIA. Both *Af-Cap* and *FG Hemisphere* have required the court to draw upon prior case law and to apply it in a novel manner.[130]

IV. The Vulture Fund Cases

Af-Cap, Inc. v. The Republic of Congo[131] and *FG Hemisphere v. La République du Congo*[132] are very similar cases. They both involve vulture funds that made a very high-risk investment at bargain prices, hoping that they would receive a windfall.[133] The riskiest element of the vulture funds' investment was not the defaulted Congolese debt that they purchased; it was the risk of successfully navigating the FSIA in U.S. courts.[134] Had Af-Cap and FG Hemisphere been able to convince the court their cases satisfied both the jurisdictional requirements and the execution requirements of the FSIA, they would have collected an enormous amount of money and permanently altered the way that foreign oil companies approach oil drilling opportunities in sub-Saharan Africa.[135]

A. The *Af-Cap* Cases

1. *Connecticut Bank of Commerce v. Congo*

On December 14, 1984, Equator Bank Ltd. loaned the Congo $6.5 million for the construction of a highway.[136] In the loan agreement, the Congo explicitly waived its right "to claim foreign sovereign immunity either from suit or from attachment or execution of its property."[137] The Congo defaulted on the loan a year later.[138] After several years had passed, an assignee of Equator Bank Ltd., Connecticut Bank of Commerce (CBC), obtained a judgment against the Congo in London.[139] The Congo, however, did not make any of the payments required by this judgment.[140] In response, CBC filed suit in New York.[141] When the Congo did not make an appearance in the New York action, the court entered a default money judgment in favor of the bank.[142] CBC then registered the judgment in Texas state court and obtained a writ of garnishment from the clerk of the court directed at a group of Texas oil com-

130. *Af-Cap*, 383 F.3d 361, 366 (interpreting Conn. Bank of Commerce v. Congo, 309 F.3d 240 (5th Cir. 2002), to hold if foreign sovereign has waived immunity, one can execute judgment against "commercial activity"); *FG Hemisphere*, 455 F.3d 575, 586 (drawing on *Af-Cap*, 383 F.3d at 363).

131. 383 F.3d at 363.

132. 455 F.3d at 582.

133. *See Af-Cap*, 383 F.3d at 364; *FG Hemisphere*, 455 F.3d at 580.

134. *See* Morkin et al., *supra* note 4 (describing the various intricacies of FSIA).

135. *See generally* Gwenann Seznac, *The Role of the African State in International Commercial Arbitration*, 8 VINDOBONA J. OF INT'L COMMERCIAL L. & ARBITRATION 211, 211–12 (2004) (describing the difficulties that sub-Saharan African countries have in finding investments).

136. *See Conn. Bank of Commerce*, 309 F.3d 240, 247.

137. *Id.*

138. *Id.*

139. *Id.*

140. *Id.*

141. *Conn. Bank of Commerce*, 309 F.3d at 247.

142. *Id.*

panies consisting of CMS Nomeco Congo, Inc., The Nuevo Congo Ltd., and several of their affiliate companies (hereinafter "the garnishees").[143] The garnishees had oil-drilling operations located off the Congolese Coast.[144] As a condition of their operations in Congolese waters, the Congo required the garnishees to pay royalties and taxes on the oil they obtained.[145] As part of the contract, CMS Nomeco had the option to pay the royalties in cash or in kind with a percentage of the oil they collected.[146] The writs of garnishment from the clerk of the Texas state court prohibited the garnishees from making those payments to the Congo and instead directed them toward CBC in order to satisfy the judgment.[147]

The Congo and the garnishees immediately removed the case to the U.S. District Court for the Western District of Texas and filed a motion to dismiss.[148] The court dissolved the writs of garnishment and dismissed the case for two reasons.[149] The first reason was very straightforward—under section 1610(c) of the FSIA, only a *court* may execute against a foreign sovereign's property.[150] When the clerk issued the writ without any court order, it violated the requirements of this provision.[151] The second reason came as the result of the court's narrow interpretation of the FSIA.[152] It concluded that "the royalty and tax payments owed by the oil companies to the Congo did not arise from a 'commercial activity in the United States,' and therefore were not subject to garnishment."[153] This element of the decision was appealed by CBC and constitutes the majority of the discussion in the court's holding in *Connecticut Bank of Commerce*.[154]

In the appeal, the U.S. Court of Appeals for the Fifth Circuit upheld the rulings of the District Court.[155] In analyzing the "commercial activity" exceptions in the FSIA, the court delineated between section 1605 (jurisdiction) and section 1610 (execution).[156] The court distinguished the wording of the statute, asserting Congress had deliberately made section 1610 a narrower exception than section 1605.[157] While not explicitly holding that jurisdiction was

143. *Id*.

144. *See Af-Cap*, 462 F.3d 417, 422.

145. *See id*.; *see also* Derman & Melsheimer, *supra* note 59 (explaining the Congo permits CMS to extract oil in return for royalties and periodic tax payments).

146. *See Af-Cap*, 462 F.3d at 422.

147. *See Conn. Bank of Commerce*, 309 F.3d at 247.

148. *Id*.

149. *Id*. at 247–48.

150. *See* FSIA, 28 U.S.C. § 1610(c); *see also Conn. Bank of Commerce*, 309 F.3d at 247.

151. *See Conn. Bank of Commerce*, 309 F.3d at 247.

152. *Id.* at 248.

153. *Id*.

154. *Id*. at 246.

155. *Id*. at 256–57.

156. *Id*. at 252.

157. *Conn. Bank of Commerce*, 309 F.3d at 255.

proper, the court essentially granted the jurisdictional exception to CBC.[158] However, jurisdiction over a foreign sovereign is worthless if that sovereign is immune from execution.[159] Unfortunately for CBC, the court's narrow interpretation of section 1610 upheld Congolese sovereign immunity.[160]

In analyzing section 1605, the court focused on the phrase "in connection."[161] Section 1605(a)(2) provides a foreign state shall not be immune from jurisdiction of the U.S. courts "in which the action is based upon . . . an act in the United States *in connection* with a commercial activity. . . ."[162] In effect, "it allows a plaintiff to pierce a foreign state's immunity for suits based on acts that have any connection with a commercial activity in the United States."[163] In section 1610, however, the court focused on the phrase "used for," which it says makes the exception to immunity in execution much narrower.[164] Section 1610(a) states, "[T]he property in the United States of a foreign state, *used for* a commercial activity in the United States, shall not be immune from attachment in aid of execution. . . ."[165] CBC argued that property is "used for" a commercial activity "whenever it is 'integral' or 'related' to a commercial activity" located in the United States.[166] The court, however, pointed out that the royalty obligations in this case represented *revenue* or *income* from the commercial activity.[167] As a result, the royalties were not something that would have been "used for" the commercial activity in the present or the future; they were simply the end result of something that had occurred in the past.[168] While the court admitted the royalties and taxes may be "in connection" with a commercial activity,[169] they were not "used for" a commercial activity.[170] The court remanded the case to

158. The Court stated, "[I]f we were to take the Bank's approach, we would interpret away the difference in phrasing between these two sections: the Bank is asking us to ignore an obvious difference in the way these two different immunities have been crafted." *Id*. This implies that if the two were the same, CBC would have been successful because they did satisfy the jurisdictional requirement. *See id*.

159. *See generally* FSIA, 28 U.S.C. § 1609 (stating property of a foreign state shall be immune from attachment, arrest, and execution in the United States).

160. *See Conn. Bank of Commerce*, 309 F.3d at 260.

161. *See id*. at 255 (interpreting § 1605's use of the phrase "in connection" with a commercial activity to mean "related to" or "integral to").

162. FSIA, 28 U.S.C. § 1605(a)(2).

163. *Conn. Bank of Commerce*, 309 F.3d at 255.

164. *See id.* at 252–53; FSIA, 28 U.S.C. § 1610(a).

165. FSIA, 28 U.S.C. § 1610(a).

166. *Conn. Bank of Commerce*, 309 F.3d at 254.

167. *Id*. (holding that the revenue from a commercial transaction does not have the relationship to the commercial activity denoted by "used for," and that "integral to" and "related to" differ from the intended statutory meaning).

168. *Id*. (reasoning that revenue from a commercial transaction is merely an end result of a commercial activity). The court also states "even the Bank appear[s] to recognize that what matters under the statute is how the *foreign state* uses the property, not how private parties have used it in the past." *Id*. at 256 n.5.

169. *Id*. at 259.

170. They represented revenue from a commercial activity—"in ordinary usage, we would not say that the revenue from a transaction is 'used for' that transaction . . . it is not put in service of that activity, instead it is the end result or income of the activity." *Id*. at 255.

the district court to determine, in light of this new discussion on the "used for" provision, how the Congo used its royalty and tax obligations.[171]

Despite the fact the original highway contract waived immunity from execution, the courts still had to abide by the FSIA, requiring CBC meet two criteria: 1) that the property be in the United States, and 2) that it be used for a commercial activity in the United States.[172] The court's rationale for parsing the statute to such an intense degree was "confiscating funds that are being put immediately to some sovereign use interrupts a sovereign's public acts."[173]

2. *Af-Cap I*

After the district court remanded the *Connecticut Bank of Commerce* case in order to determine whether the tax and royalty obligations were property "used for" commercial activities, Af-Cap stepped in and acquired the debt from CBC.[174] Af-Cap "vigorously" pursued discovery in order to prove that the royalties *were* "used for" commercial activities.[175] In *Af-Cap, Inc. v. The Republic of Congo (Af-Cap I)*,[176] Af-Cap made two arguments: 1) the district court erred in disregarding the Congo's express waiver of immunity in the original loan contract and 2) the district court erroneously concluded that the royalty and tax payments did not fall within the section 1610 exception to foreign sovereign immunity.[177] In response to the first argument, the court quickly upheld its decision in the prior case, stating that "even when a foreign state completely waives its immunity from execution, courts in the U.S. may execute only against property that meets [the] two statutory criteria."[178] In the second argument, however, the court departed from its original decision and determined that the extensive discovery by Af-Cap had, in fact, produced evidence that the property was used for commercial purposes and could therefore be garnished.[179]

In *Connecticut Bank of Commerce*,[180] the court had ruled the "used for" clause must be strictly construed in order to prevent garnishment of money that is being used for a sovereign

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171. *Conn. Bank of Commerce*, 309 F.3d at 259.

172. *See id.* at 247; *see also* Donald R. Cassling, *Under the Foreign Sovereign Immunity Act, Property Is Used for a Commercial Activity in the United States When It Is Put into Action, Put into Service, Availed, or Employed for a Commercial Activity,* 124 BANKING L. J. 667, 667 (2007).

173. *Id.* at 253.

174. *See Af-Cap I*, 383 F.3d 361, 366; *see also* Pam Radtke Russell, *Congo Case's "Dramatic" Ruling Favors Energy Firms: Oil Royalty Can't Be Converted to Cash to Pay 3rd-Party Debt*, TIMES-PICAYUNE, Oct. 10, 2006 (reporting Af-Cap purchased the $13.6 million Congolese debt for 7 to 10 cents on the dollar).

175. *See Af-Cap I*, 383 F.3d at 366 (remarking Af-Cap received thousands of pages of responsive documents and deposed numerous witnesses to argue the royalties were "used for" commercial activities); *see also* Brown, *supra* note 174, at 481–82 (reiterating Af-Cap's arguments regarding § 1610(a) of the FSIA).

176. 383 F.3d 361.

177. *See id.* at 366; *see also* Michael Brown, *Recent Business Developments*, 49 TEX. J. BUS. L. 465, 481–82 (2005) (discussing Af-Cap's contentions to the district court).

178. *Af-Cap I*, 383 F.3d at 366.

179. *Id.* at 370; *see* Brown, *supra* note 177, at 482 (summarizing the findings of the appeals court that the tax and royalty payments constituted commercial activity). *But see Conn. Bank of Commerce*, 309 F.3d 240 (5th Cir. 2002) (finding the royalty and tax payments did not arise from commercial activity).

180. 309 F.3d 240 (5th Cir. 2002) (defining the FSIA term "used for" to refer to how money or assets are spent).

act.[181] In *Af-Cap I*, however, the court highlighted the fact that the Congo had used these same funds to pay off a $26 million debt to National Union Fire Insurance Company (NUFI) as the result of settlement agreement.[182] The court employed an "essential use" test, meaning a holistic approach was used when determining how a state has used these funds in the past.[183] In doing so, the court noted, "for nearly half of the twenty-four years that these [tax and royalty] obligations existed [between the Congo and the garnishees], the Congo has used at least fifty percent of them to repay a commercial debt."[184] Therefore, the Congo *had* been using these funds for years to pay commercial creditors.[185]

Under the FSIA, section 1610(a), the property in question must not only be used for commercial purposes; the property must also be located in the United States.[186] Therefore, before allowing execution, the court addressed the situs question: Was the property located in the United States?[187] The royalty and tax payments were intangible in nature, so the court took a "commonsense" approach.[188] The court asserted that precedent in many jurisdictions dictated the situs of a debt obligation was the situs of the debtor.[189] Because the debtor in this case (the garnishees) was located in Texas, the situs was held to be in the United States.[190] As a result, both conditions of section 1610(a) were satisfied and the court granted *Af-Cap* permission to garnish the royalty and tax payments.[191]

3. *Af-Cap II*

After determining the royalties and taxes could be garnished in *Af-Cap I,* the Court remanded with instructions to determine which funds had been used to pay the NUFI debt,[192]

181. *Id.* at 253.

182. *See Af-Cap I*, 383 F.3d at 368.

183. *Id.* at 368 (explaining the "essential use" test requires the court to focus on what the property was essentially used for as opposed to isolated and unusual uses).

184. *Id.* at 370.

185. *Id.* at 368 (outlining the settlement agreement with NUFI); *see* Grunstein et al., *supra* note 16, at 491 (describing the Congo's assignment of a portion of its royalties to satisfy a debt).

186. FSIA, 28 U.S.C. § 1610.

187. *See Af-Cap I*, 383 F.3d at 371; *see also FG Hemisphere*, 455 F.3d 575, 585 (establishing that courts in the United States may execute only against property in the United States); *see also* Grunstein et al., *supra* note 16, at 491 (analyzing the court's assessment of whether the property was in fact "in" the United States).

188. *See Af-Cap I*, 383 F.3d at 371; *see also* Severnoe Sec. Corp. v. London & Lancashire Ins. Co., 255 N.Y. 120, 123 (directing the situs of intangible property be based on where it is most just or convenient*)*; U.S. Indus., Inc. v. Gregg, 540 F.2d 142, 151 n.5 (Del. 1976) (stating the commonsense approach requires justice and convenience with respect to intangible property).

189. *See Af-Cap*, 383 F.3d at 371 (citing Alliance Bond Fund v. Grupo Mexicano de Desarrollo, 190 F.3d 16, 25 n.9 (2d Cir. 1999)) (recognizing this rule generally applies under New York law); Great Falls Transfer & Storage Co. v. Pan Am. Petroleum Corp., 353 F.2d 348, 349 (10th Cir. 1965) (revealing Montana and Wyoming adopted this rule).

190. *Af-Cap I*, 383 F.3d at 371.

191. *Id.* at 373.

192. *See Af-Cap II*, 462 F.3d 417, 422.

because only those funds would fall within the "commercial activity" exception.[193] On remand, the District Court hit a major snag that derailed all of their prior work sorting out the intricacies of the FSIA. According to the original agreement between the Congo and the garnishees, the Congo had the choice whether to receive their payments in cash or in kind.[194] Since 1999, the Congo had opted to accept all of its payment in kind.[195] Unfortunately for Af-Cap, this was a diversity action, and thus Texas law was applied.[196] Texas law prohibits garnishments of in-kind payments.[197] Therefore, in lieu of the writs of garnishment the District Court issued a "turnover order" that effectively forced the Congo to accept cash instead of in-kind royalties and pay them into the registry of the Court.[198]

On appeal, the Fifth Circuit vacated the lower court's turnover order that forced the Congo to accept cash instead of in-kind royalties.[199] The Fifth Circuit determined the turnover order, as an alternate method of garnishment, was barred because the District Court did not have personal jurisdiction over the Congo.[200] The court explained "the dissolution of the writs of garnishment and creation of the turnover order required the Court to find a new justification for jurisdiction in the case."[201] Originally, the court found jurisdiction "based on the fact the obligations were held by the CMS companies who were located in the United States and Texas specifically."[202] When the court entered the turnover order, however, they bypassed the CMS Companies and directly ordered the Congo to act, which they did not have jurisdiction to do.[203] Therefore, by dissolving the writs and replacing them with the turnover order, the District Court "lost the original foothold for jurisdiction" under the FSIA.[204] As a result, the "commercial activity" exception did not apply and *Af-Cap* was barred from attaching the royalties.[205]

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193. *See id.*; *see also Af-Cap I*, 383 F.3d at 504 (instructing only those obligations that were used to settle NUFI debt were subject to garnishment by Af-Cap).

194. *Af-Cap II,* 462 F.3d at 422.

195. *Id.*

196. *See* Erie R.R. Co. v. Tompkins, 304 U.S. 64, 78 (1938) (commanding federal courts to apply state law in a diversity of citizenship case); *see also Af-Cap*, 462 F.3d at 423 (explaining the Court must apply the law of Texas because it is a diversity case).

197. *See Af-Cap II*, 462 F.3d at 424; *see also* Derman & Melsheimer, *supra* note 59, at 281–84.

198. *See Af-Cap II*, 462 F.3d at 423; *Af-Cap,* 383 F.3d at CS624.

199. *See Af-Cap II*, 462 F.3d at 426–27.

200. *Id.*; *see also* Jennifer Toole et al., *International Litigation*, 41 INT'L L. 329, 342 (2007) (stating because the Congo did not waive immunity, the District Court had no jurisdiction to issue the turnover order).

201. *Af-Cap II*, 462 F.3d at 426–27.

202. *Id.* at 426.

203. *Id.* The *Af-Cap I* Court held that the situs requirement under both sections 1605 and 1610 was possible only because the CMS companies that held the property of the Congo were located in the United States. *Id.*; *see* FSIA, 28 U.S.C. § 1605(a).

204. *Af-Cap II*, 462 F.3d at 426–27. *See* FSIA, 28 U.S.C. § 1605(a); O. Rey Rodriguez & Kendyl Hanks, *Fifth Circuit Appellate Update: Foreign Sovereignty Immunities Act*, APP. ADVOC., Fall 2006, at 80, *available at* http://www.tex-app.org/advocate/advocate_v19n1.pdf.

205. *See* FSIA, 28 U.S.C. § 1605(a)(2); *see also Af-Cap II*, 462 F.3d at 426; Derman & Melsheimer, *supra* note 59, at 282 (noting the Fifth Circuit had reasoned the Congo had not participated in commercial activity in the United States).

4. The Result of the *Af-Cap* Cases: One Vulture Fund Thwarted, but Loopholes Exposed

After spending five years adjudicating the *Af-Cap* cases, the court failed to define an applicable standard upon which these vulture fund cases could be resolved.[206] The courts intensely analyzed the FSIA in these cases.[207] However, the resulting decision hinged on a technicality of Texas state law.[208] While these cases give some insight into how courts applied the FSIA, they established very little concrete precedent. In fact, these cases demonstrate that if the circumstances had been slightly different, Af-Cap would have *succeeded* in garnishing the taxes and royalties.[209] In *Af-Cap I*, the Fifth Circuit Court of Appeals granted Af-Cap permission to garnish the royalties and taxes from the garnishees.[210] Had the Congo simply decided to accept the payments in cash instead of in-kind in 1999, Af-Cap would have been successful.[211]

Further analysis indicates a number of variables that could have changed the outcome of the case. For instance, if the garnishees had not been located in Texas, but instead, in a state where in-kind garnishment was permitted, Af-Cap would have been successful.[212] Or, from another prospective, had the NUFI payments not been unearthed, *Af-Cap I* would have had the same result the *Connecticut Bank of Commerce* had, with Af-Cap being prevented from garnishing the payments.[213] *Af-Cap* highlights the intricacy of cases in which the FSIA is

206. *See supra,* Parts IV.A.1-3.

207. *See id*.

208. *Af-Cap II*, 462 F.3d at 424.

209. *See supra,* Parts IV.A.1-3; *see also* Derman & Melsheimer, *supra* note 59, at 281 (noting the royalties were not immune from garnishment, but Texas law did not allow for the garnishment of such royalties); James Thuo Gathii, *The Sanctity of Sovereign Loan Contracts and Its Origins in Enforcement Litigation*, 38 GEO. WASH. INT'L L. REV. 251, 314 (2006) (commenting the revenue itself, whether monetary or in kind, was not immune from garnishment under the FSIA); Grunstein et al., *supra* note 16, at 496 (stating the court held that the Texas garnishment statute must be strictly construed, thus not allowing for the collection of nonmonetary payments).

210. *Af-Cap*, 383 F.3d at 373.

211. Had this occurred, the Texas state law barring garnishment of in-kind payments would not have been implicated, the turnover order would not have been necessary, and the court would have retained jurisdiction to enforce the attachment under the FSIA in the amount equal to the amount the Congo had paid NUFI. *See supra* Part IV.A.3; *see also* Gathii, *supra* note 209, at 314 (maintaining that the revenue was subject to garnishment under the FSIA without applying Texas state law); *Congo Evades Creditor's Attempt to Recover on Judgment*, COMMERCIAL LENDING LITIG. NEWS, Sept. 14, 2006, at ¶ 5 (reporting that the only factor preventing the garnishment of royalties was that they were nonmonetary in nature).

212. *See* Derman & Melsheimer, *supra* note 59, at 281; *see also* Grunstein, *supra* note 16, at 496 (demonstrating that Texas law, not the FSIA, prevented garnishment).

213. *See* Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt*, 36 GEO. J. INT'L L. 299, 312 (2005) (emphasizing that property "used for a commercial activity" may be garnished, thus the diplomatic property at issue in Connecticut Bank was protected); *see also* Paul Lee, *Central Banks and Sovereign Immunity*, 41 COLUM. J. TRANSNAT'L L. 327, 345 n.67 (asserting even when a waiver is present that covers all property of a foreign state, only that property used for a "commercial purpose" can be subject to execution).

employed.[214] It exposes how easily mistakes[215] can be made and how minor variables can dramatically affect the outcome of a case. It does *not* define an applicable standard upon which vulture fund cases can be resolved.[216]

B. *FG Hemisphere*

1. The Case

The basic facts of *FG Hemisphere*[217] are very similar to the facts in the *Af-Cap* cases. In 1982, the Banco do Brasil, S.A., made a loan to the Congo.[218] The Congo defaulted on the loan and attempts to collect on the loan were unsuccessful.[219] Eventually, 20 years after the loan was made, FG Hemisphere, another vulture fund, bought the debt for pennies on the dollar and sued for attachment of royalties in a U.S. court.[220] FG Hemisphere sued the same American oil company, CMS Nomeco, as well as the Congo in the U.S. District Court for the Southern District of Texas.[221] After the District Court ordered writs of garnishment against CMS Nomeco and the SNPC, both appealed to the U.S. Court of Appeals for the Fifth Circuit.[222]

Despite the factual similarities between *FG Hemisphere* and the *Af-Cap* cases, the *FG Hemisphere* court tackled new legal issues regarding the application of the FSIA.[223] In the *Af-Cap* cases, the court focused primarily on the "used for" provision of section 1610(a).[224] However, in *FG Hemisphere* the court carefully analyzed the location of the garnishee's operations—

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214. *See generally* Allison Taylor, *Another Front in the War on Terrorism? Problems with Recent Changes to the Foreign Sovereign Immunities Act*, 45 ARIZ. L. REV. 533, 550 (2003) (discussing the use of the FSIA to sue countries that sponsor terrorism).

215. One problem with the FSIA is that various officers of the court do not have the expertise to properly handle it or even know they are working with it. This can be illustrated most vividly in the *Af-Cap* cases when the Texas court clerk failed to recognize he could not simply enter the judgment in Texas, and when the turnover order was issued without any thoughts regarding FSIA jurisdictional issues.

216. *See* Vinson & Elkins LLP, *Developments in Garnishment of U.S. Oil Companies to Collect Foreign-State Debt*, Apr. 2, 2007, *available at* http://www.vinsonelkins.com/resources/resource_detail.asp?rid+323250101&rtype+pub (explaining the vulture fund cases raise a number of legal issue which the court did not resolve).

217. 455 F.3d 575, 575 (5th Cir. 2006).

218. *Id.* at 581.

219. *Id.*

220. *Id.*

221. *Id.*

222. *Id.* at 575.

223. *Id.* at 589 (assessing the "situs snapshot" determination question and proclaiming the property must be in the United States when the court authorizes an execution).

224. Citing the Congo's practice of using royalties to pay its commercial debt with NUFI, the court determined the Congo had shown through the "essential use" test that the royalties had been used for a commercial purpose. *See Af-Cap I*, 383 F.3d 361, 368; *see also Developments in Garnishment of U.S. Oil Companies to Collect Foreign-State Debt*, *supra* note 216 (stating a "commercial use" that occurred in the past would be enough to satisfy the requirement of the act).

something they did not do in the *Af-Cap* cases.[225] As a result, situs became the major issue in *FG Hemisphere*.[226] The court also addressed how intangible property should be treated under the FSIA.[227]

The court addressed the situs issue first.[228] In May 2002, CMS Oil and Gas Co. and its subsidiary CMS Oil and Gas (International) Co. owned exploration and production assets in the United States, the Congo and various other countries.[229] In July 2002, CMS Oil and Gas Co.'s parent company sold the stock of CMS Oil and Gas (International) Co. along with its subsidiary, CMS Nomeco, to affiliates of Perenco S.A. Perenco S.A. and its affiliated companies, including the garnishees, which were headquartered in Europe.[230] In September 2002, CMS Nomeco, a Delaware corporation, became a member of the Perenco group of companies, with officers and directors located in Paris and London.[231] Operations relating to the Congo that were previously performed in the United States were then performed in the Congo.[232] By July 2004, none of the garnishees had operations, officers, or a physical presence in the United States.[233]

Because all operations had left the United States, garnishees argued FG Hemisphere could not satisfy the situs requirement of section 1610(a).[234] FG Hemisphere countered the situs of both the royalty obligations and working interest share obligations were, and had been, "in the United States" for purposes of section 1610(a) because the Congo defendants subjected themselves to personal jurisdiction through their removal of this action from Texas state court into federal court.[235] They also argued two of the garnishees were incorporated in Delaware at the

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225. *FG Hemisphere* asserted the *Af-Cap* cases had already settled the situs issues. However, the *FG Hemisphere* court disagreed, asserting in *Af-Cap* the issues of: a) the garnishees' continuous presence in Texas; and b) the garnishees' activities related to the tax and royalty payments having taken place in Texas were both undisputed. As a result, the *Af-Cap* cases did not make determinations that were essential to the *FG Hemisphere* case. The *FG Hemisphere* court then went on to consider whether the garnishees were in the United States during the applicable time period necessary to qualify for an exception under FSIA § 1610(a). *FG Hemisphere*, 455 F.3d at 585–86. *See Af-Cap III*, 309 F.3d 240, 262 (5th Cir. 2002) (affirming the place of the garnishee's headquarters were undisputed facts with no need for further analysis in *Af-Cap*); *see also* Grunstein et al., *supra* note 16, at 495 (stating the court in *Af-Cap* did not analyze the position of the garnishee).

226. *See FG Hemisphere*, 455 F.3d at 588.

227. *See FG Hemisphere*, 455 F.3d at 595–96; *see also* Mark D. Christiansen, *Energy and Natural Resources Litigation 2006 Annual Report*, 2006 ABA ENV'T, ENERGY, & RESOURCES L.: YEAR IN REV. 174, 183 (2007) (discussing the rules of the FSIA and their affects on certain types of property).

228. *FG Hemisphere*, 455 F.3d at 585–86.

229. *Id.* at 582 (quoting the exploration and production assets of CMS Oil and Gas Co.).

230. *Id.*

231. *Id.*

232. *Id.*

233. *Id.*

234. *FG Hemisphere*, 455 F.3d at 588. *See* FSIA, 28 U.S.C.A. § 1610 (clarifying that property in the United States is immune from attachment).

235. *Id.*

commencement of the litigation and were therefore legally present in the United States.[236] However, the court held the FSIA required the property to be located in the United States when the district court authorizes *execution*.[237] Although the garnishees had been located in the United States when litigation began, they were no longer located in the United States at the time of execution and thus were barred from attaching the royalties under the FSIA.[238]

The court also addressed, but did not rule on, the issue of "intangible property" under the FSIA.[239] The Congo and garnishees operated the royalty payment scheme according to a "Lifting Agreement."[240] A "lifting" occurs when oil is offloaded from a storage vessel and sold.[241] Since 1999, garnishees had paid their royalties in-kind.[242] Therefore, the garnishees occasionally would devote an entire lifting to the Congo as payment.[243] Garnishees kept track of the amount they owed in an "over/under statement."[244] When the garnishees owed royalties, they were in an "under-delivered" position."[245] When the garnishes become under-delivered by a certain amount, they would over-pay royalties in a single lifting in order to be "over-delivered."[246] Garnishees then waited until they were under-delivered again and repeated the process.[247] This accounting scheme cut down the amount of liftings the garnishees had to devote to the Congo.[248] However, the court determined the Lifting Agreement did more: It effectively "extinguished the in-kind royalty obligation" and essentially created a revolving loan.[249]

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236. *Id*. *See* Melvin R. Goldman et al., *Derivative Securities Litigation: Recent Trends and Developments*, 417 PRAC. L. INST. 543, 554 (1991) (reporting that corporations can be legally present in the state in which they are incorporated).

237. As a result FG Hemisphere would have failed to satisfy section 1610(a) with a showing the garnishees were in the United States at commencement of the action *or* they were in the United States at the time jurisdiction was granted under the FSIA. *See* FSIA, 28 U.S.C. § 1610.

238. *FG Hemisphere*, 455 F.3d at 596. *See generally* Margaret E. Tahyar, *The Act of State Doctrine: Resolving Debt Situs Confusion*, 86 COLUM. L. REV. 594, 596 (1986) (discussing the importance of location and situs when the right to repayment is at issue).

239. *See FG Hemisphere*, 455 F.3d at 595–96 (noting there were no findings on whether the royalty interests were intangible property).

240. *See id.*; *see also* Derman & Melsheimer, *supra* note 59, at 279 (illustrating the Congo has assigned the right to lift the royalty oil).

241. *FG Hemisphere*, 455 F.3d at 581.

242. *Id*.

243. *Id.*

244. *See id.* (referring to the accounting process); *see also Af-Cap I*, 383 F.3d 361, 365 n.2. *See generally US Oil & Gas Corp., Operation and Sale of Oil*, *available at* http://www.usoilandgas.net/operationsale.htm (last visited Feb 26, 2008) (referring to the process of selling oil).

245. *See FG Hemisphere*, 455 F.3d at 581; *cf.* In re Rally Partners, L.P., 306 B.R. 165, 171 n.9 (E.D. Tex. 2003) (imputing an "under-delivered" position to be a negative balance requiring cure). *But cf.* City of Rockwood v. IMCO Recycling, Inc., 415 F. Supp. 2d 853, 856 (E.D. Tenn. 2006) (alluding the "over-delivered" position is one of surplus).

246. *See FG Hemisphere*, 455 F.3d at 582 (suggesting that lifting 550,000 barrels would create an "over-delivered" position); *see also Rockwood*, 415 F. Supp. 2d at 856 (defining "over-delivered" to mean delivering more gas to a company than redelivered in return).

247. *See FG Hemisphere*, 455 F.3d at 582.

248. *Id.*; *see also Af-Cap I*, 383 F.3d 361, 365 n.2 (postulating both the Congo's and SNPC's interests are satisfied).

249. *FG Hemisphere*, 455 F.3d at 593.

Although the court did not rule on this particular issue, the Lifting Agreement may have created a scenario where, technically, there was no property the creditors could attach.[250]

2. Variables Prevent Precedent Again

FG Hemisphere, much like the *Af-Cap* cases, barred attachment of taxes and royalties under the FSIA.[251] Also, much like *Af-Cap,* the *FG Hemisphere* holding raised more questions about FSIA application than it answered.[252] For instance, the holding seems to indicate if the garnishees had not relocated out of the country during the applicable time frame, then the holding from *Af-Cap I* would have applied, resulting in a success for FG Hemisphere.[253] The court's holding also created a potential loophole in section 1610(a).[254] It appears from the holding that property is deemed to be located outside of the United States, and thus not attachable, if it is moved before *execution*.[255] Under the FSIA, jurisdiction is determined first, litigation is performed next, and execution is conducted last.[256] Therefore, the fact that property is not attachable as long as it is out of the country before execution invites foreign sovereigns to simply move their property out of the United States after a suit is brought and before execution is rendered.[257] This seemingly would offer little recourse for creditors.[258] Finally, the court raised the issue of tangible property as a potential problem, but never resolved it.[259] It

250. *See id.*; *see also* Andrew B. Derman & Andrew Melsheimer, *International Oil and Gas Companies Under Attack: Garnishment of Royalty Oil of Foreign Governments and Payments Owed to National Oil Companies*, TEX. TRANSNAT'L L. Q., Dec. 2006, at 1, *available at* http://www.ilstexas.org/ttlq/2006_December.pdf (elucidating the lack of property located in the United States through CMS Nomeco's argument); *cf.* Hal S. Scott, *Sovereign Debt Default: Cry for the United States, Not Argentina* 13 (Washington Legal Foundation, Working Paper No. 140, 2006) (establishing the court ruled on technical grounds and not on issues such as whether the agreement was, in fact, a loan).

251. *See supra,* Part IV.B.1; *see also* Derman & Melsheimer, *supra* note 59 (summarizing the application of both *FG Hemisphere* and *Af-Cap I, II*, and *III*).

252. *See* Derman & Melsheimer, *supra* note 250, at 3–4 (describing the many issues the Fifth Circuit failed to address); *see also* Derman & Melsheimer, *supra* note 59 (claiming the failure by the Fifth Circuit to provide guidance for future courts to be "unfortunate").

253. *See FG Hemisphere*, 455 F.3d at 593 (focusing on the location of the garnishees in describing the facts); *see also Af-Cap*, 383 F.3d at 365 n.2 (establishing the holding in *Af-Cap* that the situs is the United States).

254. *See* FSIA, 28 U.S.C. § 1610(a); *see also Em Ltd. v. Argentina*, 473 F.3d 463, 473 (2d Cir. 2007) (explaining subsection (a) is to be narrowly construed).

255. *See* Scott, *supra* note 250, at 13 (confirming that this interpretation will invite defendants to take advantage of the loophole to protect their property); *see also FG Hemisphere*, 455 F.3d at 593 (illustrating the properties' prior presence in the United States may not matter, depending on the court's situs determination).

256. *See supra*, Part III.

257. *See* Timothy B. Atkeson & Stephen D. Ramsey, *Proposed Amendment of the Foreign Sovereign Immunities Act: The Mathias Bill*, 79 AM. J. INT'L L. 770, 776 (1985) (suggesting a risk of foreign states removing assets from the jurisdiction of the court to avoid collection); *see also* William R. Dorsey III, *Reflections on the Foreign Sovereign Immunities Act After Twenty Years*, 28 J. MAR. L. & COM. 257, 270 (1997) (explaining how removing assets from the United States will thwart execution under FSIA); *see also* Larson, *supra* note 86, at 977–78 (indicating the likelihood that foreign states will remove their assets from the United States to avoid attachment).

258. *See* William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 VAND. L. REV. 1, 15 (2004) (observing that sovereigns in default will frustrate creditors by hiding assets); *see also* Larson, *supra* note 86, at 977 (recognizing that convincing a court to enforce a judgment against the country in which it sits is nearly impossible).

259. *See FG Hemisphere*, 455 F.3d at 595.

appears the court introduced the topic as another potential pitfall for FG Hemisphere, but it would not have affected the case, so the court did not rule on it.[260] Nevertheless, it could be another complicating factor for future application of the FSIA.

V. Success for Vulture Funds Spells Danger Domestically and Abroad

In both the *Af-Cap* cases and *FG Hemisphere*, the vulture funds were barred from attaching Congolese taxes and royalties.[261] However, a careful analysis of these cases shows factual and procedural nuances and technicalities were as important to the courts' holdings as their application of the FSIA.[262] These cases demonstrate a vulture fund *could* be successful if the necessary circumstances were in place; success would simply hinge on a vulture fund finding the correct set of circumstances. If vulture funds become successful in these types of cases, grave effects will follow for U.S. oil companies, the U.S. economy and businesses, and U.S. foreign policy, potentially affecting debt restructuring in all emerging markets.[263]

A. Effects on United States Oil Companies

U.S. oil companies are at the greatest risk if vulture fund litigation becomes successful. Congolese courts have already held that U.S. attachment orders would not be enforceable in the Congo.[264] Thus, CMS Nomeco, and any other American oil company,[265] would be forced to comply with its Congolese lifting contract.[266] In fact, "the Congo has expressed its intent, if necessary, to take the lifting by force."[267] As a result, U.S. oil companies would be forced to choose between two evils: 1) losing their current and future international oil concessions for failure to pay taxes and royalties[268] or 2) accepting a role as guarantors of defaulted sovereign

260. *Id.* (mentioning the possibility of oil as a tangible asset, but dismissing the issue because it was not presently before the court).

261. *See supra*, Part IV.A–B (explaining the variables responsible for the failure of both lawsuits).

262. *See supra*, Part IV.A–B (showing the cases might have resulted differently if the suits took place in another state or the foreign assets were moved prior to execution).

263. *See* Derman & Melsheimer, *supra* note 250, at 4 (describing the negative impact these vulture fund cases will have on business between foreign sovereign debtors and U.S. companies operating internationally); *see also* Wheeler & Attaran, *supra* note 9, at 254 (identifying the IMF and the U.S. Treasury Department among those who protest the disruptive effects of vulture fund litigation).

264. *See* Derman & Melsheimer, *supra* note 250, at 4 (citing a Congolese Court's decision rejecting the enforcement of a U.S. court order precluding CMS Nomeco from delivering its royalty oil to the Congo); Jim Landers, *Operators in Congo Squeezed by Debt Laden Nation, Vulture Funds*, DALLAS MORNING NEWS, June 5, 2006, *available at* http://www.wfaa.com/sharedcontent/dws/bus/columnists/jlanders/stories/DN-worldview_05bus.ART.State.Edition1.dd1ca01.html (reporting the Congolese courts have advised CMS Nomeco to ignore orders of U.S. courts by threat of imprisonment); *see also* Don Stowers, *Editor's Comment: Garnishment Threat Looms for Industry*, OIL & GAS FIN. J., June 2006, *available at* http://www.ogfj.com/display_article/256325/82/ARCHI/none/none/1/Editor's-Comment:-Garnishment-threat-looms-for-industry/.

265. Af-Cap also sued Chevron Oil Company in the Ninth Circuit. The court affirmed the district court's judgments dissolving and vacating garnishments and liens and dismissing the actions for execution. *See* Af-Cap, Inc. v. Chevron Overseas (Congo) Ltd., 475 F.3d 1080, 1094 (9th Cir. 2007).

266. *Id.*

267. Taylor, *supra* note 57, at 2. *See* Derman & Melsheimer, *supra* note 250, at 2 (noting the Congolese courts sanctioned the use of force to guarantee compliance with oil contracts).

268. *See* Derman & Melsheimer, *supra* note 250, at 4; Stowers, *supra* note 264.

debt, "thereby incurring double payments for [their] foreign contractual obligations."[269] Moreover, these two evils do not even take into account the hefty litigation costs for U.S. oil companies or the potential safety risks to oil company employees under a scenario where the Congo takes its lifting "by force."[270] The resulting scenario would put U.S. oil companies at a "serious competitive disadvantage when competing for concessions against non-U.S. companies."[271] Most of the countries competing with the United States do not have laws equivalent to the FSIA, making vulture fund litigation in these countries impossible.[272] U.S. competitors, such as China, would have a distinct advantage when bidding for oil projects, because the likelihood that these competing governments would ever order seizures similar to those in the vulture fund cases is extremely remote.[273] Consequently, U.S. competitors would not need to consider the expense of this business risk.[274] Vulture funds are currently "gobbling up" notes for delinquent debt in countries such as Angola, Nigeria, and Russia.[275] If the vulture funds become successful, the cost of doing business with those countries may prove to be too pricey for American oil companies to operate in any of these nations.[276] Eventually, energy sector firms may decide to relocate their headquarters permanently outside of the United States in order to remain competitive.[277]

B. Effects on the United States Economy and Businesses

The oil industry is not the only sector of the U.S. economy that would be affected by a successful vulture fund: "[A]ny US entity that has a business relationship or agreement with financial obligations to a sovereign nation that has defaulted on an unrelated debt could be forced to effectively assume financial responsibility for the debt of that sovereign nation."[278] As

269. Derman & Melsheimer, *supra* note 59, at 287.

270. *See* Derman & Melsheimer, *supra* note 250, at 4 (hypothesizing these decisions will nearly guarantee that U.S. oil companies operating abroad will be enmeshed in litigation to avoid being responsible for foreign debt); *see also* Wheeler & Attaran, *supra* note 9, at 254 (enumerating the disruptive effects of vulture fund litigation).

271. Derman & Melsheimer, *supra* note 250, at 4.

272. *See, e.g.*, Andrea Bianchi, *Ferrini v. Federal Republic of Germany*, 99 AM. J. INT'L L. 242, 242 (2005) (referring to Italy's lack of a foreign sovereign immunity statute).

273. *See* Terrence Murray & Matt Piotrowski, *Court Ruling Could Have Implications for U.S. Investment Overseas*, OIL DAILY, July 13, 2006, at 6; Stowers, *supra* note 264.

274. *See* Murray & Piotrowski, *supra* note 273, at 6 (concluding U.S. competitors will not have to face many of the same risks as U.S. companies).

275. *See* Mark A. Cymrot, *Barricades at the IMF: Creating a Municipal Bankruptcy Model for Foreign States*, 36 INT'L L. 1103, 1111 (2002) (illustrating the widespread existence of vulture funds); Stowers, *supra* note 264 (stating the vulture finds are becoming very popular throughout the world).

276. *See* Dittrick, *supra* note 55, at 26 (claiming U.S. companies may become involved in costly efforts brought about by creditors with sovereign debt); Stowers, *supra* note 264 (stating that the costs that may result may be too high for U.S. companies).

277. *See* M. Ray Perryman, *Risk, Return, Investment, and the Global Economy: Potential Obstacles to Sustainable Prosperity*, THE PERRYMAN GROUP REP., May 2006, at 19 (stating U.S. companies may have no choice but to relocate to another country in order to remain competitive).

278. Perryman, *supra* note 277, at 2 (discussing the risks involved with doing business with any foreign nation).

a result, U.S. businesses would be much more hesitant to invest in developing nations[279] or emerging markets[280] because of the high level of risk involved, and conversely, developing nations with distressed debt would avoid dealing with U.S. companies to avoid the risk that their property would be garnished by U.S. courts.[281] As the largest importer[282] of goods from developing nations in the world, the U.S. economy could suffer dramatically.[283]

Not only would future investment decline; existing ventures in developing nations or emerging markets would suddenly become liabilities.[284] Every U.S. business analyzes the risk and reward of a foreign venture.[285] For existing ventures, the vulture fund risk did not exist when the companies made their investment analyses.[286] All of a sudden, U.S. businesses would be faced with garnishment risks and costly litigation fees.[287] The resulting decrease in return or increase in risk to these firms could reduce the projected performance of their investments, adversely affecting their access to credit, thereby altering shareholder wealth, pension funds, and public sector revenues.[288]

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279. The World Bank classifies "developing nations" as those with a low gross national income per capita. Perryman, *supra* note 277, at 2. *See* S.W. O'Donnell, *Antitrust Subject Matter Jurisdiction Over State Owned Enterprises and the End of Prudential Prophylactic Judicial Doctrines*, 26 SUFFOLK TRANSNAT'L L. REV. 247, 272 (2003) (stating U.S. companies are less likely to do business with developing nations).

280. "Emerging markets" are typically countries that are restructuring their economies. Perryman, *supra* note 277, at 2. The following 26 countries have emerging market status: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, Turkey, and Venezuela. *See* Morgan Stanley Capital International, Inc., *Index Definitions*, *available at* http://www.msci.com/equity/indexdesc.html#EM (displaying statistical evidence of emerging market status in numerous countries).

281. *See* Owen L. Anderson, *Internal Energy Issue*, 29 HOUS. J. INT'L L. 271, 276 (2007) (warning that developing countries will think twice before doing business with U.S. companies); *see also* Maria Cecilia Andrade et al., *Energy and Natural Resources*, 41 INT'L LAW. 491, 495 (2007) (admitting U.S. companies will be affected significantly in operations abroad); *see also* Violeta I. Balan & Ashish S. Prasad, *Strategies for U.S. Companies to Mitigate Legal Risks from Doing Business in India*, 1587 PRACTISING L. INST. 9, 56 (2007) (attributing much of the hesitation by foreign countries to work with U.S. companies to section 1605(a)(2) of the FSIA).

282. The United States imported $604 billion of goods from developing countries in 2003. *See* Perryman, *supra* note 277, at 5.

283. *See* Jeff Nemerofsky, *Litvinov Lives? U.S. Investors May Be Playing Russian Roulette*, 8 MICH. ST. U. J. INT'L L. 487, 500 (1999) (discussing the enormous risk facing U.S. commerce); Perryman, *supra* note 277, at 2–5 (stressing the U.S. economy relies heavily on imports from developing nations worldwide).

284. *See* Perryman, *supra* note 277, at 11 (admonishing that foreign commercial relations may lead to financial injury).

285. *See id.*; *see also* Ian Bremmer, *Managing Risk in an Unstable World*, BUSINESS DAY (South Africa), June 27, 2005, at 2 (discussing risk analysis techniques often used by foreign investors).

286. *See* Perryman, *supra* note 277, at 11 (noting companies would not have made investments if vulture fund risks had existed at the time).

287. *See id.*

288. *See id.*; *see also* Tony Van Alphen, *Deutsche Bank's Stelco Rescue Would Give It Half; Holders Told They Won't Be Shut Out, Would be Granted Stock Warrants*, TORONTO STAR, Nov. 16, 2004, at D01 (acknowledging the great effect vulture funds can have on pension funds); Aaron Elstein, *Vultures Heed Birdcall Feast on Cheap Stakes in Private Equity Funds*, CRAIN'S N.Y. BUS., Oct. 27, 2003, at 3 (reiterating the negative impact upon pension funds).

C. Effect on U.S. Foreign Policy

Successful vulture fund litigation would affect U.S. Foreign Policy in at least two ways. First, interference with a sovereign's internal contracts by a U.S. court order could inevitably lead to tension between the United States and that country.[289] Second, successful vulture fund litigation could eliminate alternative sources of natural resources for the U.S., increasing U.S. dependence on the Middle East.[290] In 2005, 21 percent of U.S. imported crude oil came from Africa—much of that from U.S. ventures in sub-Saharan Africa.[291] Currently, Africa is estimated to have 10 percent of the world's oil reserves.[292] American oil companies also have oil ventures in developing nations in Latin America.[293] If U.S. ventures in Africa and Latin America were eliminated because of the financial infeasibility created by vulture funds, the U.S. could find itself entirely at the mercy of OPEC.[294]

D. Effect on Debt Restructuring in Emerging Markets

Developing countries are extremely dependent on external capital for economic development and the alleviation of poverty.[295] The United States has been at the forefront of implementing initiatives to assist developing nations to restructure their debt.[296] Programs such as the IMF's Highly Indebted Poor Countries Initiative (HIPC) provide assistance to developing nations.[297] Upon the nation's completion of a poverty-reduction plan and the organization of its government accounting records, the HIPC provides that nation with a permanent source of

289. *See* Jean-Marc Golier, *Monetary Institutions in an Evolving World*, 55 BUFF. L. REV. 613, 613 (2007) (commenting that successful vulture funds litigation has caused a decrease in global harmony); Perryman, *supra* note 277, at 13 (claiming successful vulture fund litigation could lead to tension between the United States and foreign countries).

290. *See* Perryman, *supra* note 277, at 13–14.

291. *See* Morgan Stanley Capital International, Inc., *Index Definitions*, *available at* http://www.msci.com/equity/indexdesc.html#EM; *Africa Tops Mideast as U.S. Crude Source, Helped by Market Changes,* INT'L HERALD TRIB., Feb. 21, 2007, *available at* http://www.iht.com/articles/ap/2007/02/21/business/NA-FIN-US-Oil-Imports.php (stating Africa accounts for 22 percent of U.S. crude imports).

292. *See* ENERGY INFO. ADMIN., *World Proved Reserves of Oil and Natural Gas, Most Recent Estimates, available at* http://www.eia.doe.gov/emeu/inter national/reserves.html (2007) (listing the world's oil reserves).

293. *See* Perryman, *supra* note 277, at 14; *Africa Tops Mideast as U.S. Crude Source, Helped by Market Changes, supra* note 291 (explaining the United States imports crude oil from Latin American countries); *see also* Juan Forero, *China's Oil Diplomacy in Latin America*, N.Y. TIMES, Mar. 1, 2005, at C1 (showing Venezuela is a major source for American oil companies).

294. *See Africa Tops Mideast as U.S. Crude Source, Helped by Market Changes, supra* note 291 (pointing out the United States is dependent on oil from Africa and Latin America).

295. *See* Dale Furnish et al., *Trade and Finance Prospects for the Developing Nations in the 1980s*, 76 AM. SOC'Y INT'L L. PROC. 206, 224 (1982); Perryman, *supra* note 277, at 15; *see also* Forero, *supra* note 293 (concluding the sale of crude oil oftentimes leads countries from poverty to development).

296. *See* Richard Euliss, *The Feasibility of the IMF's Sovereign Debt Restructuring Mechanism: An Alternative Statutory Approach to Mollify American Reservations*, 19 AM. U. INT'L L. REV. 107, 109–10 (2003) (discussing the U.S. debt relief plans for developing countries); Perryman, *supra* note 277, at 18 (admitting that the United States has been assisting developing nations to restructure their debt).

297. *See* Korinna Horta, *Rhetoric and Reality: Human Rights and the World Bank*, 15 HARV. HUM. RTS. J. 227, 242 (2002); *see also* International Monetary Fund*, A Fact Sheet: Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative*, Dec. 2006, *available at* http://www.imf.org/external/np/exr/facts/hipc.htm (outlining the purposes and functions of the HIPC).

funding.[298] However, if successful, vulture funds would undermine these initiatives by "running to U.S. courts rather than cooperat[ing] with [these] international debt restructuring initiatives."[299]

The relationship between the Congo and the IMF is especially important. In March 2006, the IMF finally approved the Congo for participation in the HIPC.[300] Under the terms of the HIPC, the Congo began receiving interim debt relief from certain creditors,[301] "but had to address serious concerns about governance and financial transparency in order to qualify for irrevocable debt relief at the completion point."[302] The Congo committed to:

> 1) bringing the internal controls and accounting system of the state-owned oil company (SNPC) up to internationally recognized standards;
>
> 2) preventing conflicts of interests in the marketing of oil;
>
> 3) requiring officials of SNPC to publicly declare and divest any interests in companies having a business relationship with SNPC; and
>
> 4) implementing an anti-corruption action plan with international support, monitored by The World Banks's International Development Association and the IMF.[303]

With vulture funds implementing U.S. attachment orders, all of these goals would be adversely affected.[304] Therefore, vulture funds would be a major obstruction in the Congo's ability to comply with the IMF standards.[305]

VI. Revisions Are Needed in the FSIA to Prevent Vulture Funds from Succeeding

In its current form, the FSIA leaves open the possibility that a vulture fund could successfully attach financial obligations owed by a U.S. business to a foreign sovereign in order to satisfy *unrelated* defaulted debts of that sovereign.[306] The FSIA should be revised to prevent that

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298. *See* Balakrishnan Rajagopal, *From Resistance to Renewal: The Third World, Social Movements, and the Expansion of International Institutions*, 41 HARV. INT'L L. J. 529, 571 (2000).

299. Threattooil.com, *Major Threat to U.S. Oil Industry*, *available at* http.//www.threattoil.com/index.html.

300. *See* International Monetary Fund, *Republic of Congo Reaches Decision Point Under the Enhanced HIPC Debt Relief Initiative*, Mar. 9, 2006, *available at* http://www.imf.org/external/pubs/ft/scr/2006/cr06148.pdf (approving the Congo as eligible for the HIPC); Eric A. Friedman, New Development, *Debt Relief in 1999: Only One Step on a Long Journey*, 3 YALE HUM. RTS. & DEV. L. J. 191, 193 (2000).

301. *See Republic of Congo Reaches Decision Point Under the Enhanced HIPC Debt Relief Initiative*, *supra* note 300.

302. *Republic of Congo Reaches Decision Point Under the Enhanced HIPC Debt Relief Initiative*, *supra* note 300.

303. *Id*.

304. *See generally* Wheeler & Attaran, *supra* note 9, at 280 (discussing U.S. policy regarding vulture fund litigation).

305. *See* Bratton & Gulati, *supra* note 258, at 34 (remarking on the IMF's proposal to deal with the enforcement of vulture funds); *see also* Fisch & Gentile, *supra* note 7, at 1089–90 (remarking that bondholders, of vulture funds in particular, are not susceptible to IMF pressure).

306. *See supra*, Part IV (describing the gain in vulture fund cases).

unrelated attachment from occurring.[307] A revision of the FSIA would prevent the myriad problems[308] that successful vulture fund litigation could cause. Using legislative means to remedy the vulture fund threat may be considered a bold move.[309] After debunking counter-arguments to a proposed revision, however, comparing the FSIA with the UK State Immunity Act and analyzing proposed FSIA revisions, this legislation would appear to be not only effective, but essential.[310]

A. Counterarguments Debunked

1. The FSIA Revision Is Not a Revolutionary Endeavor

A revision of the FSIA is not an entirely new concept; it would merely codify practices already utilized by some courts, much like the codification of the FSIA relative to the Tate Letter. The Supreme Court has held that federal courts have the inherent ability to stay lawsuits if proceeding with that lawsuit would cause overly deleterious effects to a nation's ability to perform its sovereign acts.[311] Following that line of reasoning, in *Pravin Banker Associates Ltd. v. Banco Popular del Peru*,[312] the Second Circuit Court of Appeals approved the district court's stay of a lawsuit brought by a creditor against the Peruvian government because the lawsuit would have disrupted Peru's economic adjustment plan.[313] In another case, the Southern District of New York vacated an attachment against Liberia's maritime trust fund, finding "the order was not necessary to secure the final judgment but had inflicted and could continue to inflict 'harsh consequences . . . on the people of Liberia.'"[314] These cases demonstrate the public policy interest in allowing a country to perform its sovereign acts.[315] These cases were very

307. *See* Joan E. Donoghue, *Taking the "Sovereign" Out of the Foreign Sovereign Immunities Act: A Fundamental Approach to the Commercial Activity Exception*, 17 YALE J. INT'L L. 489, 552 (1992) (discussing the problems of FSIA with respect to the United States including immune transactions). *See generally* Steven H. Thomas, Note, *Two Faces of the Trader: Guidelines for Distinguishing between Governmental and Commercial Acts under the Foreign Sovereign Immunities Act of 1976*, 23 TEX. INT'L L.J. 465, 465–68 (1988) (analyzing the weaknesses of FSIA).

308. *See supra*, Part V (discussing the likelihood of financial risk in the United States and internationally because of the success of vulture funds).

309. *See* James W. Bowers, *Groping and Coping in the Shadow of Murphy's Law: Bankruptcy Theory and the Elementary Economics of Failure*, 88 MICH. L. REV. 2097, 2097 (1990) (noting the changes that new legislation would bring to vulture funds and their success); *see also* Wheeler & Attaran, *supra* note 9, at 263 (discussing the need for litigation with respect to vulture funds).

310. *See* Stephen C. McCaffrey, *The Thirty-fifth Session of the International Law Commission*, 78 AM. J. INT'L L. 457, 465 (1984) (detailing the differences between the UK State Immunity Act and the FSIA).

311. *See* Landis v. North American Co., 299 U.S. 248, 254 (1936); *see also* Bratton & Gulati, *supra* note 258, at 35 (noting a stay would allow a sovereign to act without incurring cost).

312. 109 F.3d 850 (2d Cir. 1997).

313. *Id*. at 854.

314. *See* Andrew N. Vollmer et al., *Reforming the Foreign Sovereign Immunities Act*, 40 COLUM. J. TRANSNAT'L L. 489, 529–31 (2002) (quoting Meridien Int'l Bank Ltd. v. Govt. of Republic of Liberia, No. 92 Civ. 7039, 1996 WL 22338 (1996)).

315. *See Pravin*, 109 F.3d at 854 (concluding that the stay favors public policy); *see also Meridien Int'l Bank*, No. 92 Civ. 7039, 1996 WL 22338 (1996) (recognizing the public policy considerations involved in allowing countries to act on their own behalf).

unique, however.[316] If vulture fund litigation were to become successful, U.S. courts could face an onslaught of new cases.[317] U.S. Courts should not be put in a position of making judgment calls about the economic viability of a foreign country every time a vulture fund case comes along.[318]

2. FSIA Revision Would Not Affect the Enforceability of Contracts

U.S. bankruptcy law balances the interests of creditors and private debtors.[319] There is no such structure in international law.[320] Therefore, vulture funds have taken advantage of this free-for-all by purchasing decades-old debt and hoping to obtain a windfall through litigation in American courts.[321] While a revision of the FSIA would not go nearly so far as implementing an international scheme of bankruptcy law, it would provide some needed balance between the rights of creditors and the rights of sovereigns with defaulted debts.[322]

A revision to the FSIA preventing the type of vulture fund litigation witnessed in *Af-Cap* and *FG Hemisphere* would be beneficial because the revision would be targeted at a very specific type of debt. As a result, the revision would not affect the general enforceability of a contract.[323] These vulture funds are not normal debts.[324] Both *Af-Cap* and *FG Hemisphere* bought debts that were decades old for pennies on the dollar and attempted to collect in a manner never anticipated by any party to the original agreements.[325] Had either of these funds never

316. *See* Michael D. Ramsey, *Acts of State and Federal Sovereign Obligations*, 39 HARV. INT'L L.J. 1, 99 n.356 (1998) (detailing situations where sovereign immunity and public policy might not overlap).

317. In *Connecticut Bank of Commerce,* the court's rationale for parsing the FSIA to such an intense degree was that "confiscating funds [by using a vulture fund] that are being put immediately to some sovereign use interrupts a sovereign's public acts." *Connecticut Bank of Commerce v. Republic of Congo*, 309 F.3d 240, 253 (5th Cir. 2002). *See* Fisch & Gentile, *supra* note 7, at 1045–46 (discussing the "unprecedented amount of litigation" vulture funds might bring).

318. *See* Brenneman, *supra* note 12, at 664–66 (remarking that U.S. courts ordinarily defer to foreign proceedings).

319. *See* William T. Bodoh & Lawrence P. Dempsey, *Bankruptcy Reform: An Orderly Development of Public Policy*, 49 CLEV. ST. L. REV. 191, 193 (2001) (acknowledging Congress carefully drafted the bankruptcy laws to balance the rights of creditors and debtors).

320. *See* Liza Perkins, Note, *A Defense of Pure Universalism in Cross-Border Corporate Insolvencies*, 32 N.Y.U. J. INT'L L. & POL. 787, 788 (2000) (discussing the lack of balance between creditors and debtors in international bankruptcy law).

321. *See* John C. Coffee, Jr. & William A. Klein, *Bondholder Coercion: The Problem of Constrained Choice in Debt Tender Offers and Recapitalizations,* 58 U. CHI. L. REV. 1207, 1214 (1991) (illustrating how vulture funds invest in distressed bonds, buying them at a fraction of their face amount in anticipation of a restructuring).

322. *See* John H. Chun, *"Post-Modern" Sovereign Debt Crisis: Did Mexico Need an International Bankruptcy Forum?*, 64 FORDHAM L. REV. 2647, 2700 (1996) (arguing that an amendment to the FSIA could help to resolve disputes between sovereign debtors and creditors); *see also* Vollmer, *supra* n. 314. 489, 529–31 (discussing that an amendment to the FSIA would help to minimize the potential harm to sovereigns with defaulted debts).

323. *See* Brenneman, *supra* note 12, at 664–66 (noting that courts tend to side with vulture funds and holdout litigation will continue to be a problem for sovereign debt restructurings unless a suitable solution is found). *But see* Fisch & Gentile, *supra* note 7, at 1044–47 (asserting the benefits of holdout vulture fund litigation).

324. *See* Bratton, *supra* note 13, at 823–32 (explaining that a vulture fund purchases debt at a deep discount after the onset of distress looking for spectacular short term returns).

325. *See* Kurt S. Abraham, *CMS Nomeco Acquired by Britain's Perenco,* EUROMONEY INSTITUTIONAL INVESTOR, July 1, 2006; Dittrick, *supra* note 55.

purchased the debt, they would be no worse off because they were never an original party to the debt.[326] An FSIA revision can prevent an enormous risk while having virtually no impact on the enforceability of the original contract.[327]

3. Prohibition of Vulture Fund Litigation Would Not Increase Loan Defaulting Among Developing Countries

The Congo is by no means an innocent victim when it comes to its defaulted debt.[328] In fact, a case in front of the UK High Court in 2005 uncovered the Congo's elaborate scheme to hide portions of its oil revenues from attachment in a shell company named Sphynx Bermuda.[329] However, an FSIA revision preventing vulture fund litigation would not cause the Congo or other developing nations to suddenly feel free to default on their loans because the risk of litigation in U.S. courts has disappeared.[330] The only way these developing nations will achieve a sustainable economy is through participation in international debt reduction initiatives such as the HIPC.[331] The IMF is not blind to these evasive accounting techniques either.[332] The Congo failed to receive assistance a number of times before finally being cleared in 2006.[333] In the end, the trade-off that would allow decades-old defaulted debt to tempo-

326. *See Congo Evades Creditor's Attempt to Recover on Judgment*, *supra* note 211, at 9 (stating Af-Cap, Inc. was the sixth owner of the original judgment obtained against the Congo for its default).

327. *See* Morrissey, *supra* note 65, at 703 (demonstrating how a revised FSIA would treat sovereigns like private parties when and if they behave like them). *But see* Vanessa A. Wernicke, *The "Retroactive" Application of the Foreign Sovereign Immunities Act in Recovering Nazi Looted Art,* 72 U. CIN. L. REV. 1103, 1125 (2004) (suggesting that applying the FSIA in a commercial transaction to events taking place before its enactment could alter a contract between defendant nations and the plaintiff).

328. *See supra*, Part II.A; Jim Landers, *Oil Firms May Pay Double to Stay Put: Operators in Congo Squeezed by Debt-Laden Nation, Vulture Funds*, DALLAS MORNING NEWS, May 5, 2006, at A1 (revealing the Congolese national oil company has moved oil revenue through dummy companies to avoid obligations to the vulture funds); *see also* Taylor, *supra* note 57, at A1 (commenting on the Congo's sophisticated program of fraudulent conveyances and transactions).

329. *See* Kensington Int'l Ltd v. Republic of the Congo, 2005 EWHC, 2006 2 BCLC 296 (Commercial Court 2005); *see also Congo Oil Trading Scandal Implicates Top Government Officials,* GLOBAL WITNESS, Dec. 13, 2005, at A1, *available at* http://www.globalwitness.org/media_library_detail.php/409/en/congo_oil_trading_scandal_implicates_top_governmen.

330. Charles D. Schmerler of the NEW YORK LAW JOURNAL wrote in 2005 that, depending on the outcome of vulture fund litigation, "[e]ither sovereign debtors will learn that they are free to default without the threat of litigation, or creditors will see that an effective judicial remedy exists." Charles D. Schmerler, *Defaulted Sovereign Debt? Litigate It!,* NEW YORK LAW JOURNAL, Feb. 22, 2005, at A1.

331. *See supra*, Part V.D.

332. *See* Barbara Crutchfield George et al., *The 1998 OECD Convention: An Impetus for Worldwide Changes in Attitudes Toward Corruption in Business Transactions,* 37 AM. BUS. L.J. 485, 520 (2000) (noting a primary focus of the IMF is to control fraud and corruption in the projects it finances); *see also* Dino Mahtani, *Donor Partners Face Dilemma as Congo Heads for Meltdown*, FIN. TIMES (London), Nov. 27, 2006, at A1 (revealing that due to Congo's government missing targets on economic discipline, the IMF suspended the Congo from its program).

333. *See Congolese Shun Own Currency for Dollars*, AFX NEWS, Nov. 10, 2006, at A1 (stating how the IMF refused to renew the backing of Congo's monetary policy because the country had not reined in corruption); *see also* IMF, *Republic of Congo: First Review Under the Poverty Reduction and Growth Facility, and Requests for Waiver of Performance Criteria and Modification of Performance Criterion*, Aug. 25, 2005, at 70, *available at* http://www.imf.org/external/pubs/ft/scr/2005/cr05301.pdf. (examining the IMF report on the poverty reduction and growth facility in the Republic of Congo).

rarily remain unsatisfied in order to prevent harmful effects on the economies of the U.S. and developing nations seems logical.[334]

B. A Comparison of the FSIA and the UK State Immunity Act of 1978

The British equivalent to the FSIA is the State Immunity Act of 1978.[335] While the State Immunity Act has its own faults, it is useful to compare another country's version of a law enacted to serve the same purpose as the FSIA when drafting revisions of the FSIA.[336] The United Kingdom's attitudes toward sovereign immunity followed a timeline similar to that of the United States.[337] Absolute sovereign immunity was applied for most of the 19th century and into the 20th century.[338] In a case similar to the *Schooner Exchange v. McFaddon*,[339] British courts upheld the sovereign immunity of Spain in *Compania Naviera Vascongado v. S.S. Cristina*.[340] After the Spanish government had requisitioned all ships registered at the port of Bilbao, the *Cristina* pulled into port at Cardiff.[341] At that time, the Spanish consul located in Cardiff took possession of the ship.[342] When the owners of the *Cristina* attempted to sue the government of Spain for the return of the ship, the British court held that the Spanish government was immune from suit.[343]

Shortly after the Crown Proceedings Act of 1947, which abolished domestic sovereign immunity in the United Kingdom, the absolute immunity of foreign states from suit in the

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334. *See* Peter Eigen, *Fighting Corruption in a Global Economy: Transparency Initiatives in the Oil and Gas Industry,* 29 HOUS. J. INT'L L. 327, 354 (2007) (reporting the IMF agreed to cancel $2.9 billion of the Congo's debt if the Congo fulfilled several obligations to reduce its high poverty levels).

335. *See* State Immunity Act of 1978, 10 Halsbury's Stats. 641 (1985), 17 I.L.M. 1123 (1978).

336. *See* ELIHU LAUTERPACHT, INTERNATIONAL LAW REPORTS 569 (1989) (asserting the purpose of the State Immunity Act, like the FSIA, is to grant immunity from execution over a foreign state's policy); *see also* INTERNATIONAL MONETARY FUND LEGAL DEPT., IMF INSTITUTE, CURRENT DEVELOPMENT IN MONETARY AND FINANCIAL LAW 453 (2005) (declaring the FSIA and the State Immunity Act are the most comprehensive statutory approaches to central bank immunity).

337. *See* Phillip A.D. Hurst et al., *Minimising Political Risk: Preserving Your Bargain and Enforcing Your Rights*, 44A RMMLF-INST 1B (1997). *See generally* Ronald L. Ohren et al., *Recent Developments in International Law*, 42 TORT TRIAL & INS. PRAC. L.J. 595, 591 (2007) (describing the three-part development of sovereign immunity doctrine in the United States); Joseph W. Dellapenna, *Foreign State Immunity in Europe*, 5 N.Y. INT'L L. REV. 51, 52 (1992) (recounting the historical development of sovereign immunity in the United Kingdom).

338. *See* Ernesto Hernandez-Lopez, *International Migration and Sovereignty Reinterpretation in Mexico*, 43 CAL. W. L. REV. 203, 212 n.28 (2006) (describing the development of the non-intervention doctrine in the 19th century); *see also* Avi Lew, *Republic of Argentina v. Weltover, Inc.: Interpreting the Foreign Sovereign Immunity Act's Commercial Activity Exception to Jurisdictional Immunity,* 17 FORDHAM INT'L L.J. 726, 731–32 (1994) (claiming the United States moved away from its traditional "absolute sovereignty" stance in the 20th century).

339. 11 U.S. 116, 136 (1812).

340. Ll. L. Rep. 47, 49 (1937).

341. *Id.* at 48.

342. *Id.*

343. *Id.*

United Kingdom was also eliminated.[344] Thereafter, a number of cases[345] further challenged foreign state immunity in British courts and in 1978, the British Parliament passed the State Immunity Act.[346]

Like the FSIA, the British State Immunity Act provides a presumption of immunity unless the action falls under one of its exceptions.[347] The core of the State Immunity Act closely resembles the FSIA.[348] However, there are a few differences.[349] A major difference is that the British act gives a clearer definition of "commercial transaction":[350]

> (a) any contract for the supply of goods or services;
>
> (b) any loan or other transaction for the provision of finance and any guaranty of indemnity in respect of any such transaction or of any other financial obligation; and
>
> (c) any other transaction or activity (whether of a commercial, industrial, financial, professional or other similar character) into which a State enters or in which it engages otherwise than in the exercise of sovereign authority.[351]

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344. *See* Dellapenna, *supra* note 337, at 52 (signaling that the Crown Proceedings Act of 1947 started the retreat from absolute immunity); *see also* James E. Pfander, *Government Accountability in Europe: A Comparative Assessment*, 35 GEO. WASH. INT'L L. REV. 611, 616 (2003) (stating the Crown Proceedings Act of 1947 made the Crown subject to the same liability for tort as that to which a private person would be subject).

345. *See, e.g.*, Rahimtoola v. Nizam of Hyderabad, A.C. 379, 399–400 (1958) (stating the Court of Appeals' decision that Pakistan had no claim was too narrow); Thai-Europe Tapioca Service Ltd. v. Government of Pakistan, 1 Lloyd's Rep. 1, 5–6 (1976) (upholding Pakistan's sovereign immunity claim and remarking that Karachi was the proper forum for the case to be heard); *see also* Tedtex Trading Corp. v. Central Bank of Nigeria, 1 Lloyd's Rep. 581, 587 (1954) (stating when a foreign government claims that its property interest will be affected in a trial to which it is not a party, it must show the court that its claim is not illusory).

346. *See* State Immunity Act 1978, ch. 33, *reprinted in* 10 Halsbury's Stats. 830 (4th ed. 1985) (stating the State Immunities Act was passed in 1978 to create a new law with respect to proceedings against foreign states in the United Kingdom).

347. *See* State Immunity Act, 10 Halsbury's Stats. at 830–31; *see also* Reinhard Von Hennigs, *European Convention on State Immunity and Other International Aspects of Sovereign Immunity*, 9 WILLAMETTE J. INT'L DISP. RESOl. 185, 189–90 (2001) (listing the various exceptions to the general rule of state immunity).

348. *See* Georges R. Delaume *The State Immunity Act of the United Kingdom*, 73 AM. J. INT'L L. 185, 186 (1979) (averring the State Immunity Act and the FSIA both restate the principle of sovereign immunity and subject those principles to various exceptions).

349. *See* Georges R. Delaume, *The Foreign Sovereign Immunities Act and Public Debt Litigation: Some Fifteen Years Later*, 88 AM. J. INT'L L. 257, 274 n.96 (1994) (remarking the two statutes differ regarding authority to consent to a waiver of immunity); *see also* Amber Fitzgerald, *The Pinochet Case: Head of State Immunity Within the United States*, 22 WHITTIER L. REV. 987, 1010 (2001) (arguing the biggest contrast between the FSIA and the State Immunities Act is that the FSIA does not refer to foreign heads of state, while the State Immunities Act includes such persons in its definition of a foreign state).

350. *See generally* Michael D. Smith, *Executing Judgments Against "Mixed" Commercial and Non-Commercial Embassy Bank Accounts in the United States: Where Sovereign and Diplomatic Immunities Clash*, 10 U. PA. J. INT'L BUS. L. 707, § 3.2 n.132 (1998) (stating that under the State Immunities Act, the head of a mission's certificate showing that property is not being used for commercial purposes sufficiently proves that fact unless contrary evidence is offered).

351. State Immunity Act, 1978, ch. 33, *reprinted in* 10 Halsbury's Stats. 832.

Another major difference between the FSIA and the State Immunity Act is that the State Immunity Act is not applied nearly as often as the FSIA.[352] In his law review article, Joseph M. Dellapenna asserts that the FSIA is relatively ambiguous.[353] As a result many of the court decisions become somewhat politicized.[354] He then distinguishes the UK State Immunity Act, stating that the act "adopts a shopping list that defines the non-immunity of foreign states in fairly precise terms."[355]

On the other end of the spectrum, however, that lack of discretion under the UK State Immunity Act in politically sensitive cases has caused problems for British courts.[356] Therefore, a hybrid statute incorporating parts of both the FSIA and the UK State Immunity Act may be the most effective way to eliminate the threat of vulture fund litigation.[357]

C. The Revisions

All legislation goes through a large amount of drafting and redrafting, so this article will not attempt to propose any new language for the FSIA. It will propose some ideas of what will make a revision to the FSIA barring vulture fund litigation effective. First, the revision should appear in section 1605 of the FSIA. It is essential vulture fund litigation be stopped at the jurisdiction level instead of the execution level. If not, companies would still incur costly litigation in vulture fund cases in the process of reaching the execution stage.[358] Second, if the revised language is located in section 1605, it will most likely appear as "an exception to the exceptions."[359] For instance, it could appear as section 1605(a)(2)(A) stating, "[B]ut if the damage liability arises from a vulture fund, jurisdiction will be barred." It will be important to create a

352. *See* Dellapenna, *supra* note 337, at 52 (stating British courts have confronted far fewer cases raising issues under the State Immunity Act as compared to the United States under the FSIA); *see also* Delaume, *supra* note 348, at 1083–84 (claiming because the British State Immunities Act is more specific than the FSIA, it has achieved greater certainty in litigation than the FSIA).

353. Dellapenna, *supra* note 337, at 61–62.

354. *Id*.

355. *Id.* at 62.

356. *See* Dellapenna, *supra* note 337, at 52 (explaining the law of absolute immunity for foreign sovereigns was argued in British courts). *But see* C. L. Lim, *Singapore Crimes Abroad*, 2001 SING. J. LEGAL STUD. 494, 527 (2001) (demonstrating British courts maintain some discretion through their interpretation of the statute).

357. *See* Dellapenna, *supra* note 337, at 62 (showing problems exist in both the United States and the British sovereign immunity laws). *But see* Anna Gelpern, *What Iraq and Argentina Might Learn from Each Other*, 6 CHI. J. INT'L L. 391, 400 (2005) (proposing that regardless of what certain countries' laws may, be the United Nations could be the greatest tool in foreign sovereign cases).

358. *See generally* Harvey L. Temkin, *When Does the "Fat Lady" Sing?: An Analysis of "Agreements in Principle" in Corporate Acquisitions*, 55 FORDHAM L. REV. 125, 163 (1986) (itemizing the various costs parties incur during litigation).

359. *See* FSIA, 28 U.S.C. § 1605 (stating multiple situations when a foreign state shall not be immune for jurisdiction; currently there are no "exceptions to these exceptions").

presumption that vulture funds are barred, and then either create an exception for "legitimate business endeavors"[360] or leave it to the court's discretion.[361]

Defining both "vulture fund" and "legitimate business endeavor" will be the most difficult part of the revision process.[362] An advantage and a disadvantage of the FSIA is that it is open to a large measure of interpretation by U.S. courts.[363] It is an advantage because it can be interpreted to apply to many circumstances, but it is a disadvantage because too much ambiguity leads courts to confusion and inconsistent results.[364] Vulture funds are a very specific problem.[365] Therefore, when it is drafted, it is essential that the language used to prevent vulture fund litigation be very specific as well.[366]

VII. Conclusion

The American system of government was designed to be able to identify problems with the law and to provide reasonable methods by which those problems can be resolved. Though the American system is generally believed by most Americans to be firmly planted on the moral high ground, and though the vulture fund litigation problem is easily cast as born out of a cheap-shot at those receiving an "underhanded" windfall, a revision of the FSIA should not be seen as a moral reawakening aimed at ending greed and corruption in the world. Instead, a revision of the FSIA should be taken as a sign of the American form of government working smoothly to prevent the practices of vulture funds, which are a threat to the U.S. economy and emerging markets around the world. Now that the problem has been identified, it can solved. While vulture funds may be a clever investment scheme, the collection efforts discussed in this article—including efforts to garnish taxes and royalty payments intended for debt-laden third world governments—should not be allowed to succeed because of the negative impacts these efforts would cause.

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360. Many may consider vulture funds as "legitimate business endeavors." However, the purpose of this revision is to prevent the negative impacts vulture fund litigation could create and not to subject anyone to a certain moral business standard. As a result, all of this language would need to be analyzed carefully and phrases used in this article should not be taken as proposals for language in an FSIA revision. *See generally* Joseph P. Hildebrandt, *Regulation of Real Estate Securities*, 698 CORP. L. & PRAC. COURSE HANDBOOK SERIES 239, 285–86 (1990) (listing various elements that could be present in a "legitimate business endeavor").

361. *See* John F. Decker, *Overbreadth Outside the First Amendment*, 34 N.M. L. REV. 53, 96 (2004) (showing that the New York Supreme Court sees an illegitimate business endeavor as one that us a "pernicious practice").

362. *See* Wilson Parker, *At-Will Employment and the Common Law: A Modest Proposal to De-marginalize Employment Law*, 81 IOWA L. REV. 347, 376 (1995) (stating a legitimate business endeavor is something that has a "logical relationship" to the person's business).

363. *See* FSIA, 28 U.S.C. § 1602 (highlighting the courts' broad discretion in cases dealing with foreign states). *But see* H.R. REP. NO. 94-1487 at 14 (1976) *reprinted in* 1976 U.S.C.C.A.N. 6604, 6613 (insisting on the "restrictive theory" of sovereign immunity).

364. *See* Andrew Loewenstein, *The Foreign Sovereign Immunities Act and Corporate Subsidies of Agencies or Instrumentalities of Foreign States*, 19 BERKLEY J. INT'L L. 350, 379 (2001) (commenting the courts have actually found it very difficult to interpret the FSIA).

365. *See* Coffee & Klein, *supra* note 321, at 1207 (explaining how bankruptcy law has had a difficult time deterring vulture funds from operating).

366. *See* Wheeler & Attaran, *supra* note 9, at 281 (suggesting that to create a "clear and predicable" process the law must become more predicable and specific). *See generally* FRANK J. FABOZZI, THE HANDBOOK OF FIXED INCOME SECURITIES 463 (2005) (discussing the specificity required to prevent holdout litigation).

The Federal Reserve and European Central Bank as Lenders-of-Last-Resort: Different Needles in Their Compasses

Steven R. Blau*

I. Introduction

Early morning on Friday, September 14, 2007, concerned depositors lined up outside the London branch of UK bank Northern Rock, a mere 100 meters from the Bank of England, after it became public that the Bank of England was providing Northern Rock with a dedicated liquidity facility to "secure an orderly resolution to its current liquidity problems."[1] So began the first bank run England had seen in 140 years.[2]

Northern Rock was once a sparkling success story, but the seeds of its success were the seeds of its downfall.[3] A small building society a decade prior, Northern Rock grew to become Great Britain's fifth-largest mortgage provider.[4] It pulled off that stunning feat, however, by fully embracing the new "originate and distribute" approach to banking.[5] In other words, rather than keeping the loans it made on its books, Northern Rock, like many other banks, preferred to repackage those loans into bonds, and sold those bonds, known as collateralized debt obligations (CDOs), to investors.[6]

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1. *See* Tom Braithwaite, *Customers Line Up to Withdraw Funds*, FIN. TIMES (London), Sept. 14, 2007, http://www.ft.com/cms/s/0/29682764-629d-11dc-b3ad-0000779fd2ac.html; Press Release, HM Treasury, Bank of England, and Fin. Services Authority, Liquidity Support Facility for Northern Rock PLC (Sept. 14, 2007), *available at* http://www.bankofengland.co.uk/publications/news/ 2007/090.htm.

2. *See* Chris Tighe, *Troubles Come Home to Staff in the North-east*, FIN. TIMES (London), Nov. 22, 2007, at 19.

3. *See* Mark Ritson, *Northern Rock Has Eroded Its Equity*, MARKETING, Sept. 19, 2007, at 25 (arguing Northern Rock was a victim of its own success); *see also Northern Rock: Lessons of the Fall*, ECONOMIST (U.S.), Oct. 20, 2007, at 11 (analyzing the causes of the economic downturn that prompted the failure of Northern Rock).

4. *See* Ann Lawlor, *Rocky Road Ahead*, FIN. ADVISER, Sept. 27, 2007 (characterizing Northern Rock as a successful and well-established lender prior to the sub-prime mortgage crisis); *see also* Clinton Manning, *Your Money: Solid as a Rock*, MIRROR (London), Jan. 25, 2007, at 53 (revealing profits for the UK's fifth largest lender equaled £627 billion).

5. *See* Peter Keonig et al., *How Time Ran Out for Mr. Brash: The Fall of Northern Rock, Part Three*, DAILY TELEGRAPH (London), Nov. 26, 2007, at 4 (establishing Northern Rock used the "originate and distribute" scheme on a larger scale than most banks).

6. *See* Gillian Tett, *Regulators Start Rethinking Their Rules on Banks*, FIN. TIMES (London), Sept. 20, 2007, at 13 (defining the "originate and distribute" scheme as one where a bank makes loans, then sells the loans to capital market investors); *see also* John G. Walsh, Office of the Comptroller of the Currency Chief of Staff, *Remarks at the Mossavar-Rahmani Ctr. for Bus. and Gov't* (Oct. 27, 2007) in CONG. Q (2007) (illuminating the implications of the "originate and distribute" practice for banks).

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Northern Rock differed from other banks, however, in the extent to which it came to rely on that market funding, rather than the more costly, but more stable, retail deposits: over 40 percent of its funding derived from CDOs.[7] On August 9, 2007, there was a complete failure of all the market funding sources Northern Rock had come to rely on, as financial markets realized the credit risk inherent in both CDOs and the vehicles that held or relied on them.[8] On August 13, Northern Rock informed Britain's Financial Services Authority that it was in trouble.[9]

When Northern Rock was in urgent need of liquidity, the Bank of England provided it, carrying out the traditional role of a central bank as a lender-of-last-resort (LOLR).[10] On September 14, 2007, the Bank of England publicly announced the creation of a dedicated liquidity

7. *See Lex Column: Rock Bottom*, FIN. TIMES (London), Sept. 16, 2007, at 16 (claiming that Northern Rock used wholesale market securitization for 43 percent of its funding). *But see* Peter Thal Larsen, *N. Rock Denies Subprime Risk*, FIN. TIMES (London), Aug. 21, 2007, at 16 (quoting Northern Rock's statement to investors that CDOs constituted only 0.25 percent of its total assets).

8. *See* Howard Schneider, *Markets Shudder at Central Bank Bailout of Major British Lender*, WASH. POST, Sept. 15, 2007, at D02 (noting the losses investment firms suffered as a result of defaults in the mortgage markets); *see also Irish Banks Less Exposed to Risk*, IRISH TIMES, Sept. 21, 2007, at 5 (naming the U.S. mortgage crisis as the cause of turmoil in the world securitization market).

9. *Northern Rock: Lessons of the Fall*, *supra* note 3, at 11. The problem with CDOs began in late 2005 when defaults on sub-prime mortgages, the asset backing many CDOs, began to increase. *See Timeline: Sub-Prime Problems*, BBC NEWS, Aug. 31, 2007, http://news.bbc.co.uk/2/hi/business/6945672.stm (outlining events leading to the credit crisis). Investors began to refuse to buy either CDOs or the commercial paper funding the Structured Investment Vehicles (SIVs) that distributed them for banks. *See Northern Rock: Lessons of the Fall*, *supra* note 3, at 11 (stating markets dried up). In June 2007, Moody's, a rating agency, cut the ratings of 131 securities backed by subprime mortgages and committed to review the grades of 136 others. *See CSI: Credit Crunch*, ECONOMIST, Oct. 20, 2007, at 89. IKB Deutsche Industriebank, a German lender, had to be rescued because of its exposure to American mortgages, and then in early August, BNP Paribas announced it was suspending withdrawals from funds invested in illiquid credit securities. *See A Liquidity Squeeze: Bankers' Mistrust*, ECONOMIST, Aug. 18, 2007, at 33; *see also Timeline: Sub-prime Problems*, BBC NEWS, Aug. 31, 2007, at http://news.bbc.co.uk/2/hi/business/6945672.stm (describing the near-failure of the German bank). On August 8, overnight interbank rates in the Eurozone (the rate at which banks make overnight, uncollateralized loans to each other, which is a benchmark interest rate) spiked to 4.6 percent, having been close to the European Central Bank's 4 percent target before. *See CSI: Credit Crunch*, ECONOMIST, Oct. 20, 2007, at 89. Those interbank rates spiked because banks were reluctant to lend to each other due to the uncertainty of which banks might prove bad credit risks. These banks had good cause to hoard their own cash, fearing they might have to rescue their own troubled SIVs or bring their subsidiaries' assets back to their balance sheets. *See id.* "[T]he banks deserted each other," as the ECONOMIST put it; they were hoarding their liquidity. *Id.* Sachsen LB, east Germany's first (and last) Landesbank, is a case study in how banks used off-balance sheet entities (so-called conduits or structured investment vehicles) to hold their CDOs. *See* Gerrit Wiesmann & Ivar Simensen, *Saxon Klaxon: Warnings Behind the Bailout of a Heedless Bank*, FIN. TIMES (London), Nov. 23, 2007, at 9. To be able to buy more CDOs than its low capitalization allowed, Sachsen LB used off-balance sheet subsidiaries called conduits. *See id.* These conduits borrowed money by issuing commercial paper. *See id.* Sachsen LB bet that the difference between the cost of borrowing and the interest flowing from the CDOs would bring a reliable profit, but that model crashed when investors, worried about the number of U.S. homeowners unable to service their loans, stopped lending to the funds that owned the bonds. *See id.* Within days, Sachsen LB was forced to assume billions of dollars in assets it had never been able to afford. *See id.*

10. *See* Kim Murphy, *Mortgages: Major British Lender Gets Help*, L.A. TIMES, Sept. 15, 2007, at C1 (reporting the Bank of England provided Northern Rock with an emergency loan).

support facility for Northern Rock.[11] Such an announcement was in line with the March 2006 memorandum of understanding issued by HM Treasury, the Financial Services Authority (FSA), and the Bank of England,[12] which delineated the three entities' roles in a financial crisis.[13] The memorandum stated, in pertinent part:

> In exceptional circumstances there may be a need for an operation which goes beyond the Bank [of England]'s published framework for operations in the money market. Such a support operation is expected to happen very rarely and would normally only be undertaken in the case of a genuine threat to the stability of the financial system [and] to avoid a serious disturbance in the UK economy.[14]

Six weeks after the creation of the facility, Northern Rock had borrowed over £21 billion from it.[15]

But what if the troubled bank, instead of being a relatively local UK lender, was one of the two- or three-dozen pan-European banking groups?[16] Since 2000, cross-border mergers and acquisitions (M&A) among Eurozone banks have skyrocketed.[17] In 2005, the European Central Bank ("ECB") found that there were 33 banking groups with significant cross-border activity, which accounted for 53 percent of total euro-area banking assets.[18] Moreover, 16 of the 33

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11. Press Release, HM Treasury, Bank of England, and Fin. Services Authority, Liquidity Support Facility for Northern Rock PLC (Sept. 14, 2007) *available at* http://www.bankofengland.co.uk/publications/news/2007/090.htm.

12. *See* Memorandum of Understanding between HM Treasury, the Financial Services Authority, and the Bank of England, *available at* http://www.bankofengland.co.uk/publications/news/2006/037.htm (undertaking the responsibility for ensuring stability in the financial system); *see also* Chris Giles & George Parker, *King to Face Questions Over Darling,* FIN. TIMES (London), Dec. 18, 2007, at 2 (suggesting HM Treasury, the Bank of England, and the FSA were responsible for bailing out financial institutions).

13. *See Bank's Role Key to Economic Stability*, BIRMINGHAM POST, Sept. 15, 2007, at 3 (claiming the memorandum of understanding between the Bank, the Treasury, and the FSA required the Bank to step in in the event of a crisis); *see also* Peter Thal Larsen, *Treasury, Bank and FSA Set Out Crisis Roles, Emergency Planning*, FIN. TIMES (London), Mar. 23, 2006, at 10 (relating the responsibilities of each financial institution in the event of a crisis as enumerated in the memorandum of understanding).

14. Memorandum of Understanding, *supra* note 12.

15. *See* Scheherazade Daneshkhu, *Credit Squeeze: Rock Borrowing Rises to Pounds 21bn*, FIN. TIMES (UK), Oct. 26, 2007, at 3.

16. *See Financial Catch-Up: EU Integration Requires Convergence Among Supervisors*, FIN. TIMES (Asia), Dec. 6, 2007, at 10 (noting while the Northern Rock crisis affected only Europe on a local level, it would have been more severe had it been a cross-border bank).

17. *See* Wim Fonteyne, *EU: From Monetary to Financial Union: Overcoming the Remaining Hurdles to Financial Integration in Europe*, FIN. & DEV., June 1, 2006, ¶ 9 (arguing many cross-border mergers and acquisitions have been successful and are increasing). In 2005–2006 cross-border M&A rose to 38 percent of total bank M&A in the Eurozone. For example, in 2006 Credit Agricole of France acquired Emporiki of Greece for €3.3 billion, and BNP Paribas of France acquired Banca Nazionale di Lavoro of Italy for €10 billion. *See Financial Integration in Europe*, EUR. CENT. BANK, Mar. 2007, at 35, *available at* http://www.ecb.int/pub/pdf/other/financialintegrationineurope200703en.pdf.

18. *See Financial Integration in Europe*, *supra* note 17, at 35; *see also* Wolfgang Munchau, Comment, *Cross-Border Banks Require a Single Regulator*, FIN. TIMES (UK), Apr. 2, 2007, ¶ 6.

groups were active in at least half of the Eurozone nations.[19] That explosion of pan-European banking has created grave questions as to who would stabilize such a group if one were in liquidity trouble. As Europe's central bank, one might expect the ECB to step in and act like the Bank of England did for Northern Rock.[20]

Indeed, in the two major banking crises that occurred since the ECB's 1998 establishment—the liquidity crisis that arose after September 11, 2001, and the credit crisis that began in August 2007—the ECB and U.S. Federal Reserve (the Fed) have acted quite similarly, and the Federal Reserve clearly has LOLR statutory authority.[21] The Fed and the ECB are the world's two main central banks, a position derived from their leadership of the world's two largest economies and two most important currencies.[22] On September 11, 2001, with banks largely unable to send payments to each other—due to the malfunction of telephone switching equipment in Lower Manhattan, the evacuation of buildings housing large banks' payments operations, and the suspension of air delivery of checks—liquidity shortages developed at many banks, as expected payments did not arrive, and those banks in turn began to hoard their liquidity.[23]

Unless bank confidence was restored, the payments system, which is the lifeblood of economic activity, would seize up. When no one else would lend to banks, the Fed and the ECB did, and in a massive manner.[24] On September 11 itself, both the Fed and ECB issued press

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19. *Financial Integration in Europe*, *supra* note 17, at 35; Jean-Claude Trichet, President, Eur. Cent. Bank, Keynote Address at CEBS Conference in London: Toward the Review of the Lamfalussy Approach: Market Developments, Supervisory Challenges and Institutional Arrangements (May 9, 2007), *available at* http://www.ecb.int/press/key/date/2007/html/sp070509.en.html.

20. *See* Tony Barber, *EU Adopts Flexible Stance on Bank Crises*, FIN. TIMES. (UK), Sept. 17, 2007, at 8 (noting European Central Bank officials were discussing plans to prepare for a Pan-European bank crisis similar to the one that hit Northern Rock); *see also* John Griffith-Jones, *Greed, Fear, Risk*, WORLD TODAY, Jan. 1, 2008, at 17 (stating the European Central Bank, similarly to the Bank of England in its rescue of Northern Rock, made $95 billion available to banks during the August 2007 credit crunch).

21. *See* George K. Walker, *The Lawfulness of Operation Enduring Freedom's Self-Defense Responses*, 47 VAL. U. L. REV. 489, 497 (2003) (noting the Federal Reserve and the European Central Bank injected $120 billion into money markets on September 13, 2001); *see, e.g.*, Pub. L. No. 73-1, § 403, 48 Stat. 1, 7 (codified as amended at 12 U.S.C. § 347c (2000))

22. *See Northern Rock: Lessons of the Fall*, *supra* note 3, at 11 (stating the world's two main central banks are the Federal Reserve and the European Central Bank).

23. *See* Christine M. Cumming, *September 11 and the U.S. Payment System: What Lessons Can We Draw from September 11 to Help Us Safeguard the Financial System Against Possible Future Disasters?*, FIN. & DEV., Mar. 11, 2002, at 20 (noting the attacks caused a disruption of communications in Lower Manhattan and consequently, liquidity imbalances); James J. McAndrews & Simon M. Potter, *Liquidity Effects of the Events of September 11, 2001*, 8 ECON. POL'Y REV. 59, 59–60 (2002), *available at* http://www.newyorkfed.org/esearch/epr/02v08n2/0211mcan.pdf (stating the attacks caused severe disruptions to the U.S. banking system).

24. *See* Walker, *supra* note 21, at 497 (explaining the Federal Reserve and the European Central Bank injected $120 billion into money markets in the two days following September 11, 2001).

releases stating that they stood ready to provide liquidity to markets.[25] On September 12 alone, the Fed injected over $80 billion of liquidity into the banking system via open-market operations and the discount window,[26] and the ECB conducted an unscheduled "fine-tuning operation" lending €69.3 billion to credit institutions.[27]

In early August 2007, banks again began to hoard their cash as investors became skittish about the value of CDOs, which in turn led to a quick spike in overnight interbank loan rates.[28] As the ECB put it, "On the morning of 9 August a dislocation of the money market took place, characterised by a very small trading volume and a sudden increase in short-term money market rates.[29] Or, in the words of the *Economist*, "[T]he banks deserted each other."[30] The Fed and ECB once again lent to banks when no one else would.

On August 9, the ECB carried out an unscheduled liquidity injection of €94.8 billion, lending funds to any Eurozone bank that asked for it.[31] On August 10, it injected €11.1 billion in another unscheduled operation.[32] On August 13, the ECB lent €47.7 billion in an unscheduled operation, and in a regularly scheduled operation, the ECB injected €73.5 billion more than the published benchmark amount.[33] The Fed's injections were a bit more muted. On

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25. *See* Press Release, European Cent. Bank, Eurosystem to Support Normal Functioning of Markets (Sept. 11, 2001), *available at* http://www.ecb.int/press/pr/date/2001/html/pr0 10911.en.html (stating the Eurosystem was ready to support regular market functioning, including liquidity needs, in response to September 11); *see also* Press Release, Fed. Reserve Sys., Federal Reserve Is Open and Operating (Sept. 11, 2001), *available at* http://www.federalreserve.gov/BoardDocs/Press/general/2001/20010911/default.htm (acknowledging the Federal Reserve System and the discount window were functioning to meet liquidity needs).

26. The Federal Reserve's use of open-market operations and the discount window are discussed in depth *infra* at notes 83–142 and accompanying text. See Federal Reserve Bank of Philadelphia, *2001 Annual Report* 6 (2001), *available at* http://www.philadelphiafed.org/publicaffairs/annualreport/2001/ar01sept11.pdf (outlining the Federal Reserve's response to the September 11 crisis, including the use of open-market operations and the discount window, discussed in notes 18–141).

27. *See* EUROPEAN CENTRAL BANK, MONTHLY BULLETIN: OCTOBER 2001, 13 (2001), *available at* http://www.ecb.int/pub/pdf/mobu/mb200110en.pdf (detailing the European Central Bank's response to September 11 to promote normal functioning of international markets).

28. *See* Danny Fortson, *ECB Injects Euro 98bn but Markets Are Gripped by Panic: Global Sell-Off Continues*, THE INDEPENDENT (London), Aug. 10, 2007, ¶ 3 (emphasizing the overnight spike in interbank loan rates threatened the stability of Europe's financial system); *see also* Ambrose Evans-Pritchard, *Analysis: Stock Market Crash—Confidence Buckles as Rates Rocket*, THE DAILY TELEGRAPH (London), Aug. 10, 2007, ¶ 3 (reporting the spike in overnight rates surged to an unheard of 62 points).

29. *See* EUROPEAN CENTRAL BANK, MONTHLY BULLETIN: SEPTEMBER 2007, 30 (2007), *available at* http://www.ecb.int/pub/pdf/mobu/mb200110en.pdf (ECB Bulletin: Sept. 2007).

30. *CSI: Credit Crunch*, *supra* note 9, at 89.

31. *See* ECB BULLETIN: SEPT. 2007, *supra* note 29, at 32; *see also Update: ECB Injects _95bn into Money Markets to Smooth Squeeze*, MARKET NEWS INT'L (London), Aug. 9, 2007, at ¶1 (noting the overnight injection of liquidity was the first emergency action of its kind since the September 2001 response).

32. *See* ECB BULLETIN: SEPT. 2007, *supra* note 29, at 32.

33. *See id*; *see also ECB Injects Another 48 Billion Euros to Stabilize Market*, XINHAU GEN. NEWS SERV. (Berlin), Aug. 13, 2007, at ¶1 (noting the continued liquidity injections' purpose was to ease fears about the U.S. mortgage crisis).

August 9, the Federal Reserve's Open Market Trading Desk (the Desk)[34] carried out open-market operations, injecting $24 billion into the U.S. system which, by one analyst's estimation, was $9 billion more than the Fed's normal injection in the course of achieving its interbank rate target.[35] On August 10, the Desk was in the market three times and injected a total of $38 billion.[36] Furthermore, the Fed announced its discount window would accept mortgage bonds, the very securities in which the markets had no faith, as collateral for loans to banks.[37] Two weeks later, the U.S.'s four biggest banks—Citigroup, Bank of America, JP Morgan, and Wachovia—announced they had each borrowed $500 million from the discount window.[38]

One *Wall Street Journal* article noted "[t]he Fed and the ECB [have been] playing the traditional role of central banks as lenders of last resort. . . ."[39] Indeed, as the above-described crises illustrate, the Fed and ECB have become the world's most important lenders-of-last-resort. But just because the Fed and ECB acted similarly after September 11 and during the 2007 credit crunch does not mean the two central banks have identical LOLR authority.[40]

The Fed, after all, was established in 1913 with the express purpose of stabilizing the banking system, came to be assigned the mission of safeguarding the American economy, and has clear and express statutory authority to lend to banks for the sake of their stabilization.[41] The ECB, on the other hand, was created essentially as the guardian of the new unified European currency and as the implementer of monetary policy.[42] Banking supervision remains the

34. As elaborated upon below, the Federal Reserve System increases bankers' reserves in two main ways: open-market operations and "discount-window" lending. Open-market operations are conducted by the New York Fed, and involve the Fed conducting transactions with securities dealers. Those transactions indirectly increase banks' reserves, because the dealers deposit the proceeds of their transactions in clearinghouse banks. Conversely, discount-window lending is direct lending to banks on a collateralized basis. See Michael Wade Strong, *Rethinking the Federal Reserve System: A Monetarist Plan for a More Constitutional System of Central Banking*, 34 IND. L. REV. 371, 381 (2001) (explaining when the Federal Reserve buys securities, the issued check increases the reserves at the seller's bank, thereby increasing the money available for lending).

35. *See* Greg Ip and Joellen Perry, *Credit Turmoil Tests Central Banks: As Market Losses Spread, Policy Makers Grapple with Hard-Line Stance*, WALL ST. J., Aug 11, 2007, at B3 (commenting that although the move by the Fed was aggressive, it was less so than the actions taken right after September 11, 2001).

36. *See* Deborah Lynn Blumberg & Anusha Shrivastava, *Treasurys Gain Moderately in Calm After the Fed's Move*, WALL ST. J., Aug. 11, 2007, at B3.

37. *See* John Authers, *Comment and Analysis: The Plumber Must Stem the Panic as the Water Rises*, FIN. TIMES (UK), Aug. 11, 2007, at 9 (acknowledging the Fed accepted mortgage bonds as collateral).

38. *See* Eric Dash, *Four Major Banks Tap Federal Reserve for Financing*, N.Y. TIMES, Aug. 23, 2007, at C10.

39. David Wessel, *Central Banks Scale Back Cash Injections*, WALL ST. J., Aug. 14, 2007, at A3.

40. *See generally* Ambrose Evans-Pritchard & Ben Bland, *ECB Injects Emergency Funds for the First Time Since 9/11*, TELEGRAPH MEDIA GROUP, Sept. 8, 2007, http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2007/08/09/bcnecb109.xml (revealing both the Fed and the ECB injected funds into their respective economies).

41. *See infra* notes 50–55, 100.

42. *See infra* notes 129–145; *see also* Ralph Atkins & Mark Schiertz, *Europe: ECB Warns Finance Ministers It Will Retain Sole Control of Euro*, FIN. TIMES (UK), Sept. 27, 2004 (describing the ECB as the guardian of the euro); Ralph Atkins & Norma Cohen, *ECB Steels Itself for a Leap Outside the Realm of Rates*, FIN. TIMES (UK), Apr 16, 2007 (stressing the ECB is the pure monetary guardian).

purview of the National Central Banks of the Eurozone Member States.[43] The ECB clearly has the authority to provide banks with liquidity, but it is not clear if it is has the authority to do so as an end in itself—the quintessence of an LOLR operation—or merely as a means of carrying out its monetary policy.[44] As ECB President Jean-Claude Trichet noted, inflation is the sole "needle in our compass."[45]

The ECB's authority, or lack thereof, to act as LOLR depends upon the nature of the liquidity crisis. If that crisis is a payments system lock-up, such as the one that occurred after September 11, 2001, the ECB has clear authority to act as LOLR, because it is expressly authorized to conduct credit operations for the purpose of ensuring the smooth function of payment systems.[46] In a generalized liquidity dry-up, such as the one that began in August 2007, the question of whether or not the ECB has the authority to act as LOLR is academic,[47] as the tools used for LOLR operations would likely be the same as those normally used for monetary policy operations, and the true LOLR purpose of the operation would therefore be hidden.[48] The question really becomes, could the ECB have acted as the Bank of England did with Northern Rock? Could it create a dedicated liquidity support facility clearly designed to lend to a bank for the sake of keeping it liquid, a facility outside any published framework for monetary policy operations?[49]

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43. *See infra* notes 175–183; Klaus C. Engelen, *Central Bank Losers: The Inside Story of How the ECB and the Bundesbank Are Being Pushed Aside as Financial Regulators*, THE INTERNATIONAL ECONOMY, Summer 2002 (reporting that within the European Union, Central Banks still share power in banking supervision); *Commentary: Europe's Costly Surplus of Central Bankers*, Bus. WK. ONLINE, Jan. 21, 2002, http://www.businessweek.com/magazine/content/02_03/b3766140.htm?chan=search (affirming the National Central Banks supervise the local banks).

44. Modern central banks carry out their monetary policy by providing liquidity to or absorbing liquidity from banks, as those adjustments affect the rates at which banks lend to each other, which in turn impact the money supply. As the FINANCIAL TIMES noted, "[Banks] are the medium through which central bank policy is transmitted to the rest of the economy." Editorial, *Bank of England Buys Insurance*, FIN. TIMES, Dec. 7, 2007.

45. Ralph Atkins, *ECB Keeps Rates on Hold Amid Tough Talk*, FIN. TIMES (UK), Dec. 7, 2007, at 5.

46. *See* The Statute of the European System of Central Banks and of the European Central Bank, Art. 3.1 (1992), *available at* http://www.ecb.int/ecb/legal/pdf/en_protocol_18.pdf ("ESCB Statute"). *See e.g.*, Pub. L. No. 73-1, § 403, 48 Stat. 1, 7 (codified as amended at 12 U.S.C. § 347c (2000)

47. *See* Cynthia Crawford Lichtenstein, *The Fed's New Model of Supervision for "Large Complex Banking Organizations": Coordinated Risk-Based Supervision of Financial Multinationals for International Financial Stability*, 18 TRANSNAT'L LAW 283, 287 (2005) (alleging the European Central Bank does not have clear LOLR authority); Laura Shea, *Deposit Protection in the European Economic Community*, 17 B.C. INT'L & COMP. L. REV. 33, 44 (1994) (arguing the European Central Bank is denied the right to act as an LOLR).

48. The operations would be indistinguishable because central bank monetary policy operations typically work through massaging interbank markets, as the FINANCIAL TIMES noted, "[T]hey are the medium through which central bank policy is transmitted to the rest of the economy." *Editorial, Bank of England Buys Insurance*, FIN. TIMES (U.S.), Dec. 7, 2007; Christos Hadjiemmanuil, *European Monetary Union, the European System of Central Banks, and Banking Supervision: A Neglected Aspect of the Maastricht Treaty*, 5 TUL. J. INT'L & COMP. L. 105, 125 (1997) (comparing the lender of last resort function to that of banking supervision).

49. *See Liquidity Support Facility for Northern Rock Plc*, FIN. SERV. ORG., Sept. 14, 2007, *available at* http://www.fsa.gov.uk/pages/Library/Communication/Statements/2007/northern.shtml (explaining the authorization by the UK government for the Bank of England to provide liquidity support to Northern Rock).

This article concludes that although the ECB's authority for such a facility is ambiguous, sources for such an authority can indeed be found without resorting to legal acrobatics. Thus, the ultimate question becomes, is it good policy for the ECB, Europe's central bank but one without any supervisory function over Eurozone banks, to act as European LOLR?

Part II of this article examines the historical impetus for the founding of the Fed, its institutional architecture and competencies, and the source and nature of its LOLR powers. Part III examines the ECB in a similar manner. Part IV analyzes whether the ECB should act as European LOLR. Part V is the author's conclusion.

II. The U.S. Federal Reserve as Lender-of-Last-Resort

A. Origins and Institutional Architecture of the Federal Reserve

The failure of the U.S. banking system to provide sufficient funding to troubled depository institutions, especially during the bank panic of 1907, prompted Congress to establish the National Monetary Commission, which in turn put forth proposals for an institution that would help prevent and contain such financial disruptions.[50] The Federal Reserve Act (the 1913 FRA) was signed into law by President Woodrow Wilson on December 23, 1913,[51] and the Federal Reserve System began operations in November 1914.[52]

The 1913 FRA stated the Federal Reserve System was established "to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."[53] The 1913 FRA did not assign any macroeconomic goals to the Federal Reserve System,[54] perhaps because the *raison d'être* of the FRA was to stabilize the U.S. banking system.[55] Further legislation, however, has supplemented the 1913 FRA, giving the Federal Reserve System not only additional powers

50. *See* BOARD OF GOVERNORS, THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS 1–2 (2005), *available at* http://www.federalreserve.gov/pf/pdf/pf_complete.pdf (establishing the crisis of 1907 caused Congress to create the Commission); *see also* Milton Friedman, *An Essay in Petitio Principii*, 52 AM. ECON. REV. 291, 291–92 (1962) (claiming the bank crisis "crystallized" the creation of the Commission).

51. Federal Reserve Act of 1913, Pub. L. No. 63-43, 38 Stat. 351 (codified as amended by sections of 12 U.S.C.) ("Federal Reserve Act of 1913").

52. *See* DONALD R. WELLS, THE FEDERAL RESERVE SYSTEM: A HISTORY 21 (2004).

53. Federal Reserve Act of 1913, *supra* note 51.

54. The closest the 1913 FRA comes to stating a macroeconomic goal is the preamble's notion of furnishing a "more elastic currency." *See* Federal Reserve Act of 1913, *supra* note 51. *See* also Patricia S. Pollard, *A Look Inside Two Central Banks: The European Central Bank and the Federal Reserve*, 85 FED. RES. BANK OF ST. LOUIS REV. 11, 11 n.4 (2003) *available at* http://research.stlouisfed.org/publications/review/03/ 01/Pollard.pdf (positing a lack of macroeconomic goals in the 1913 Act); Governor Kevin Warsh, Speech at the New York State Economic Association Conference, n.4 (showing macroeconomic goals were introduced for the first time in 1977).

55. *See* Federal Reserve Act of 1913, *supra* note 51; Governor Kevin Warsh, *supra* note 54, at n.4 (stating the driving force of the Federal Reserve was financial instability).

but also expressly assigning it broad macroeconomic objectives.[56] In particular, the Federal Reserve Reform Act of 1977 charged the Federal Reserve System with adjusting monetary and credit conditions "commensurate with the economy's long-run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates."[57]

The Federal Reserve System is a federal system, composed of a central governmental agency—the Board of Governors—in Washington, D.C.,[58] as well as 12 regional Federal Reserve Banks.[59] The regional Reserve Banks are the operating arms of the System, given that the Board of Governors is not a bank.[60] For instance, direct lending to banks (i.e., discount-window lending) is carried out by the regional Reserve Banks, the lending rates of which are proposed by the regional Reserve Banks but which are subject to the approval of the Board of Governors.[61] The Federal Reserve's open-market operations, the principal tool by which it implements monetary policy,[62] are formulated by the Federal Open Market Committee—composed of the seven members of the Board of Governors and five of the 12 Reserve Bank presidents—and carried out by the "Open Market Trading Desk" at the Federal Reserve Bank of New York.[63]

In addition to the Federal Reserve System's responsibilities for formulating and implementing monetary policy, it also supervises and regulates banking institutions, unlike the

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56. Key laws affecting the Federal Reserve include the Banking Act of 1935; the Employment Act of 1946; the Bank Holding Company Act of 1956 and the amendments of 1970; the International Banking Act of 1978; the Full Employment and Balanced Growth Act of 1978; the Depository Institutions Deregulation and Monetary Control Act of 1980; the Financial Institutions Reform, Recovery, and Enforcement Act of 1989; the Federal Deposit Insurance Corporation Improvement Act of 1991; the Gramm-Leach-Bliley Act of 1999; the Employment Act of 1946; the Federal Reserve Reform Act of 1977; and the Full Employment and Balanced Growth Act of 1978. BOARD OF GOVERNORS, *supra* note 50, at 1–2.

57. Federal Reserve Reform Act of 1977, Pub. L. No. 95-188, §2(a), 91 Stat. 1387 (codified as amended by 12 U.S.C. § 225(a) (2000)). Moreover, the Employment Act of 1946 required the federal government to "promote maximum employment, production, and purchasing power." Employment Act of 1946, Pub. L. No. 79-304, § 2, 60 Stat. 23, 23 (codified at 15 U.S.C. § 1021(a) (2000)). Although the Employment Act did not expressly mention the Federal Reserve, it was interpreted as applying to it. *See* Pollard, *supra* note 54, at 20 n.24 (positing the application of the Employment Act to the Federal Reserve).

58. The Board of Governors is composed of seven members, appointed by the President of the United States and confirmed by the Senate, and whose terms of office last 14 years. BOARD OF GOVERNORS, *supra* note 50, at 1–2. The Board of Governors is supported by a staff in Washington, D.C., numbering around 1,800 as of 2004. *Id.*

59. *Id.*

60. *See id.* at 10 (indicating the Fed operates primarily through regional banks subject to congressional oversight).

61. *See* 12 U.S.C.A. § 357 (authorizing Reserve Banks to establish discount rates subject to approval of the Board of Governors); *see also* BOARD OF GOVERNORS, *supra* note 50, at 11 (explaining regional boards propose interest rates to the Board of Governors).

62. *See* Fed. Open Market Comm. of Fed. Reserve System v. Merrill, 443 U.S. 340, 343 (1979) (declaring open-market operations to be the most important monetary policymaking tool); Strong, *supra* note 34, at 380 (citing open-market operations as the Federal Reserve Board's most important tool in creating policy).

63. BOARD OF GOVERNORS, *supra* note 50, at 11, 37. *See* also Kathleen J. Woody, The International Economic Implications of Deregulating the U.S. Banking Industry, 31 AM. U. L. REV. 25, 49 (1981) (explaining the Federal Reserve Board buys or sells treasury notes, bills, or bonds based on recommendations of the Open Market Trading Desk).

ECB.[64] Bank supervision refers to the monitoring, inspecting and examining of banking organizations to assess their condition and compliance with relevant laws and regulations.[65] The Board of Governors has supervisory responsibilities for state-chartered banks that are members of the Federal Reserve System, bank holding companies (companies that control banks), the foreign activities of member banks, the U.S. activities of foreign banks, and the Edge Act and agreement corporations (limited-purpose institutions that engage in a foreign banking business).[66] Bank regulation, on the other hand, entails issuing regulations and guidelines that govern the operations, activities, and acquisitions of banking organizations.[67]

B. The Authority for the Federal Reserve to Act as LOLR and the Means by Which It Does

The Federal Reserve System typically provides liquidity to banks—the essence of a LOLR operation—via two instruments: the discount-window and open-market operations (OMOs).[68] After 9/11 and during the 2007 credit crunch, the Federal Reserve used massive open-market operations to get money to banks when banks were essentially unwilling to pay or lend to each other.[69] As for the discount window, given the stigma associated with borrowing

64. BOARD OF GOVERNORS, *supra* note 50, at 4. *See* Dr. Rosa M. Lastra, *The Governance Structure for Financial Regulation and Supervision in Europe*, 10 COLUM. J. EUR. L. 49, 56 (2003) (identifying bank regulation as a nonbasic function of the ECB).

65. *See* 12 U.S.C.A. § 248 (enumerating the various powers of the Board of Governors); BOARD OF GOVERNORS, *supra* note 50, at 59 (listing the various functions involved in bank regulation).

66. BOARD OF GOVERNORS, *supra* note 50, at 4. *See also* 25 NO. 6 BANKING & FIN. SERVICES POL'Y REP. 12, 24 (2006) (illustrating the Federal Reserve Board's supervisory capacity over the institutions by requiring their compliance with the Bank Secrecy Act).

67. *See* BOARD OF GOVERNORS, *supra* note 50, at 60 (reviewing the various ways in which banks may be regulated).

68. *See* Pollard, *supra* note 54, at 20.

69. As noted above, on September 12, 2001, the Federal Reserve injected over $80 billion of liquidity into the banking system via open-market operations. On August 9, 2007, the Federal Reserve used OMOs to inject $24 billion into the U.S. system, and on August 10 it repeated OMOs to the tune of $38 billion. *See* Federal Reserve Bank of Philadelphia, *supra* note 26, at 6 (reporting the injection of over $38 billion through open-market operations into the U.S. money market the day after the September 11 attacks); Ip & Perry, *supra* note 35, at A3 (announcing that on August 10, 2007, the Federal Reserve injected $24 billion into the U.S. money market in response to tensions in the European money market).

from it[70] the Federal Reserve does not publicize the institutions that have come to the window.[71] The Federal Reserve does, however, publish statistics about the volume of discount-window lending.[72] For example, in the week ending September 5, 2001, the Federal Reserve Banks extended an average of $21 million per day in discount-window loans, whereas on September 13 alone the Fed extended $45.5 billion in discount-window credit.[73]

This section examines the Fed's statutory authority for its open-market operations and discount-window lending. That authority differs from that of the ECB, in that the Fed's statutory authority is remarkably specific about the form those operations must take,[74] and also in

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70. The stigma derives from a perception that banks turned to the discount window only if other banks refused to lend to them, which would provoke market concerns about their financial condition. James A. Clouse, *Recent Developments in Discount Window Policy*, 80 FED. RES. BULL. 965, 965 (1994). If anything, that stigma was reinforced when the public announcement that Northern Rock had borrowed from the Bank of England led to a depositors' panic and bank run. Willem Buiter, Blog, *Why Didn't the Bank of England Adopt the Discount Window Rule Book of the Fed or the ECB?*, Sept. 20, 2007, http://blogs.ft.com/mavereco n/2007/09/why-didnt-the-b.html. Bank of England Governor Mervyn King testified before Parliament that the Market Abuse Directive, which came into force in England in 2005 as required by the European Union, prevented the facility from being conducted covertly. Anatole Kaletsky, *Brown in the Hot Seat over Northern Rock Advice*, THE TIMES (London), Sept. 24, 2007, at 40, *available at* http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article2517920.ece.

    The stigma is somewhat anachronistic, as on January 9, 2003, the Federal Reserve switched to its current system, which opens the discount window at a penalty rate, from its old system whereby discount-window lending was actually conducted below the federal funds rate. *See* BOARD OF GOVERNORS, *supra* note 50, at 45. Under the old system, the Federal Reserve needed to discourage discount-window borrowing except as a last resort, so the stigma was somewhat helpful; under the new system, which brings the Federal Reserve in line with the ECB's system, the above-market rate of discount-window lending is disincentive enough. *See id*. In an effort to reduce the anachronistic stigma associated with the discount window, which undermines the window's ability to promote financial stability and set a ceiling on interest rates, several major banks, at the prodding of the Fed, came to the discount window in August 2007, borrowing $500 million each and, more importantly, publicly announcing that they did. Dash, *supra* note 38, at C10. All four banks announced, however, they could borrow money more cheaply elsewhere, and all said they had "substantial liquidity," thus indicating the stigma continues. *See id*. That same day, Deutsche Bank confirmed it had borrowed from the discount window on Friday, August 17. *Id.*

71. There are often only rumors as to which institutions have used the discount window. Gillian Garcia notes there is uncertainty whether there was discount-window lending during the 1987 crash. On the one hand, total discount-window lending did increase during the relevant time period, but in Garcia's conversations with Fed officials, they stressed the Federal Reserve did not use discount-window lending during the crash. Garcia speculates those denials might mean the Fed did not lend directly to any broker, dealer, customer, or clearing corporation during the crash. Garcia also notes similar rumors circulated in 1980 during the silver crisis that the Fed had bailed out Prudential Bache. Gillian Garcia, *The Lender of Last Resort in the Wake of the Crash*, 79 AM. ECON. REV. 151, 151–52 (1989); *See* also Dash, *supra* note 38, at C10 (describing the stigma that is involved with borrowing money from a lender of last resort).

72. *See* Fed. Res. Stat. Release, http://www.federalreserve.gov/releases/h41/; Arthur E. Wilmarth, *The Transformation of the U.S. Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks*, 2002 U. ILL. L. REV. 215, 236 (2002) (illustrating the large amounts of money being lent by major U.S. banks);

73. *See* Wilmarth, *supra* note 72, at 472 (stressing the Federal Reserve increased liquidity after September 11, 2001); Press Release, Financial Markets Center, Discount Window Liquidity for the Airlines? (Sept. 18, 2001) (on file with author) (comparing discount-window lending before and after September 11, 2001).

74. *See* Treaty on European Union, Protocol on the Statute of the European System of Central Banks and of the European Central Bank, art. 18, Feb. 7, 1992, 1973 O.J. (C 191) 72 (Treaty on European Union) (setting forth laws the ECB and central banks must follow when lending money); David Small & James Clouse, *The Limits the Federal Reserve Act Places on the Monetary Policy Actions of the Federal Reserve*, 19 ANN. REV. BANKING L. 553, 554 (2000) (emphasizing the U.S. Federal Reserve is quite specific in its statutory authority).

many instances impliedly envisions the operations being carried out for the stability of individual banks and of the banking system in general, rather than for monetary policy ends.[75]

Note, however, that although the Fed's LOLR operations have typically been carried out through OMOs and the discount window, the Fed's statutory authority allows a much wider universe of LOLR methods.[76] For example, under the FRA's "incidental powers clause," the regional Federal Reserve Banks have "such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act."[77] It was under this clause that, in late 1999, the Federal Reserve Bank of New York wrote options to promote the smooth function of money markets before Y2K, even though the FRA does not expressly give the Federal Reserve the authority to buy and sell options.[78] In addition, on December 12, 2007, given the inability of central bank liquidity injections to free up interbank money markets and the typical reluctance of banks to come to the discount window,[79] the Fed announced what commentators termed a "fundamental overhaul"[80] of the way the Fed provides liquidity in financial markets: a temporary Term Auction Facility Program (TAF). The TAF is a hybrid of the discount window and OMOs: Like OMOs, the TAF auction would not be at a penalty rate, but

75. *See* Treaty on European Union, *supra* note 74 (exemplifying the fact that such rules may be in place to assist the banking system); *see also* Maksym V. Burlaka, Note, *Bank Corporate Governance: The Emerging Ukrainian Market Compared to the International Best Practices*, 11 FORDHAM J. CORP. & FIN. L. 851, 872 (2006) (stressing it is very important for the Federal Reserve Board to promote a safe and sound banking system).

76. *See* John W. Head, *Getting Down to Basics: Strengthening Financial Systems in Developing Countries*, 18 TRANSNAT'L LAW. 257, 261 (2005) (describing the different services available to a lender of last resort); *see also* Jean-Marc Gollier, Book Review, *Monetary Institutions in an Evolving World*, 55 BUFF. L. REV. 613, 625 (2007) (stating that lending of last resort can result in various solutions).

77. 12 U.S.C. § 341 (2000).

78. *See* David H. Small & James A. Clouse, *The Scope of Monetary Policy Actions Authorized Under the Federal Reserve Act* (July 19, 2004), *available at* http://www.federalreserve.gov/Pubs/Feds/2004/200440/200440pap.pdf (stating implied powers may exist); *see also* Clouse & Small, *supra* note 74, at 557 (referring to the Federal Reserve Act as a statutory authority with flexibility).

79. *See* Krishna Guha, *Fed to Overhaul Provision of Market Liquidity*, FIN. TIMES (U.S.), Dec. 12, 2007, at 2 (asserting the current system has been unable to adjust high rates in the market); *see also* Krishna Guha, Saskia Scholtes & Gillian Tett, *Bank Co-ops Keep US Afloat*, FIN. TIMES (UK), December 12, 2007, at 8 (stating the U.S. Federal Reserve did not have much success lending money through their discount window).

80. *See* Guha, *supra* note 79, at 2 (asserting the current system has been unable to adjust high rates in the market).

rather closer to the federal funds rate;[81] like the discount window, however, it would lend directly to banks and accept a broad range of collateral.[82]

1. The Discount Window

a. Statutory Authority

"Discount-window" lending refers to regional Federal Reserve Banks lending directly to entities on a collateralized basis.[83] The Federal Reserve Banks have statutory authority to perform discount-window lending in two different ways: by "discounting" assets presented to the Bank or by making a secured advance to the borrower.[84]

The Federal Reserve Banks first received authority to extend credit via the discounting method.[85] The 1913 FRA gave regional Federal Reserve Banks the authority to discount

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81. *See* Press Release, Board of Governors of the Federal Reserve System, 2007 Monetary Policy Releases (Dec. 12, 2007) *available at* http://www.federalreserve.gov/newsevents/press/monetary/20071212a.htm; *see also Central Banks: A Dirty Job, but Someone Has to Do It*, ECONOMIST (London), Dec. 15, 2007, at 40 (noting the dramatic changes brought about by the new term auction facility); *The Fed's Lifeline*, INV. BUS. DAILY (U.S.), Dec. 13, 2007 (describing the term auction facility as a way to let banks bid in the open market for funds).

82. *See* Press Release, Bd. of Governors of the Fed. Reserve System, *supra* note 81 (stating the Federal Reserve will auction term funds to depository institutions against the wide variety of collateral that can be used to secure loans at the discount window). The TAF is conducted as an auction of loans for a fixed amount of money (the December 17, 2007 auction was scheduled for $20 billion), with banks bidding interest rates subject to a minimum bid rate. *Id*. Four auctions were announced in the December 12, 2007 press release, and the auctions for which details were announced will be for 28- and 35-day loans. *Id*. Commentators termed the TAF "the kind of creative regulatory plumbing we've been waiting to see in this credit imbroglio," that avoids the OMO problem of the small number of banks receiving OMO funds being unwilling to lend those funds to other banks, and as a more surgical strike reduces the inflationary pressures of OMO liquidity injections. *See also* Guha, *supra* note 79, at 2 (declaring the TAF allows loans to a large number of banks and accepts a broad range of securities as collateral in return); banks will be able to tap the TAF facility at lower rates than they can at the discount window. *See* Editorial, *A Better Fed Idea*, WALL ST. J., Dec. 13. 2007, at A22 (explaining banks will now be able to use the TAF in order to borrow money).

83. *See* Robert R. Bliss & George G. Kaufman, *U.S. Corporate and Bank Insolvency Regimes: A Comparison and Evaluation*, 2 VA. L. & BUS. REV. 143, 162 (2007).

84. Federal Reserve Act, 12 U.S.C. §§ 341–361 (1998). *See* Clouse, *supra* note 70, at 965–66 (discussing the discount method and the secured advance method of discount-window lending in the Federal Reserve Bank system). In the discounting method of lending, a bank would present a short-term business loan or other asset meeting the type and maturity specifications of the Federal Reserve Act, and the Federal Reserve Bank would extend credit in an amount reflecting the value of the asset at maturity minus a "discount" based on the Federal Reserve's discount rate and the time until maturity of the asset. When the asset matured, the Federal Reserve would return it to the bank and receive from the bank a cash payment equal to the asset's maturity value. In an advance, a bank requests a loan from a Federal Reserve Bank, the Reserve Bank sets an interest rate equal to the discount rate, and requests satisfactory collateral for the loan.

85. Federal Reserve Act, 12 U.S.C. §§ 341–361 (1998). For a table summarizing the powers of the Federal Reserve Banks to discount or make advances and those powers' statutory provenance, see Small & Clouse, *supra* note 78, at 11; *see also* Small & Clouse, *supra* note 74, at 553 (discussing the Federal Reserve Bank's methods of lending).

"notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes."[86] That discounting authority was supplemented by laws passed in 1915[87] and 1923[88] that expanded the types of assets the Reserve Banks could discount.[89] For many years now, however, discount-window credit has been extended exclusively via advances.[90]

Federal Reserve Banks first received the authority to make advances in 1916.[91] In what would become section 13(8) of the FRA, the Reserve Banks received authority to make advances against banks' promissory notes if some were secured by assets available for discount or by U.S. Treasury securities, securities guaranteed by the United States or by a U.S. agency.[92] In 1932, the Federal Reserve Banks' advance-granting authority was expanded considerably.[93] In what would become section 10(B) of the FRA, the Reserve Banks were granted authority to make advances against notes secured by any collateral deemed adequate by the Reserve Bank.[94] Section 13(8), on the other hand, expressly limited the class of acceptable collateral.[95] Nonetheless, 10(B) does have certain limitations. First, section 10(B) grants the Federal Reserve Board the authority to limit by regulation the classes of assets that may be deemed acceptable collateral.[96] Second, if the note extended by the bank is a demand note, the maximum maturity

86. Federal Reserve Act of 1913, Pub. L. No. 63-43, § 13, 38 Stat. 251, 263 (1913) (codified as amended at 12 U.S.C. § 343).

87. *See* Federal Reserve Act of 1913, Pub. L. No. 64-281, 38 Stat. 958, 958 (1915) (codified as amended at 12 U.S.C. § 346) (granting Federal Reserve Banks the authority to discount bankers' acceptances that are based upon the importation or exportation of goods and that have a maturity at time of discount of not more than three months).

88. *See* Pub. L. No. 67-503, §402, 42 Stat. 1454, 1479 (1923) (codified as amended at 12 U.S.C. §344) (granting Federal Reserve Banks authority to discount or purchase bills of exchange payable at sight or demand which are drawn to finance the domestic shipment of nonperishable, readily marketable staple agricultural products and are secured by bills of lading or other shipping documents conveying or securing title to such staples).

89. *See* Strong, *supra* note 34, at 371 (explaining the Federal Reserve Bank's discount rate).

90. *See* Federal Reserve Act, 12 U.S.C. §§ 341–361 (1998); *see also* Ross M. Robertson & Almarin Phillips, *Are Uniform Reserve Requirements Really Necessary?*, 91 BANKING L. J. 403 (1974) (detailing the Federal Reserve Bank's discount-window lending method).

91. Pub. L. No. 64-270, 39 Stat. 752, 753 (1916) (codified as amended at 12 U.S.C. § 347).

92. *Id.*

93. *See* Henry Hilgard Villard, *The Federal Reserve System's Monetary Policy in 1931 and 1932*, 45 J. POL. ECON. 721, 727 n.13 (Dec. 1937) (discussing the Glass-Steagall Act of 1932); *see also* David Fettig, *Lender of More Than Last Resort*, THE REGION, ¶ 14 (Dec. 2002), *available at* http://minneapolisfed.org/pubs/region/02-12/lender.cfm (stating the 1932 legislation gave the Federal Reserve the authority to grant advances). *See generally* 12 U.S.C. §343 (1932) (noting any bank can discount acceptances in accordance with the 1932 law).

94. *See* 92 Pub. L. No. 72-44, § 10(b), 47 Stat. 56, 56 (codified as amended at 12 U.S.C § 347b(a); *see also* 12 U.S.C. § 343 (discussing the standard which the banks should use when accepting advances); 12 C.F.R § 201.3 (stating banks may take advances of "acceptable quality").

95. 12 U.S.C. § 347 (codifying the Federal Reserve's right to limit collateral); *see also* 12 C.F.R. § 201.33 (listing the "acceptable" standards); FRANKLIN R. EDWARDS, THE NEW FINANCE: REGULATION & FINANCIAL STABILITY 92 (American Enterprise Institute 1996) (noting the acceptance standards).

96. 12 U.S.C. § 347b(a). *See* also 12 C.F.R. § 201.3(a)(1) (2006), (stating the Federal Reserve has two options for making advances, one of them being "acceptable collateral"); EDWARDS, *supra* note 95, at 92 (limiting the acceptable collateral to "highly liquid assets").

is four months.[97] If the note is a time note, there is no restriction on the note's maturity, assuming the note is secured by mortgage loans covering a one-to-four family residence.[98]

Before 1978, the only banks eligible to borrow at the discount window were Federal Reserve System member banks.[99] The International Banking Act of 1978, however, opened the discount window to foreign banks' U.S. branches and agencies.[100] In 1980, the Depository Institutions Deregulation and Monetary Control Act broadened the set of depository institutions subject to reserve requirements and simultaneously extended discount-window access to those institutions.[101] As a result, nonmember commercial banks and savings banks, savings and loan associations, and credit unions became eligible to borrow at the discount window.[102]

Moreover, Federal Reserve Banks have long enjoyed statutory authority to lend to individuals, partnerships and corporations that are not banks at all. Under section 13(13) of the FRA, added in March 1933, any Federal Reserve Bank, subject to regulations of the Board of Governors, may make an advance to an individual, partnership or corporation if the advance is secured by U.S. Treasury or federal agency obligations.[103] Under section 13(3) of the FRA, added in 1932, if there are "unusual and exigent circumstances," the Board of Governors may also authorize any Federal Reserve Bank to lend to any individual, partnership or corporation by discounting of notes, drafts or bills of exchange which are secured to the satisfaction of the

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97. *See* 12 U.S.C. § 347b(a).

98. *See id*.

99. Pub. L. No. 64-270, 39 Stat. 752, 753 (codified as amended at 12 U.S.C. § 347 (2000)). *See* Clouse, *supra* note 70, at 966 n.4 (noting that as of 1978, the only banks that were eligible for the discount window were member banks).

100. *See* Clouse, *supra* note 70, at 966 n.4 (discussing the International Banking Act of 1978); *see also* FARAMARZ DAMANPOUR, THE EVOLUTION OF FOREIGN BANKING INSTITUTIONS IN THE UNITED STATES 55 (Greenwood Publishing Group, 1990) (discussing the discount-window policies in general); *Banking Institutions and Their Regulators* (2006), *available at* http://www.newyorkfed.org/banking/regrept/BIATR.pdf, n.17 (Feb. 2003) (stating foreign banks that have branches in the United States are subject to the Federal Reserve's regulations).

101. *See* Clouse, *supra* note 70, at 966 n.4; *see also* STUART I. GREENBAUM & ANJAN V. THAKOR, CONTEMPORARY FINANCIAL INTERMEDIATION 473 (Academic Press, 2007) (discussing the discount-window access to the depository institutions).

102. *See* Clouse, *supra* note 70, at 966 (noting the breadth of the depository institutions that may use the discount window); *see also* GEORGE B. GREY, FEDERAL RESERVE SYSTEM: BACKGROUND, ANALYSES AND BIBLIOGRAPHY 33 (Nova Publishers, 2002) (stating all institutions that are "fundamentally sound" may borrow from the local Federal Reserve); Press Release, The Federal Reserve, Federal Reserve Actions (Dec. 12, 2007), *available at* http://www.federalreserve.gov/newsevents/press/monetary/20071212a.htm (analyzing which institutions may borrow from the Federal Reserve).

103. The FRA requires those advances to be made for periods not exceeding 90 days and to bear interest at rates fixed by the Federal Reserve Bank but subject to review and determination by the Board of Governors. *See* Pub. L. No. 73-1, § 403, 48 Stat. 1, 7 (codified as amended at 12 U.S.C. § 347c (2000)); *see also* Small & Clouse, *supra* note 78, at 14 (discussing which entities may borrow from the Federal Reserve).

Federal Reserve Bank, so long as the potential borrower is unable to otherwise obtain sufficient credit through the banking system.[104] No 13(3) lending has occurred since the 1930s, though some commentators have recently called for a revisitation as a way to "restart the stalled securitised credit machine."[105]

Particularly relevant to the Federal Reserve's statutory lending powers is the Federal Deposit Insurance Corporation Improvement Act of 1991, widely known as "FDICIA."[106] FDICIA bars any Federal Reserve Bank from lending to an "undercapitalized" institution for more than 60 days in any 120-day period, unless the depository institution is certified as viable. FDICIA also bars the Fed from lending to a "critically undercapitalized" institution more than five days after the institution becomes critically undercapitalized.[107] If any such advance is made, the Federal Reserve Board of Governors becomes liable to the Federal Deposit Insurance Corporation (FDIC) for the interest on that advance or losses the Federal Reserve would have incurred if the increased advances were unsecured, whichever is lesser.[108] FDICIA's restraints on

104. FDIC Improvement Act of 1991, 12 U.S.C. § 343 (2000); Press Release, The Federal Reserve, Policy Statements on Payments System Risk 3 n.4 (Apr. 16, 2004), *available at* http://www.federalreserve.gov/ BoardDocs/Press/ Other/2004/20040205/attachment.pdf (stating the Federal Reserve may lend to corporations, individuals, or partnerships under "unusual and exigent circumstances"). *See also* BOARD OF GOVERNORS, *supra* note 50, at 38 (explaining section No 13(3) of the FRA); Wilmarth, *supra* note 72, at 304 (affirming the FRB's ability to provide loans in emergency situations).

105. John Dizard, *Chance to Restart the Stalled Securitised Credit Machine*, FIN. TIMES (U.S.), Dec. 11, 2007, at 15. John Dizard argues the discount window has been ineffective during the credit crunch because in discount-window lending, the credit risk of the paper placed with the Fed remains with the banks, so the pressure on banks' balance sheets is not relieved, and the interbank rates, the benchmark of all credit rates, are likely to stay high. *Id*. But section 13(3) lending, Dizard notes, allows the Federal Reserve to assume credit risk since 13(3) places "essentially no restriction on the form a written credit instrument must take in order to be eligible for discount." *Id*. (citing Small & Clouse, *supra* note 78). Dizard concludes: "This seems to me to be one of the few possible ways to jump-start the stalled securitised credit machine, since the [individuals, partnerships, and corporations] could include the key securities dealers. The Fed wouldn't have to take on the riskiest paper. But since it's now hard to place even the investment grade stuff, loopholes such as 13(3) could be useful." *Id*.

106. *See* Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. § 347b(b) (2000) (illustrating the relevance of the FDICIA to the Federal Reserve's statutory power).

107. *Id*. at (1)–(2). *See also* Krishna G. Mantripragada, *Depositors as a Source of Market Discipline*, 9 YALE J. ON REG. 543, 567 (1992) (discussing the restriction placed on the FRB's lending power).

108. FDICIA, § 347b(3). *See also* Clouse, *supra* note 70, at 965 (explaining the potential liability the Board incurs to the FDIC); Ross S. Delston, *The FDIC Improvement Act of 1991: What Banks and Thrifts Need to Know Now*, 615 PLI/COMM 7, 29 (1992) (illustrating the terms under which the FDIC could incur liability).

Federal Reserve lending to undercapitalized institutions aim to enhance market and regulatory discipline and protect federal deposit insurance funds.[109]

FDICIA's restraints underscore the difference between the lending power granted to the ECB and to the Fed. Like the Fed, the ECB enjoys clear authority to lend to credit institutions.[110] That lending authority, however, is granted in a chapter entitled "Monetary Function and Operations," emphasizing that the ECB's primary purpose, and the primary purpose of its lending activity, is to set monetary policy.[111] The Federal Reserve's lending powers, on the other hand, are part of a statute that expressly states the Federal Reserve System was created to pursue bank stability and macroeconomic goals.[112] FDICIA limitations, moreover, implicitly recognize the Fed may lend to a bank to restore liquidity to it, rather than merely lending to banks to carry out monetary policy.[113]

b. Regulation A

Regulation A (Reg A) is the rules laid down by the Federal Reserve's Board of Governors to regulate discount-window lending by the regional Federal Reserve Banks in accordance with section 10(B) of the FRA, which grants Federal Reserve Banks the authority to make advances, but only under the rules and regulations prescribed by the Board of Governors.[114]

Reg A sets up two main categories of discount-window lending: primary credit and secondary credit.[115] Primary credit is extended at the primary credit rate to generally sound financial institutions, usually overnight, but on terms of up to a few weeks if the institution cannot obtain such credit from the market on reasonable terms.[116] The primary credit rate is generally

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109. *See* Clouse, *supra* note 70, at 975; *see also* Stephen K. Huber, *The Federal Deposit Insurance Corporation Improvement Act of 1991*, 4 BANKING L. J. 109, 319 (1992) (showing the FDICIA's restraint on Federal Reserve lending is to prevent or minimize losses to the deposit insurance funds); Donald J. Toumey, *Bank Regulation, Bank Accounting, and Bank Failures*, 1991 ANN. SURV. AM. L. 823, 830 (1992) (stressing the "prompt corrective action" the FDICIA requires of the federal banking regulators with respect to banking institutions falling below minimum capital standards).

110. *See* Treaty on European Union, *supra* note 74 (establishing ESCB's authority to conduct credit operations with credit institutions).

111. *Id.*

112. *See* Federal Reserve Reform Act of 1977, Pub. L. No. 95-188, § 2(a), 91 Stat. 1387 (codified as amended by 12 U.S.C. § 225(a) (2000)); *see also* Federal Reserve Act of 1913, *supra* note 51.

113. *See* FDICIA, 12 U.S.C. 347b(b) (2000) (citing the FDICIA that highlights the Fed's role in lending is for the purpose of stabilizing financial institutions); *see also* DAVID A. MOSS, WHEN ALL ELSE FAILS: GOVERNMENT AS THE ULTIMATE RISK MANAGER 116 (Harvard University Press 2000) (illustrating the main reason the Federal Reserve was created is to provide stabilization to financial institutions).

114. *See* FDICIA, 12 U.S.C.A. § 347b(a) (2000) (authorizing Federal Reserve Banks to make advances to institutions); *see also* Thomas C. Baxter, Jr. & Joseph H. Sommer, *Liquidity Crises*, 34 INT'L LAW. 87, 87 (2000) (explaining Regulation A is the Board's interpretation of the Federal Reserve Act).

115. There is also seasonal credit, extended mainly to banks in agricultural areas. *See* 12 C.F.R. § 201.4(a)–(b) (2006).

116. 12 C.F.R. § 201.4(a) (2006). *See also* John C. Murphy, Jr. & Paul E. Glotzer, *Manual of Foreign Investment in the United States Database*, 2 MANUAL OF FOREIGN INVESTMENT IN THE U.S. § 14:15 (3d ed.) (2007) (describing the processes of the Federal Reserve Bank's three discount-window programs, including the primary credit program's practice of extending short-term credit to sound depository institutions).

set 100 basis points above the federal funds rate.[117] Secondary credit is granted at a rate above the primary credit rate, and is extended to an institution that is not in generally sound financial condition but for whom lending would allow a timely return to reliance on market funding sources or would allow the orderly resolution of serious financial difficulties.[118] Like primary credit, secondary credit is usually granted overnight but can be extended on a longer-term basis.[119] Reg A's rules for secondary credit extension to troubled banks indicate the Federal Reserve, in line with its statutory authority, envisions the discount window not just as a tool of monetary policy,[120] but also for purposes of stabilizing distressed financial institutions.[121]

Reg A, as authorized by FRA §§ 13(3) and 13(13), does allow lending to individuals, partnerships, and corporations, but only in consultation with the Board of Governors, and only if credit is not available from other sources and failure to obtain such credit would

117. BOARD OF GOVERNORS, *supra* note 50, at 46 (comparing primary credit rates and target federal funds rates). *Cf.* W. Christopher Barrier, *Usury in Arkansas: Bears and Borders and Buicks, Oh My!*, 39-WTR ARK. LAW. 22, 23–24 (2004) (stating after Reg A was revised in 2003, primary credit rates remain 100 basis points above the federal funds rate) *with* Jacqueline S. Akins, *Selected Statutes and Regulations Affecting Day-to-Day Bank Operations*, 48 CONSUMER FIN. L.Q. REP. 368, 384 (1994) (describing a more flexible approach taken toward seasonal credit rates).

118. *See* 12 C.F.R § 201.4(b) (listing the different circumstances in which secondary credit may be issued to depository institutions that either do not qualify for primary credit or are experiencing serious financial difficulties); *see also* Barrier, *supra* note 117, at 22–23 (stating the secondary credit rate is 50 points higher than the primary credit rate).

119. *See* 12 C.F.R § 201.4(b) (stating that secondary credit can be either short-term or long-term depending on the soundness of the financial institution applying for the credit); *see also* Murphy & Glotzer, *supra* note 116, at § 14:15 (explaining when a depository is ineligible to participate in the primary credit program, the depository institution may receive similar short-term credit by applying for secondary credit); Sean Geary, *Bankruptcy, Regulatory, and Accounting Issues Affecting Collateral-Backed Securities*, 498 PLI/CORP 297, 305 (describing some of the difficulties that a banking institution may face when trying to obtain the highest possible long-term credit rating).

120. A lending facility is a tool of monetary policy for a central bank because, generally, overnight interbank rates will not rise above the interest rate offered by the central bank, thus keeping interbank rates in a corridor, the upper limit of which is marked by the lending facility interest rate. *Cf.* Eric Dorkin, *Development, the IMF, and Institutional Investors: The Mexican Financial Crisis*, 9 TRANSNAT'L L. & CONTEMP. PROBS. 247, 270 (1999) (describing how the International Monetary Fund uses the New Arrangements to Borrow lending facility as a tool of monetary policy in handling potential economic crises); Oliveria Mendencia, *The World Bank, the IMF and the Global Prevention of Terrorism: A Role for Conditionalities*, 29 BROOK. J, INT'L L. 663, 679–80 (1999) (describing how the World Bank used a lending facility to implement a monetary policy geared around "quick-disbursing balance-of-payments" for supporting developing member countries); Jan Meyers & Damien Levie, *The Introduction of the Euro: Overview of the Legal Framework and Selected Legal Issues*, 4 Colum J. EUR. L. 321, 328–29 (1998) (mentioning the European Monetary Union will define its internal monetary policy in part by establishing an overnight lending facility to manage overnight market rates).

121. *See* 12 C.F.R. § 201.4. *See generally* Barrier, *supra* note 117, at 22–23 (claiming the primary reason for revising Reg A was to allow short-term borrowing, often in the form of secondary credit rates, to address temporary liquidity problems).

adversely affect the economy.[122] The interest rate for such emergency credit will be set above the highest rate in effect for advances to depository institutions.[123]

2. Open-Market Operations

Alongside the discount window, open-market operations are the second tool the Fed has at its disposal to act as lender-of-last-resort. By volume of operations, discount-window lending is dwarfed by open-market operations.[124]

In the Fed's open-market operations, the Federal Open Market Committee (FOMC)—which is composed of the seven members of the Board of Governors as well as five of the 12 Reserve Bank presidents (but always the president of the New York Fed)[125]—meets eight times per year[126] in order to set target federal funds rate.[127] The FOMC delegates the implementation of that federal funds policy to the Manager of the System Open Market Account (SOMA) at the New York Fed through an authorization contained in the minutes of the first FOMC meeting of each year.[128] The SOMA is responsible for the staff of the Trading Desk at the New York Fed, which executes transactions with a small number of government securities dealers that have an established relationship with the Fed.[129] Those transactions affect bank reserves

122. *See* 12 C.F.R. 201.4(d) (stating when a depository institution secures credit by using collateral that does not consist of guaranteed assets and obligations of the United States, a Board of Governors must vote to authorize issuing discount credit). *See generally* BOARD OF GOVERNORS, *supra* note 50, at 59 (stating the Federal Reserve has responsibility for authorizing foreign investments of Edge and agreement corporations); Jacqueline S. Akins, *Regulatory Update or Around the Federal Register in 365 Days with a Few Detours*, 54 CONSUMER FIN. L. Q. REP. 291, 291 (explaining Reg A was designed to establish special lending programs that allow institutions to borrow from the Federal Reserve without having to look at other potential lenders first).

123. 12 C.F.R. § 201.4(d). *Cf.* Baxter & Sommer, *supra* note 114, at 100 (remarking that emergency credit typically comes with a higher "penalty" interest rate).

124. *See* BOARD OF GOVERNORS, *supra* note 50, at 45 (describing the differences between primary credit rates and target federal funds rates).

125. *See* 12 U.S.C. § 263(a) (2000).

126. BOARD OF GOVERNORS, *supra* note 50, at 12.

127. BOARD OF GOVERNORS, *supra* note 50, at 38. "Federal funds" are unsecured loans of reserve balances at the Federal Reserve Banks depository institutions make to one another. *See* Federal Reserve Bank of New York, http://www.newyorkfed.org/aboutthefed/fedpoint/fed32.html (last visited Feb. 11, 2008). The rate at which those transactions are made is termed the federal funds rate, and the control of this rate is the primary tool for implementing monetary policy, as the rate has important implications for the loan and investment policies of all institutions, especially for bank decisions concerning loans to businesses, individuals, and foreign institutions. *Id.*

128. *See* Dino Falaschetti, *Does Partisan Heritage Matter? The Case of the Federal Reserve*, 18 J. L. ECON. & ORG. 488, 491 (2002) (showing the FOMC shares its duties with the manager of the System Open Market Account); *see also* Federal Reserve Bank of New York, *supra* note 127 (describing the interplay between the FOMC and SOMA).

129. *See* Federal Reserve Bank of New York, *supra* note 127 (noting SOMA is in charge of the Trading Desk); *see also* PETER S. ROSE, MONEY AND CAPITAL MARKETS: THE FINANCIAL SYSTEM IN THE ECONOMY 605 (Business Publications 1986) (stressing the Federal Reserve System is bound by SOMA's actions).

because the securities dealers hold bank accounts,[130] and therefore when a dealer sends funds to or receives funds from the Fed, funds are added to or drained from the banking system.[131] Through this adjustment to the supply of reserve balances, open-market operations influence the federal funds rate.[132]

The history of the Fed's open-market authority illustrates how monetary policy is not the only needle in the Federal Reserve's compass. The 1913 FRA did provide the regional Federal Reserve Banks with the authority to purchase a limited array of assets: cable transfers, bankers' acceptances, and bills of exchange.[133] But at first the Reserve Banks purchased those assets merely to obtain income to pay their expenses and with the additional objective of developing a U.S. market for bankers' acceptances.[134] In the early 1920s, however, the Federal Reserve began to see open-market operations as a tool to control the aggregate quantity of credit.[135] As such in 1933 Congress created the Federal Open Market Committee and gave it control over open-market operations,[136] subject to the principle that "open market operations shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country."[137] Curiously, it would appear the Fed's main tool to control monetary policy was discovered by accident.[138]

Over time, the Federal Reserve was granted the authority to conduct OMOs in a broader variety of assets, including U.S. Treasury securities, securities fully guaranteed by the United States, U.S. agency securities, state and local government debt, and foreign government

130. *See* Bielfeldt v. Commissioner of Internal Revenue, T.C. Memo. 1998-394, 1998 WL 774132, at *7 (U.S. Tax Ct. Nov. 6, 1998) (holding the primary responsibility of the trading desk is the buying and selling of securities); *see also* FRANK J. FABOZZI, THE HANDBOOK OF FIXED INCOME SECURITIES 233 (McGraw-Hill Professional 2005) (analyzing the role of government securities deals as "primary dealers); *see also* Federal Reserve Bank of New York, *supra* note 127 (explaining the Federal Reserve works with primary dealers because they have established accounts).

131. *See* Federal Reserve Bank of New York, *supra* note127 (explaining the effect the deals with the primary dealers have on the banking system).

132. *See id.*; *see also* Thomas Ehrlich & Gerald M. Meier, *Legal Problems of International Monetary Reform*, 20 STAN. L. REV. 870, 974 (1968) (noting the Federal Reserve's influence over the federal funds rate through financing).

133. *See* Federal Reserve Act of 1913, *supra* note 51.

134. *See* 12 U.S.C. § 263(c) (2000) (stating that originally the purpose of the Federal Reserve transactions was to influence commerce and business). *But see* CAMPBELL R. MCCONNELL, ECONOMICS: PRINCIPLES, PROBLEMS, AND POLICIES 270 (McGraw-Hill Professional 2005) (analyzing the multiple policy reasons why the Federal Reserve currently engages in open-market transactions).

135. *See* Small & Clouse, *supra* note 78, at 5 (explaining that during the 1920s the Federal Reserve began to recognize it could control the "aggregate quantity of credit" through open-market transactions); *see also* DOMINICK SALVATORE, SCHAUM'S OUTLINE OF THEORY AND PROBLEMS OF PRINCIPLES OF ECONOMICS 166 (McGraw-Hill Professional 1996) (describing how the Federal Reserve controls the "aggregate quantity of credit").

136. 12 U.S.C. § 263(a) (2000).

137. Federal Open Market Committee, ch. 89, 48 Stat. 168 (1933) (codified as amended at 12 U.S.C. § 263(b)–(c) (2000)).

138. Stephen G. Cecchetti & Roisin O'Sullivan, *The European Central Bank and the Federal Reserve*, 19 OXFORD REV. OF ECON. POL'Y 30, 31 (2003).

debt.[139] OMOs are carried out in a variety of different transactions, including outright purchases and sales and long-term and short-term repurchase agreements (repos).[140]

Of course, open-market operations would not be an LOLR tool if a few specific banks were distressed, since the operations are carried out with securities dealers rather than specific banks.[141] In a generalized liquidity crisis, however, open-market operations are indeed a primary tool that supplies the banking system with liquidity, and the Fed used them as such in the 2007 credit crunch.[142]

III. The European Central Bank as Lender of Last Resort

A. The Origins and Institutional Architecture of the Eurosystem

1. Origins

The driving force behind the creation of the Fed was a need to restore order to the financial system, which had been regularly plagued by bank panics during the previous decades.[143] The Federal Reserve Act reflects this purpose in the mission it sets out for the Fed and in the powers it grants the Fed.[144] As noted, the Fed's main tool of monetary policy—open-market operations—was discovered by accident in the 1920s.[145] The establishment of the ECB, on the other hand, was a by-product of the creation of the European Economic and Monetary Union (EMU), as the new currency needed an authority to be its guardian and implement monetary policy.[146]

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139. *See* Small & Clouse, *supra* note 70, at 20 (noting OMOs consist of federal, state, local, and foreign government debt); *see also* Jeff Strnad, *Some Macroeconomic Interactions with Tax Base Choice*, 56 SMU L. REV. 171, 173 (2003) (illustrating the broad authority given to the Fed to obtain its targeted rate).

140. *See* BOARD OF GOVERNORS, *supra* note 50, at 38–40; *see also* J.B. Harris, *The Impact of the Government Securities Act on Hold-in-Custody Repurchase Agreements*, 62 FLA. B. J. 39, 39 (1988) (asserting the Fed's main transactions, other than the sale and purchase of securities, consist of repos).

141. *See generally* Rosa Maria Lastra, *The Division of Responsibilities Between the European Central Bank and the National Central Banks within the European System of Central Banks*, 6 COLUM. J. EUR. L. 167, 175 (2000) (stating that an LOLR is meant for national issues).

142. *See A Better Fed Idea*, *supra* note 82, at A22; *see also* Lastra, *supra* note 141, at 175 (stressing a market-operations approach is a solution to a liquidity shortfall).

143. *See*, *e.g.*, Strong, *supra* note 34, at 376 (stating the Federal Reserve Act was in response to the Banking Panic of 1907); *see also* Cecchetti & O'Sullivan, *supra* note 138, at 31 (expressing that the purpose behind the creation of the Fed was an attempt to restore order to the financial system).

144. Federal Reserve Reform Act of 1977, Pub. K. No. 950118, § 2a, 91 Stat. 1387 (codified as amended at 12 U.S.C. § 225a (2000)).

145. Cecchetti & O'Sullivan, *supra* note 138, at 31. The "accidental" discovery was not that Federal Reserve Banks had the power to buy securities, but that in doing so the Banks affected credit markets. *See* Edward J. Geng, *The Role of the Federal Reserve in Repurchase Agreements*, 341 PRACTISING L. INST. 105, 107 (1984) (suggesting that in 1922 the Federal Reserve Act adopted open-market operations). *See generally* Strong, *supra* note 34, at 380 (positing the Federal Reserve Act had no provisions for establishing the monetary policy).

146. *See* Cecchetti & O'Sullivan, *supra* note 138, at 31; *see also* Commission of the European Communities, *Economic and Monetary Union* (1990), *available at* http://aei.ptt.edu/1015/ (demonstrating ECB was conceived as a tool for monetary stability, rather than bank regulation or economic growth). René Smits terms price stability "the reason for which the System is created . . . its *raison d'être*." RENÉ SMITS, THE EUROPEAN CENTRAL BANK: INSTITUTIONAL ASPECTS 184 (Kluwer Law International 1997).

In December 1991, the European Council finalized an agreement to amend the Treaty of Rome (the European Community's founding treaty) to lay out the path to the EMU.[147] Those amendments are often referred to as the Maastricht Treaty, named after the Dutch town where the agreement was reached.[148] Under Maastricht, the European Monetary Institute (EMI) was established to strengthen central bank cooperation in anticipation of the single currency.[149] In 1998, as envisioned by Maastricht, the EMI was replaced by the ECB as the supranational institution charged with setting monetary policy and being the guardian of the single currency.[150] Commentators have called price stability the ECB's *raison d'être*.[151]

2. Institutional Structure

Whereas the Federal Reserve's statutory authority is found in a panoply of statutes,[152] the ECB's authority flows from a single act: the Maastricht Treaty itself, which the European Court of Justice has called a "constitutional charter,"[153] which has attached to it as a Protocol the Statute of the European System of Central Banks and of the European Central Bank

147. *See* Pollard, *supra* note 54, at 12; *see also* Hadjiemmanuil, *supra* note 48, at 106 (explaining that the Treaty of Rome was amended to create the EMU).

148. *See*, *e.g.*, Pollard, *supra* note 54, at 12.

149. *See* The Maastricht Treaty, Art. 109f, OJ 1992 C191/18 (1992) (announcing the EMI's responsibility to strengthen cooperation between national banks to further the goal of establishing a single currency); *see also* W.F. Duisenberg, President, European Monetary Institute, *The European Monetary Institute and Progress Towards Monetary Union* (Sept. 22, 1997) (on file with author), *available at* http://www.ecb.int/press/key/date/1997/html/sp970922.en.htm (stating that the purpose of the EMI is to facilitate the establishment of a monetary union between participating countries).

150. *See* The Maastricht Treaty, Art. 4A, OJ 1992 C191/6 (1992); *see also* Andrea M. Corcoran & Terry L. Hart, *The Regulation of Cross-Border Financial Services in the EU Internal Market*, 8 Colum. J. EUR. L. 221, 273 (2002) (describing the ECB's supervisory role in assuring that national banks in member countries fulfill their treaty obligations).

151. *See*, *e.g.*, SMITS, *supra* note 146, at 184; Christopher Young, *The Ramification of the Exchange Rate Collapse in Europe: Implications for Monetary Union*, 13 B.U. INT'L L.J. 263, 274 (1995) (stating the move to a monetary union was the *raison d'être* of the Treaty).

152. *See*, *e.g.*, 12 U.S.C.S. § 341 (Lexis 2007) (codifying the enumerated powers granted to the Federal Reserve); Timothy A. Canova, *The Transformation of U.S. Banking and Finance: From Regulated Competition to Free-Market Receivership*, 60 BROOK. L. REV. 1295, 1297–98 (1995) (examining the Emergency Banking Act of 1933, which expanded statutory authority of the Federal Reserve).

153. *See* CHIARA ZILIOLI & MARTIN SELMAYR, THE LAW OF THE EUROPEAN CENTRAL BANK viii (Hart Publishing 2001) (citing Parti ecologiste "Les Verts" v. European Parliament, [1986] ECR 1339 (1985)) (emphasizing that measures passed by the member states must comply with the Treaty).

("ESCB Statute").[154] That makes the ECB unique among central banks: its institutional architecture, objectives, tasks, duties, and competencies do not stem simply from a piece of national legislation, but rather from supranational constitutional law.[155]

Commentators have termed the Maastricht Treaty and ESCB Statute "primary ECB law."[156] In addition to this primary ECB law, there is also secondary ECB law. Secondary ECB law comprises the ECB's regulations, decisions, recommendations, opinions, guidelines, and instructions,[157] which are issued under the authority granted to it to "make regulations to the extent necessary to implement the tasks" assigned to the ESCB.[158]

In creating a centralized European monetary authority, the Maastricht drafters had to choose between dissolving the National Central Banks ("NCBs") and creating a "unitary" central bank or incorporating the NCBs into the new order and thereby creating some sort of dualist structure.[159] If the drafters chose a dualist structure, there was a further choice between a federalist structure in which the NCBs would have exclusive competencies or one in which

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154. *See* Treaty on European Union, Feb. 7, 1992, *available at* http://www.ecb.int/ecb/legal/pdf/maastricht_en.pdf. *See also* The Maastricht Treaty, Art. 4A, OJ 1992 C191/6 (1992). The ESCB Statute and Treaty are of equal authority and dignity for the ECB. Article 4a of the Maastricht Treaty provides both the ECB and European System of Central Banks "shall act within the limits of the powers conferred upon them by this Treaty and by the Statute of the ESCB . . . annexed thereto." *Id*.

    The subsequent Treaty reforms of Amsterdam and Nice, which amended many provisions of primary Community law, did not make any major changes in primary ECB Law. Chiara Zilioli & Martin Selmayr, *The European Central Bank: An Independent Specialized Organization of Community Law*, 37 COMMON MKT. L. REV. 591, 591 (2000). In addition, the E.U. Reform Treaty, signed by the heads of government or state of the 27 E.U. Member States, does not contain any substantive changes to any ECB authority relevant to the LOLR function. Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Community, Dec. 13, 2007, *available at* http://www.consilium.europa.eu/uedocs/cmsUpload/cg00014.en07.pdf (maintaining the substantive laws of ECB authority relevant to LOLR function).

155. *See* Zilioli & Selmayr, *supra* note 154, at 625 (emphasizing the constitutional quality of the ECB); *see also* Blaine Evanson, Book Review, 10 COLUM. J. EUR. L. 411, 411 (2004) (reviewing CHIARA ZILIOLI & MARTIN SELMAYR, THE LAW OF THE EUROPEAN CENTRAL BANK (Hart Publishing 2001)) (defending the ECB's independence from the Member States and community institutions, explaining its authority is drawn from outside those groups).

156. Chiara Zilioli & Martin Selmayr, *Recent Developments in the Law of the European Central Bank* (2006) at 1, *available at* http://www.lawofemu.info/ReadingRoom/ZilioliSelmayrYEL2006.pdf.

157. *See* Lastra, *supra* note 141, at 168 (listing the types of "secondary community legislation" available to the ECB, such as regulations, decisions, recommendations, and opinions); *see also* Zilioli & Selmayr, *supra* note 156, at 1–2 (describing the types of "secondary ECB law").

158. *See* ESCB Statute, *supra* note 46, Art. 34.1 (1992).

159. *See* Zilioli & Selmayr, *supra* note 153, at 54–55 (discussing the drafters' decision to incorporate the NCBs into the European banking structure); *see also* Kathy Jones & Alan N. Rechtschaffen, *The Euro—Ready or Not: Trading Implications of the New Common Currency*, 22 FORDHAM INT'L L.J. 786, 793 (1999) (outlining the structure of the ESCB and discussing the important role of the NCBs).

the NCBs were mere agents of the ECB.[160] The drafters chose a dualist structure,[161] and thereby co-opted the immense staffs, tradition, and reputation of the NCBs.[162]

Therefore, the ESCB Statute allocates competencies and authorities not to the ECB directly, but rather to the European System of Central Banks (ESCB).[163] However, the decision-making bodies of the ECB govern the ESCB.[164] The ESCB is thus merely the common roof for the joint existence of the ECB and NCBs, and for ESCB tasks the NCBs are merely the operating arms of the ECB.[165] Therefore, although a Eurozone lender-of-last-resort operation may technically be carried out by the ESCB as a whole, this article focuses on the ECB as the ESCB's decision-making organ.

The decision-making bodies of the ECB are the Governing Council and Executive Board.[166] The Executive Board, composed of six members appointed by the common accord of the Eurozone Member States, is responsible for the "current business of the ECB"[167] and for "implementing monetary policy in accordance with the guidelines and decisions laid down by the Governing Council."[168] In central banking however, "current business" is of decided importance, since during a fast-breaking crisis the ECB is required to take emergency measures when it is not possible to convene the Governing Council or hold a teleconference meeting

160. *See* Zilioli & Selmayr, *supra* note 153, at 55 (demonstrating the unitary and dualist structures). *See generally* Kathleen R. McNamara, *Where Do Rules Come From? The Creation of the European Central Bank*, in THE INSTITUTIONALIZATION OF EUROPE 155, 167 (Alec Stone Sweet, Wayne Sandholtz & Neil Fligstein eds., Oxford Univ. Press 2001) (speculating that the European countries chose the dualist structure to further their view that monetary policy should be kept separate from political authority).

161. *See* ESCB Statute, *supra* note 46, art. 1.2; *see also* Thilo Marauhn & Michael Weiss, *The European Central Bank as Regulator and as Institutional Actor*, in THE REGULATION OF INTERNATIONAL FINANCIAL MARKETS 209, 209 (Rainer Grote & Thilo Marauhn eds., Cambridge Univ. Press 2006) (asserting the ESCB, comprising the ECB and NCBs, has become essential to the functioning of Europe's financial markets); Patrick Deller, *The European System of Central Banks: Quo Vadis?*, 21 HOUS. J. INT'L L. 169, 173 (1999) (noting the ESCB's dual structure reflects a commitment to a federal structure).

162. It is estimated the NCBs of the Eurozone have more than 50,000 employees, of which at least 50 percent are involved in carrying out ESCB tasks, while the ECB has fewer than 1,500 staff members. Zilioli & Selmayr, *supra* note 156, at 145 n.217. As for their reputation, Jacques Delors, former European Commission president, once quipped that not every German believed in God, but they all believed in the Bundesbank. Ralph Atkins, *Bundesbank Looks to Learn From Its Past*, FIN. TIMES, July 29, 2007.

163. *See* ESCB Statute, *supra* note 46, art. 3.1 ("In accordance with Article 105(2) of this Treaty, the basic tasks to be carried out through the ESCB shall be . . ."); *see also* SMITS, *supra* note 146, at 92–93 (noting that despite the ESCB not being a separate legal entity, it is charged with formulating and implementing the Community's monetary policy). McNamara, *supra* note 160, at 155, 160 (emphasizing the prohibitions on the ECB from taking any directions from any one Community member's government or state institutions).

164. *See* ESCB Statute, *supra* note 46, art. 8.

165. *See* ESCB Statute, *supra* note 46, art. 14.3 (specifying each Member State's national central bank must act pursuant to the ECB's guidelines and instructions); *see also* Zilioli & Selmayr, *supra* note 153, at 64 (providing the two models which the drafters considered in creating the structure of the NSCB).

166. *See* ESCB Statute, *supra* note 46, art. 9.3 (declaring the Governing Council and Executive Board are the decision-making bodies of the ECB pursuant to Article 106(3) of the Maastricht Treaty).

167. ESCB Statute, *supra* note 46, art. 11.6.

168. ESCB Statute, *supra* note 46, art. 12.1.

thereof in time.[169] The Governing Council is composed of members of the Executive Board and representatives of the Eurozone NCBs.[170]

3. ESCB Competencies Relevant to an LOLR Role

The ESCB Statute provides that the primary objective of the ESCB shall be to maintain price stability.[171] Only if it does no prejudice to the objective of price stability shall the ESCB seek to support the general economic policies of the European Community.[172]

In addition to the overarching objective of price stability, the ESCB Statute lays out four "basic tasks" to be carried out through the ECSB: (1) define and implement the monetary policy of the Community; (2) conduct foreign-exchange operations consistent with the provision of Article 111 of the Treaty; (3) hold and manage the official foreign reserves of the Member States; and (4) promote the smooth operation of payment systems.[173]

The ESCB, however, has no direct role in banking supervision.[174] In the Eurozone, that responsibility remains at the national level.[175] The only thing close to banking supervision responsibility given to the ESCB is set forth in Article 3.3, which sets out its tasks: "[T]he ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities

169. *See* Zilioli & Selmayr, *supra* note 153, at 84 n.4 (putting forth the necessity of action by the ECB during times of crisis when the Governing Council is not able to act); *see also* Giorgio Di Giorgio & Carmine Di Noia, *Panel II: Appropriateness of Regulation at the Federal or State Level: Financial Market Regulation and Supervision: How Many Peaks for the Euro Area?*, 28 BROOK. J. INT'L L. 463, 476–77 (2003) (asserting that during a time of crisis, the ECB will assume the necessary role to address the issue); Lastra, *supra* note 141, at 174–75 (pointing out that due to an ambiguity in the statute, it is only during times of crisis the ECB must spring to action).

170. *See* ESCB Statute, *supra* note 46, art.10.1.

171. *See* ESCB Statute, *supra* note 46, art. 2. The ECB has a quantitative definition of "price stability" of "close to, but below" 2 percent. George Parker, *Eurozone Rules Under Fire as Lithuania Fails to Join*, FIN. TIMES (UK), May 16, 2006, at 6, *available at* http://www.ft.com/cms/s/0/f3d4872ce47711da8ced0000779e2340.html?nclick_check=1.

172. *See* ESCB Statute, *supra* note 46, art. 2; *see also* Draft Treaty Establishing a Constitution for Europe, June 20, 2003, art. I-29, ¶ 2, *available at* http://european-convention.eu.int/docs/Treaty/cv00850.en03.pdf (deeming all economic policies outside of maintaining price stability as secondary interests for the ESCB).

173. ESCB Statute, *supra* note 46, art. 3.1. *See* Andrej Fatur, *What Challenges Do the Central European and Mediterranean States Face in Trying to Join the Third Stage of European Monetary Union?*, 28 FORDHAM INT'L L.J. 145, 151 (2004) (discussing Article 105(2), which sets out the basic tasks of the ESCB).

174. *See* ESCB Statute, *supra* note 46, art. 25.1 (setting forth the method by which the ECB may influence European Community legislation); Pollard, *supra* note 54, at 18; *see also* Duncan E. Alford, *Core Principles for Effective Banking Supervision: An Enforceable International Financial Standard?*, 28 B.C. INT'L & COMP. L. REV. 237, 270 (2005) (pointing out that bank supervision takes place individually in each county and is not done by the ESCB).

175. *See* Press Release, European Cent. Bank, Memorandum of Understanding on Cooperation Between Payment Systems Overseers and Banking Supervisors in Stage Three of Economic and Monetary Union (Apr. 2, 2001), *available at* http://www.ecb.int/press/pr/date/2001/html/pr010402.en.html ("Whereas the oversight of payment systems is one of the basic tasks of the Eurosystem in accordance with the fourth indent of Article 105(2) of the Treaty establishing the European Community and Articles 3.1 and 22 of the Statute of the ESCB, the responsibility for prudential [banking] supervision has remained with the competent national authorities.").

relating to the prudential supervision of credit institutions and the stability of the financial system."[176]

In the future, however, the ECB could be empowered to be a community-wide bank supervisor. Article 105(6) of the Maastricht Treaty allows the European Council, acting unanimously on a proposal from the Commission, after consulting the ECB and after receiving the assent of the European Parliament, to confer upon the ECB specific tasks regarding bank supervision.[177] That potential enabling clause has not yet been activated by the Council of Ministers.[178] In fact, the only power the ECB has over banks is that it may require credit institutions to hold minimum reserve accounts with the ECB and NCBs in order for the ECB to achieve its monetary policy objectives.[179]

The Statute expressly allows that "[i]n order to achieve the objectives of the ESCB and to carry out its tasks," the ECB and NCBs may conduct open-market operations[180] and may "conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral."[181] That authority, given under articles 18.1 and 18.2, respectively, is part of a chapter entitled "Monetary Functions and Operations."[182] The Fed's

176. Maastricht Treaty, art. 105(5), Feb. 7, 1992. Note that article 3.3 is not the "basic tasks" section of the Statute (art 3.1), but is nonetheless part of article 3, which is entitled "Tasks."

177. ESCB Statute, *supra* note 46, art. 41.1.

178. *See* Tommaso Padoa-Schioppa, Member of Executive Bd., Eur. Cent. Bank, Address at London School of Economics, Financial Markets Group (Feb. 24, 1999) in WHICH LENDER OF LAST RESORT, 2000, at 13 (suggesting proposals made by the Lamfalussy group that would improve supervision of European financial institutions were not implemented).

179. *See* ESCB Statute, *supra* note 46, art. 19.1; *see also* Roger J. Goebel, *The European Union: Dedicated to Advocate General Francis Jacobs: Article: Court of Justice Oversight over the European Central Bank: Delimiting the ECB's Constitutional Autonomy and Independence in the Olaf Judgment*, 29 FORDHAM INT'L L.J. 610, 650 (2006) (illustrating the limited power of the ECB); Niall Lenihan, *The Role and Framework of the European System of Central Banks*, 1090 PRACTICING L. INST. 463, 468 (1998) (detailing the ECB minimum reserve account holding requirements).

180. ESCB Statute, *supra* note 46, art. 18.1. Specifically, the ECB and NCBs, to achieves the ESCB's tasks and objectives, "operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments, whether in Community or in non-Community currencies, as well as precious metals." *Id*.

181. ESCB Statute, *supra* note 46, art. 18.1.

182. *Id*. at arts. 18.1 & 18.2.

credit extension authority, on the other hand, is part of a statute which expressly grants the Fed the authority to pursue bank stabilization and broad macroeconomic goals.[183]

B. How the ECB Conducts LOLR Operations

Since its establishment in 1998, the ECB has acted as lender-of-last-resort to banks on two occasions: in the generalized liquidity crisis that followed September 11, 2001,[184] and during the outbreak of the credit crisis in August 2007.[185] The ECB provides liquidity to banks in two main ways: via open-market operations and its marginal lending facility. Both open-market operations[186] and the marginal lending facility (akin to the Fed's discount window) are authorized by ESCB Statute article 18.1.[187]

Just as the Federal Reserve Act grants the regional Federal Reserve Banks the authority to lend to credit institutions subject to regulations of the Board of Governors,[188] so the ESCB Statute requires the ECB to "establish general principles for open-market and credit operations carried out by itself or the national central banks, including for the announcement of condi-

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183. *See* Federal Reserve Reform Act of 1977, PL 95-188, § 2a, 91 Stat. 1387, 1387 (codified as amended at 12 U.S.C. § 225a (2000)) (explaining the powers of the Federal Reserve to control and provide for growth); *see also* Preamble to the Federal Reserve Act of 1913, Pub. L. No. 63-43, 28 Stat. 351 (declaring that the Federal Reserve System was created "to establish a more effective supervision of banking in the United States"). BOARD OF GOVERNORS, *supra* note 50, at 1–2 (providing an overview of how the Federal Reserve operates).

184. *See* Michele Fratianni, *Maxi Versus Mini EMU: The Political Economy, Stage II*, 4 COLUM. J. EUR. L. 375, 378 (1998) (analyzing a situation where the ECB might have to act as a lender of last resort). In response to the September 11-related liquidity crisis, the ECB conducted unscheduled, "fine-tuning" operations on both September 12 and 13. *See also* ECB MONTHLY BULLETIN: OCT. 2001, *supra* note 27, at 13. In both operations, the ECB satisfied all bids for liquidity. *Id*. On September 12, the operations provided €69 billion in liquidity to 63 credit institutions. *Id*. On September 13, the operations provided €40.5 billion to 45 credit institutions. *Id*. On September 12, the Eurozone overnight interbank rates rose sharply to the level of the ECB's marginal lending facility, the theoretical upper limit of interbank rates, but after the September 12 fine-tuning operation those rates normalized. *Id*.

185. *See* Carter Dougherty, *E.C.B. Makes $500 Billion Infusion*, N.Y. TIMES, Dec. 19, 2007, *available at* http://www.nytimes.com/2007/12/19/business/worldbusiness/19euro.html?_r=1&oref=slogin (referring to the steps taken by the ECB during the 2007 credit crisis). As noted above, on August 9, 2007, the ECB carried a fine-tuning operation of €94.8 billion, lending funds to any Eurozone bank that asked for it. *See* ECB MONTHLY BULLETIN: SEPT. 2007, *supra* note 29, at 32. On August 10 it injected €11.1 billion in another unscheduled operation. *Id*. On Monday, August 13, the ECB lent €47.7 billion in an unscheduled operation, and in a regularly scheduled operation the ECB injected €73.5 billion more than that published benchmark amount. *Id*.

186. ESCB Statute, *supra* note 46, art. 18.1. ESCB Statute article 18.1, first indent, provides: "In order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the national central banks may: operate in the financial markets by buying and selling outright (spot and forward) or under repurchase agreement and by lending or borrowing claims and marketable instruments, whether in Community or in non-Community currencies, as well as precious metals." *Id*.

187. ESCB Statute, *supra* note 46, art. 18.1. ESCB Statute article 18.1, second indent, provides: "In order to achieve the objectives of the ESCB and to carry out its tasks, the ECB and the national central banks may: . . . . conduct credit operations with credit institutions and other market participants, with lending being based on adequate collateral." *Id*.

188. *See* Federal Reserve Act of 1977, Pub. L. No. 72-44, § 10(b), 47 Stat. 56, 56 (1977) (codified as amended at 12 U.S.C.A. § 347b(a)). *See* Jones & Rechtschaffen, *supra* note 159, at 795 (stating open-market operations maintain liquidity).

tions under which they stand ready to enter into such transactions."[189] And just as the Fed's Board of Governors promulgated Reg A,[190] so the ECB publishes a Guideline for its open-market and credit operations, the last version of which was promulgated on August 31, 2006.[191]

Unlike the Federal Reserve Board of Governors, the ECB is a bank, and therefore in theory could itself carry out open-market operations and the marginal lending facility.[192] But instead it chose a decentralized approach, with the national central banks actually operating the marginal lending facility and conducting open-market operations,[193] just as in the United States it is the regional Federal Reserve Banks that extend discount-window credit and carry out open-market operations.[194] The ECB has opined that the decentralized approach has run smoothly, thanks to careful preparation and efficient information systems, and the Eurosystem benefits from the close contacts the NCBs have built up over the decades with their local counterparts.[195]

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189. ESCB Statute, *supra* note 46, art. 18.2.

190. Note that Reg A regulates discount-window lending, whereas the Federal Reserve's open-market operations are regulated less formally by the FOMC. *See* Extensions of Credit by Federal Reserve Banks, 12 C.F.R. § 201.1 (2002) (establishing rules for Federal Reserve Bank credit extensions to depository institutions); *see also* Cheryl L. Edwards, *Open Market Operations in the 1990s*, FED. RES. BULL., Nov. 1997, at 859 (describing the Federal Reserve's use of varied open-market policies rather than an adherence to a singular rule).

191. *See* Eur. Cent. Bank, Guideline of the European Central Bank of 31 August 2006, pmbl. 1, 2006 O.J. (L 352) 1, 1, *available at* http://www.ecb.int/ecb/legal/pdf/en_statute_2.pdf (ECB Guideline) (promulgating monetary policy goals of the European Central Bank); *see also* Treaty on European Union, July 29, 1992, 1992 O.J. (C 191) 1, 14 (establishing the purposes of monetary policy within the European Community).

192. *See* ESCB Statute, *supra* note 46, art. 18.2; *see also* BOARD OF GOVERNORS, *supra* note 50, at 4 (defining the role of the Board of Governors in the implementation of monetary policy).

193. *See* EUR. CENT. BANK, THE MONETARY POLICY OF THE ECB 72 (2004), *available at* http://www.ecb.int/pub/pdf/other/monetarypolicy2004en.pdf (MONETARY POLICY OF THE ECB); *see also* Lastra, *supra* note 141, at 172 (explaining decentralization in the implementation stage of monetary policy within the European Community).

194. *See* FED. RES. SYS., IN PLAIN ENGLISH: MAKING SENSE OF THE FEDERAL RESERVE 7 (1999) (recognizing that responsibility for open-market procedures lies with the Federal Reserve of New York); *see also* FED. RESERVE BANK OF NEW YORK, ANNUAL REPORT FOR THE YEAR ENDED DECEMBER 31, 2006, 18 (2007) (emphasizing the New York Federal Reserve's role in open-market operations).

195. *See* MONETARY POLICY OF THE ECB, *supra* note 193, at 74-75 (emphasizing the decentralization of monetary policy implementation within the Eurosystem); *see also* Ernst-Ulrich Petersmann, *How to Constitutionalize International Law and Foreign Policy for the Benefit of Civil Society?*, 20 MICH. J. INT'L L. 1, 31 (1998) (concluding that decentralized policy leads to increased institutional security and domestic safeguards). *But see* Nahalel A. Nellis, Note, *Deficiencies in European Monetary Union's Credible Commitment Against Monetary Expansion*, 33 CORNELL INT'L L.J. 263, 292–93 (2000) (warning that decentralized implementation can lead to a system failure because nonmembers have access to the European reserve system).

The ECB generally conducts four types of open-market operations,[196] which vary according to their aim, regularity, and structure: main refinancing operations (MROs), longer-term refinancing operations (LROs), fine-tuning operations, and structural operations.[197] MROs and LROs are conducted only via reverse transaction,[198] and are used only to provide (not absorb) liquidity.[199] MROs are conducted weekly and with a one-week maturity, whereas LROs are conducted monthly with a three-month maturity.[200] Under the ECB Guideline, MROs and LROs are conducted by NCBs.[201]

Fine-tuning operations are conducted in response to unexpected liquidity movements, and indeed after 9/11 and during the August 2007 credit crisis the ECB relied mainly on fine-tuning operations to provide liquidity to banks.[202] Fine-tuning operations can be liquidity-providing or liquidity-absorbing,[203] and maturity is nonstandardized, as is the form the fine-tuning operation takes (which can be a reverse transaction, foreign exchange swap, or an outright

196. The ECH also has the possibility of conducting "structural operations," which seek to adjust the structural liquidity position of the ESCB vis-à-vis the banking system, i.e., the amount of liquidity in the market over the longer term. MONETARY POLICY OF THE ECB, *supra* note 193, at 84. By the end of June 2003, the ECB had never conducted such an operation. *Id*. *See* ESCB Statute, *supra* note 46, art. 18.2 (allowing the European Central Bank to establish the means by which it will conduct open-market credit operations). *See generally* Eur. Cent. Bank, TRANSMISSION MECHANISM OF MONETARY POLICY, Feb. 11, 2008, *available at* http://www.ecb.int/mopo/intro/html/transmission.en.html (illustrating the effects and interrelations of various types of monetary policy).

197. *See* Blaine Evanson, Comment, *Regulation 1745/2003 of the European Central Bank on the Application of Minimum Reserves*, 10 COLUM. J. EUR. L. 405, 406 (2004) (identifying various monetary policy measures).

198. Defined by § 3.1.1 of the Guideline as "operations where the Eurosystem buys or sells eligible assets under repurchase agreements or conducts credit operations against eligible assets as collateral." ECB Guideline, *supra* note 191, at § 3.1.1. Where a reverse transaction takes the form of a repurchase agreement, the interest rate is the difference between the purchase price and the repurchase price, or, in other words, the repurchase price includes the interest to be paid. EUR. CENT. BANK, *supra* note 193, at 83. If the reverse transaction takes the form of a collateralized loan, the interest rate is determined by applying the specified interest rate on the credit amount over the maturity of the operation. *Id*. *See* Jones & Rechtschaffen, *supra* note 159, at 795 (stating reverse transactions are used in the refinancing operations of the European Central Bank).

199. ECB Guideline, *supra* note 191, §§ 3.1.2–3.1.3. *See* also Jones & Rechtschaffen, *supra* note 159, at 795 (stating that open-market operations are used to provide liquidity); Evanson, *supra* note 197, at 406 (discussing the use of reverse transactions to stabilize liquidity shortages).

200. *See* ECB Guideline, *supra* note 191, §§ 3.1.2–3.1.3; *see also* Jones & Rechtschaffen, *supra* note 159, at 795 (stating that open-market operations consist of short operations with a frequency of one week, as well as longer ones with a month-long frequency); Evanson, *supra* note 197, at 409 n.15 (explaining that main refinancing operations are issued weekly while longer term refinancing operations are issued monthly).

201. *See* ECB Guideline, *supra* note 191, §§ 3.1.2–3.1.3; *see also* Jones & Rechtschaffen, *supra* note 159, at 795 (describing the existence of 15 national central banks and their coordination with the European Central Bank); Evanson, *supra* note 197, at 408 (declaring that national central banks are liable for financing operations).

202. *See* MONETARY POLICY OF THE ECB, *supra* note 193, at 83. For a description of the ECB's actions after 9/11 and during August 2007; *see supra* notes 184–185.

203. *See* Carol C. Betraut, *The European Bank and the Eurosystem*, NEW ENG. ECON. REV. (2002) (describing the ECB's ability to affect liquidity with liquidity-providing and liquidity-absorbing operations); *see also* Evanson, *supra* note 197, at 406 (commenting on the ECB's goal of creating or enlarging a liquidity shortage with its minimal reserve system); *see also Monthly Report of the Deutsche Bundesbank*, 58 DEUTSCHE BUNDESBANK MONTHLY REP. 11, 11 (2006) (exemplifying the effect of ECB action on the value of the Euro).

purchase).[204] Fine-tuning operations are normally carried out by the NCBs, but with the approval of the ECB's Governing Council, they can be carried out by the ECB itself.[205]

One notable difference between open-market operations of the ECB and the Fed is that the Fed intervenes in the markets daily, whereas in noncrisis times the ECB intervenes only weekly.[206] Furthermore, the Fed conducts transactions with only a select group of securities dealers, whereas any credit institution that is financially sound and subject to the Eurosystem's minimum reserve system is eligible to participate.[207]

The ECB analogue of the Fed's discount window is its marginal lending facility.[208] Because the marginal lending facility provides liquidity to banks, an LOLR function inheres in it.[209] It also however has a monetary policy purpose, as it sets a de facto ceiling for interbank interest rates, which is a key interest rate for monetary policy.[210] As per the ECB Guideline, the marginal lending facility provides only overnight liquidity,[211] while the Fed's Reg A provides that primary and secondary credit, though normally overnight loans, can be extended for

204. *See* ECB Guideline, *supra* note 191, § 3.1.4 (clarifying the ECB's choices for fine-tuning operations); *see also* MONETARY POLICY OF THE ECB, *supra* note 193, at 73 (describing the effect of open-market transactions on interest rates). Jones & Rechtschaffen, *supra* note 157, at 795 (explaining the differences in the maturity of the various operations).

205. *See* ECB Guideline, *supra* note 191, § 3.1.4; *see also* FRANCESCO GIORDANO & SHARDA PERSAUD, THE POLITICAL ECONOMY OF MONETARY UNION: TOWARDS THE EURO 93 (Routledge 1998) (explaining NCBs carry out the fine-tuning operations through quick tenders or bilateral procedures); Banque de France, *Overview of the Monetary Policy Framework*, *available at* http://www.banque-france.fr/gb/eurosys/overview/overview.htm (last visited Feb. 13, 2008) (stating the usual procedure is for NCBs to carry out the fine-tuning operations, but the ECB's governing council may choose to carry them out instead).

206. *See* ECB Guideline, *supra* note 191, §§ 3.1.2–3.1.3 (detailing the frequency of ECB intervention in open-market operations); *see also Fine Tune, Cracking Sound*, FIN. TIMES (London), Aug. 10, 2007, at 14 (noting that the ECB operates its markets weekly).

207. *See* ECB Guideline, *supra* note 191, § 2.1; FED. RES. SYS., *supra* note 194, at 11 (discerning that various securities dealers compete to do business with the Fed). As of June 2003, there were 6,776 credit institutions in the Eurozone; only 2,243 fulfilled the operational criteria for participating in open-market operations. However, the number of counterparties that actually participated in MROs was 252 and for LROs, 136. MONETARY POLICY OF THE ECB, *supra* note 193, at 74–75.

208. *See* Pollard, *supra* note 54, at 21 (describing the ECB's marginal lending facility and the Fed's discount window as the systems for overnight loans); *see also* Jeffrey M. Wrase, *The Euro and the European Central Bank*, 3 (December) FED. RES. BANK OF PHILADELPHIA BUS. REV. n.24 (1999) (comparing the Fed's Change Special Liquidity Facility to the ECB's marginal lending facility).

209. *See* Wilmarth, *supra* note 72, at 215 (describing the Fed's authority to act as a lender of last resort); *see also* Pollard, *supra* note 54, at 19 (declaring the ECB has an unstated role as a lender of last resort even though it is not made public); Calbray L. Haines & Calvin T. Ho, *The Government Safety Net*, CHI. FED LETTER, Mar. 1, 2007 (concluding the ECB's marginal lending facility satisfies the requirements of a lender of last resort).

210. *See* MONETARY POLICY OF THE ECB, *supra* note 193, at 76 (clarifying the lender of last resort's creation of a ceiling in the money market); *see also* Ralf M. Fendel & Michael R. Frenkel, *Five Years of Single European Monetary Policy in Practice: Is the ECB Rule-Based?*, 24 CONTEMP. ECON. POL'Y 1, ¶ 8 (2006) (noting the ECB's monetary strategy allows it to put a ceiling on interest rates); Gabriel Rozenberg, *Alarm as ECB Lends Euro 3.9bn to Euro Zone Banks*, LONDON TIMES, Sept. 28, 2007 (discussing the role of the emergency funds rate in providing a ceiling and floor for the overnight interest rate).

211. *See* ECB Guideline, *supra* note 191, § 4.1.

longer periods of time if circumstances warrant.[212] Further, under ECB Guideline section 2.1, a party must be financially sound to use the marginal lending facility.[213] For the Fed's discount window, a party must be generally financially sound to have access to primary credit,[214] but secondary credit is available to an institution that does not qualify for primary credit but for whom secondary credit would be consistent with a return to market funding sources.[215]

Note that ECB Guideline § 4.1 states the marginal lending facility is "granted only in accordance with the objectives and general monetary policy considerations of the ECB"[216] and "[t]he ECB may adapt the conditions of the facility or suspend it at any time."[217] The next section of this article examines whether the ECB has authority to act as LOLR. If the ECB does not have LOLR authority, then under ECB Guideline § 4.1 the NCB providing the marginal lending assistance[218] should discontinue such access for any bank that is subject to a liquidity crisis. In such a case, the facility would be used primarily for the purpose of allowing the ESCB to act as LOLR, rather than for the purpose of implementing ECB monetary policy. Given that national institutions will likely want to protect their banks, such a decision would seem unlikely.

C. Commentators' Views on Whether the ECB Has LOLR Authority

Whether the ECB has LOLR authority is a gnawing and troubling question that has been percolating since the establishment of the ECB.[219] Whether the ECB has the authority to inject liquidity during a generalized credit crunch is an interesting academic question, but only that: A liquidity injection made for monetary policy reasons is indistinguishable from one

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212. *See* 12 U.S.C.A. § 347b(b)(1), (b)(B) (2006) (limiting when a Federal Reserve Bank may extend credit for longer periods of time); *see also* 12 C.F.R. § 201.4(a)–(b) (2006) (defining primary and secondary credit and noting a Federal Reserve Bank may situationally extend this credit for longer periods of time).

213. ECB Guideline, *supra* note 191, §§ 2.1, 4.1.

214. *See* 12 C.F.R. § 201.4(a) (2006) (announcing the terms which qualify a bank for primary credit); *see also* JONATHAN R. MACEY ET AL., BANKING LAW AND REGULATION 17 (3d ed. 2001) (defining the discount window); Steven Sloan, *Discount Window Lending Up*, AM. BANKER, Feb. 1, 2008, at 20 (reporting $43 million in primary credit loans given to strong, sound financial institutions).

215. *See* 12 C.F.R. § 201.4(b) (2006); *see also* Steven Sloan, *Fed Secondary Credit Reaches $402M.*, AM. BANKER, Oct. 26, 2007, at 19 (acknowledging $402 million in secondary credit loans to troubled financial institutions not healthy enough to obtain primary credit).

216. ECB Guideline, *supra* note 191, § 4.1.

217. *Id.*

218. Access to the marginal lending facility is granted through the NCB in the Member State in which the institution is established. *See id.*

219. *See* Lastra, *supra* note 141, at 174 (noting the European Community Treaty does not clearly authorize the European Central Bank to act as a Lender of Last Resort); *see also* Lastra, *supra* note 64, at 57 (recognizing the ambiguity as to whether the European Community Treaty grants the European Central Bank authority to act as a Lender of Last Resort); Lichenstein, *supra* note 47, at 286 (underscoring that uncertainty exists surrounding the European Central Bank's authority as a Lender-of-Last-Resort).

made for LOLR reasons.[220] But whether the ECB has the power to make special provisions for a particular distressed bank, or a group of distressed banks, is unresolved and has been troubling both commentators and the financial community for some time.[221]

On October 13, 1998, at an ECB Press Conference, the late president Willem F. Duisenberg fielded the question: "[W]hat about the lender of last resort function if there's a bank crisis and someone has to react to this?"[222] Duisenberg responded:

> On the lender of last resort: I would like to convey to you that the Governing Council is aware that discussion is ongoing in some quarters on the so called risk of financial crisis in Europe following the launch of the euro given the absence of a unique institution responsible for lender of last resort operations. Let me answer that question as follows very firmly and concisely. The Governing Council has this issue well under control but will never make anything public in this regard.[223]

Tommaso Padoa-Schioppa, one of the members of the first ECB Executive Board and a driving intellectual force behind EMU, in a 1999 speech at the London School of Economics, stated in the case of a solvent but illiquid Eurozone bank, "[t]he clear answer is that the euro area authorities would have the necessary capacity to act."[224] Padoa-Schioppa stated the Eurosystem's decision-making bodies had "carefully discussed the matter" and there were no "legal-cum-institutional" impediments to acting when needed.[225] In such a situation, Padoa-Schioppa implied, the ECB would rely on the statistical information of the NCBs regarding the health of the affected banks, but lack of direct access "should not be regarded as a specific flaw of the euro area's institutional framework."[226] After offering those legal certainties, Padoa-Schioppa stated that emergency, by its very nature, requires departure from rules and procedures, and "[w]ho cares so much about the red light when there are two metres of snow on the road?"[227] Padoa-Schioppa made clear the LOLR situation he was expounding upon was that of a specific distressed bank or banks, rather than a general liquidity dry-up or payment system

220. *See* Fratianni, *supra* note 184, at ¶ 39 (theorizing regardless of authority, a financial crisis may demand the ECB inject liquidity); *see also* Frank Partnoy, *Why Markets Crash and What Law Can Do About It*, 61 U. PITT. L. REV. 741, 809 n.264 (2000) (revealing a liquidity injection occurs when a central bank increases the money supply); Tommaso Padoa-Schioppa, Member of the Executive Bd., Eur. Cent. Bank, Remarks at the Invitation of the Central Bank of Indonesia (July 7, 2003), *available at* http://www.ecb.int/press/key/date/2003/html/sp030707.en.html (specifying the difference between liquidity injections for policy reasons and for specific lender reasons).

221. *See* Curtis J. Milhaupt, *Japan's Experience with Deposit Insurance and Failing Banks: Implications for Financial Regulatory Design?*, 77 WASH. U. L.Q. 399, 407 (1999) (revealing the European Central Bank's enigmatic policy concerning whether it can make special provisions for banks).

222. Willem F. Duisenberg, President, Eur. Cent. Bank, Press Conference at the European Central Bank (Oct. 13, 1998), transcript *available at* http://www.ecb.int/press/pressconf/1998/html/is981013.en.html.

223. *Id*.

224. *See* Padoa-Schioppa, *supra* note 220, at 27.

225. *Id*.

226. *Id*. at 27–28.

227. *Id*.

gridlock, in which case the LOLR action was so close to the monetary policy function there was no question the ECB would act as LOLR.[228]

Commentators have also considered whether the ECB enjoys LOLR authority. Dr. Rosa Lastra argued the ECB clearly would have LOLR authority if the crisis "originate[d] in the payment system,"[229] but that responsibilities for the "traditional understanding of LOLR (that of LOLR offering collateralized emergency credit lines to some specific illiquid but solvent institutions, when the problem did not originate in the payment system)" remain unclear.[230] Alessandro Prati and Garry Schinasi argue Maastricht is ambiguous as regards European LOLR authority, but that it is clear the Maastricht drafters did not foresee the need for a centralized crisis management system and the Treaty reflects the "narrow" concept of central banking envisioned by Maastricht. Namely, one that focuses almost exclusively on monetary policy.[231]

René Smits, on the other hand, argues the absence of LOLR support from the text of the ESCB Statute does not make the authority of the ECB to grant it questionable.[232] Smits argues that under ESCB Statute article 18.1 the capacity of the ECB and NCBs to act as LOLR is subsumed.[233] Moreover, Smits asserts the absence of an express LOLR function in the ESCB Statute is not surprising, "as the LOLR function is normally not spelled out openly in advance in legislation."[234]

D. Possible Sources of LOLR Authority for the ECB

To answer whether the ESCB Statute gives the ECB LOLR authority, the different situations calling for LOLR operations must be distinguished: a payments system lock-up, as in the post-9/11 liquidity crisis;[235] a general liquidity dry-up, as in the credit crunch that began in August 2007;[236] and where there is a specific distressed financial institution, or groups of such

228. *See id.*, at 28.

229. Lastra, *supra* note 141, at 174–75.

230. *Id*. Lastra opines that in the drafting of Maastricht, Germany was reluctant to accept the assignment of a LOLR feature to the ESCB for fear it would conflict with the sacrosanct goal of price stability, whereas other countries—based on national practices—favored inclusion of a clearly defined LOLR feature. *Id*.

231. Alessandro Prati & Carry Schinasi, *Will the European Central Bank Be the Lender of Last Resort in EMU*, in THE EURO: A CHALLENGE AND OPPORTUNITY FOR FINANCIAL MARKETS 229 (2000).

232. SMITS, *supra* note 146, at 269.

233. *Id.*

234. *Id.,* at 270.

235. *See* Baxter & Sommer, *supra* note 114, at 95 (discussing the various tools central banks could utilize during disruptions to the payment system); *see also* Lichtenstein, *supra* note 47, at 286 (stating the willingness of the European Central Bank to provide liquidity to markets after the 9/11 tragedy to prevent an international financial system failure); Corcoran & Hart, *supra* note 150, at 273 (acknowledging the EBC is authorized to adopt regulations to ensure sufficient and sound payment systems).

236. *See* Lastra, *supra* note 141, at 175 (demonstrating how the ECB could respond to a general drying-up of liquidity in the market); *see also* Rory Macmillan, *Towards a Sovereign Debt Work-Out System*, 16 NW. J. INT'L L. & BUS. 57, 62 (1995) (explaining how a general liquidity dry-up occurs); Christina Clemm, Article, 9 SAN DIEGO INT'L L.J. 1, 2–3 (2007) (documenting the worldwide credit crunch that began in August 2007).

institutions, such as occurred with the Northern Rock crisis.[237] Those situations must be distinguished because the ECB's LOLR authority hinges on the nature of the crisis.

In a crisis that involves a payments system lock-up, the ECB has clear authority to act as LOLR.[238] ESCB Statute § 3.1 states it is a "basic task" of the ESCB to "promote the smooth operation of payment systems."[239] Section 18.1 grants the ECB authority to conduct credit operations with credit institutions and open-market operations so long as they are conducted to carry out an objective or task assigned to the ESCB.[240] Since avoidance of a payment system lock-up is a clearly assigned task of the ESCB, the ECB was clearly within its authority to act as LOLR in the banking crisis caused by the September 11 attacks.[241]

LOLR operations in response to a generalized liquidity crunch or to help a particular distressed bank or banks, on the other hand, are less clearly within the ECB's authority.[242] Statute article 18.1 expressly grants the ESCB authority to conduct credit operations with credit institutions, but limits that authority to situations in which the credit operations are used to achieve the objectives of the ESCB or carry out its tasks.[243] Does the provision of liquidity to banks for the purpose of bank stabilization, rather than monetary policy, then come within a task or objective assigned to the ESCB?

ESCB § 2 states the primary objective of the ESCB is price stability, but that, if it is without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of Maastricht Treaty Article 2's goals.[244] Those goals include a high level of employment, the raising of the

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237. *See* Lorenzo Bini Smaghi, Member of the Executive Board of the ECB, *The Economic Governance of the European Union in Light of the Treaty of Lisbon: Harmonization or Competition Between Countries?*, Address at the Conference in Milan on the European Central Bank: A New Actor on the International Scene (Jan. 24, 2008) (commenting that the Northern Rock crisis has highlighted the need to review the regulatory framework for managing banking crises); *see also* Hadjiemmanuil, *supra* note 48, at 126 (discussing the difference between an LOLR to the market as a whole as compared to lending to individual financial institutions). *See generally* Nellis, *supra* note 195, at 270–71 (affirming that the ECB can adjust the money supply by lending to individual credit institutions in addition to open-market operations).

238. *See* Hadjiemmanuil, *supra* note 48, at 127 (asserting that issues with the operation of payment systems is a clear-cut case for the involvement of the ESCB).

239. ESCB Statute, *supra* note 46, art. 3.1.

240. ESCB Statute, *supra* note 46, art. 18.1.

241. *See* Flora Goudappel, The *Influence of European Monetary Integration on the Internal European Relationships*, 14 TUL. EUR. & CIV. L.F. 101, 107–08 (1999) (explaining how the ECB is authorized to act as LOLR in order to avoid a payment system lock-up); *see also* Nellis, *supra* note 195, at 290 (reiterating the EBC has an obligation to perform the ESCB's task of promoting the smooth operation of payment systems).

242. *See* Hadjiemmanuil, *supra* note 48, at 125 (discussing the uncertainty as to whether support to individual banks will be provided by the national central banks or by the ECB); *see also* Lastra, *supra* note 64, at 57 (noting LOLR operations that are not in response to the payment system are less clearly within ECBs' authority). Kenneth Kaoma Mwenda, *The Regulatory and Institutional Framework for Unified Financial Services Supervision in the United Kingdom and Zambia*, 13 MICH. ST. J. INT'L L. 347, 355 (2005) (suggesting central banks maintain discretion with details of LOLR practices to deter the banks' tendency to assume excessive risk).

243. *See* ESCB Statute, *supra* note 46, art. 18.1.

244. *See* ESCB Statute, *supra* note 46, art. 2.

standard of living, and a balanced economic development.[245] Increasing banks' liquidity and saving a specific illiquid bank would certainly support those Treaty Article 2 goals.[246] It would be a matter of interpretation, however, as to whether such lending prejudiced the primary ESCB objective of price stability. As with any provision of liquidity, an LOLR operation leads to inflationary pressure.[247]

Alternatively, there is the argument that either an August 2007–type liquidity injection or a loan to an illiquid bank would fulfill the ECB's § 3.3 task of contributing to the "smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions."[248]

IV. Should the ECB Act as Eurozone LOLR?

Given there can be good-faith arguments made that the ESCB Statute contains the authority for the ECB to act as LOLR, the question then becomes whether ECB *should* act as the Eurozone's LOLR.

There are some 16 banking groups active in over half of all Eurozone Member States, and those banking groups account for a significant amount of all Eurozone bank assets.[249] If the

245. *See* Treaty on European and Final Act, art. 2, Nov. 1, 1993, 31 I.L.M. 247, 256–57 (declaring the Community shall promote balanced economic development, a high level of employment and social protection, and economic and social cohesion among Member States); *see also* George B. Hefferan III & Joanne Katsantonis, *Movement Towards An Internal Market in 1993: An Overview of Current Legal Developments in the European Community*, 3 DUKE J. COMP & INT'L L., 1, 1–3 (1992) (detailing the goals of the Maastricht Treaty); Sari K.M. Laitinen-Rawana, *Creating a Unified Europe: Maastricht and Beyond*, 28 INT'L LAW. 973, 973 (1994) (commenting the Maastricht Treaty increased the scope of the Community beyond the economic realm and into areas previously reserved for Member States).

246. *See* Edward P.M. Gardener & Joe Falzon, *Introduction: The Malta Connection*, in STRATEGIC CHALLENGES IN EUROPEAN BANKING 3 (Edward P.M. Gardener & Joe Falzon, eds., Macmillan Press 2000) (stating the principal objective of European monetary policy under the Maastricht Treaty is price stability). *See generally* Georgette Chapman Poindexter & Wendy Vargas-Cartaya, *En Ruta Hacia el Desarrollo: The Emerging Secondary Mortgage Market in Latin America*, 34 GEO. WASH. INT'L L. REV. 257, 283 n.137 (explaining that an illiquid banking system can cause a financial crisis).

247. Elisabetta Gaulandri notes that sudden variations in liquidity can interfere with action on monetary policy. Elisabetta Gaulandri, *European Monetary Union: Issues in Supervision*, in STRATEGIC CHALLENGES IN EUROPEAN BANKING 267 (Edward P.M. Gardener & Joe Falzon, eds., Macmillan Press 2000); *see also* Lastra, *supra* note 141, at 175 (noting the national banks can decide whether to grant emergency liquidity assistance); Mwenda, *supra* note 242, at 355 (commenting that granting a national bank supervisory responsibilities can raise the cost of failure, leading to damaged reputation and credibility of the bank's monetary policy).

248. ECB Guideline, *supra* note 191, art. 3.3.

249. *See* Eur. Cent. Bank, *Organisation, The Eurosystem*, *available at* http://www.ecb.int/ecb/educational/facts/orga/html/or_002.en.html (last visited Feb. 13, 2008) (explaining the banking system of the Euroarea comprises the ECB and the NCBs of the 15 Member States who use the euro).

ECB did not act as LOLR, there are several possibilities for how LOLR operations could be conducted by the NCBs. Each is flawed. One option is that the NCB of the bank's "home" jurisdiction would operate as LOLR for the entire banking group.[250] That would mean, however, one NCB would bear the full credit risk for a banking group that may be present in many countries, which NCBs might be reluctant to do.[251] The other option is for each of the banks of the group to request LOLR assistance from the NCB of the jurisdiction where they are licensed, based on each bank's specific liquidity needs.[252] That option is flawed as well, because of the lack of confidence such a differentiated and unwieldy response might inspire.

On the other hand, there is good reason why the LOLR function has historically been strongly linked to the banking supervisory function.[253] It would not be ideal for the ECB to act as LOLR while at the same time needing to rely on the beneficence of the NCBs in providing information about the banks' real situation.[254] There may simply be coordination problems, or the NCBs may seek to protect their home banking institutions. Such an arrangement would mirror the UK's, where the Bank of England acts as LOLR but the FSA has supervisory authority over banks.[255] Indeed, some blame that division and the informational barriers it erected for the "serious regulatory fumble" that was Northern Rock.[256]

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250. *See* Di Giorgio & Di Noia, *supra* note 169, at 473–74 (emphasizing the debate among monetary economists on whether banking supervision and monetary policy responsibilities should be vested in the central bank); *see also* Lastra, *supra* note 141, at 175 (stating the NCBs can ultimately decide whether to grant emergency liquidity assistance).

251. *See* Corcoran & Hart, *supra* note 150, at 253 (discussing how financial conglomerates operate cross-border); *see also* Michael P. Malloy, *Emerging International Regime of Financial Services Regulation*, 8 TRANSNAT'L LAW. 329, 330–31 (2005) (showing how a bank in Italy, Banco Ambrosiano, acting as an LOLR would only honor its Italian obligations, which caused great distress in the banking industry).

252. *See* Thomas C. Baxter, Jr. & James H. Freis, *Fostering Competition in Financial Service: From Domestic Supervision to Global Standards*, 34 NEW ENG. L. REV. 57, 69–70 (1999) (alleging a central bank lender of last resort may feel pressure to bail out an insolvent institution).

253. *See* Gaulandri, *supra* note 247, at 267 (noting the LOLR is linked to monetary policy and to supervision); *see also* Ross P. Buckley, *The Essential Flaw in the Globalisation of Capital Markets: Its Impact on Human Rights in Developing Countries*, 32 CAL. W. INT'L. L. J. 119, 128 (2001) (explaining an LOLR increases banking stability by lending funds to banks on high interest rates and good security in times of need).

254. *See* Carl Felsenfeld & Genci Bilali, *A Speculation on the Future of the Bank for International Settleme*nts, 18 TRANSNAT'L L. 231, 240 (2005) (critiquing central banks that have tried to act as a LOLR for their failure to manage and administer economic reforms); *see also* Eilis Ferran, *Examining the United Kingdom's Experience in Adopting the Single Financial Regulator Model*, 28 BROOK. J. INT'L L. 257, 263–64 (2003) (rationalizing that separating monetary policies and regulatory roles could lead to inconsistencies between monetary policies and banking supervision). *But see* Lastra, *supra* note 64, at 55–56 (arguing the supranational arena could handle some supervisory functions, such as LOLR, while other supervisory responsibilities should remain with Member States).

255. *See* Lastra, *supra* note 64, at 66 (declaring the UK has taken steps for a supervisory financial authority within its jurisdiction for the whole financial sector). Gollier, *supra* note 76, at 626–27 (positing the UK has a separation of monetary and supervisory functions).

256. Andrew Hill, Tom Mitchell & Paul Betts, *Northern Rock Response Risks Undermining London*, FIN.TIMES (U.S. ed.), Dec. 6, 2007, at 16.

Therefore, the ECB should act as LOLR, but only if it is granted broader bank supervisory functions.

V. Conclusion

Given that the driving force behind the creation of the Federal Reserve System was recurring banking system instability, it is not surprising the Fed has long had clear statutory LOLR authority. The creation of the ECB, on the other hand, had nothing to do with problems in the banking system, but rather was motivated by the need for a European authority to set and implement monetary policy. The Fed and ECB acted nearly identically as LOLR during the September 11 liquidity crisis and the August 2007 liquidity crisis. That similarity masked the fact there are different needles in the Fed and ECB LOLR compasses: The Fed clearly has authority to conduct liquidity injections for purposes of bank stabilization, whereas it is not so clear the ECB can use its monetary policy tools for purposes of supporting an illiquid bank.

The ECB does clearly have statutory authority to conduct credit operations to stave off a payments system crisis. Moreover, in a generalized credit crunch situation, whether or not the ECB has authority to conduct credit operations with the purpose of stabilizing the banking system, or only has the authority to conduct credit operations to implement monetary policy, will be merely an academic question because either goal is reached via adjustment of the interbank rate. But what about "traditional" LOLR operations, where the central bank lends to a specific set of distressed banks to keep them liquid, such as the one the Bank of England conducted for Northern Rock?

Although it is not clear the ESCB Statute grants the ECB such authority, good-faith arguments can be made that it does. Policy considerations, moreover, would require the ECB to act as Eurozone LOLR in a future crisis afflicting a pan-European banking group. It should only do so, however, if it is granted broader banking supervision powers that provide the ECB access to the information needed to successfully carry out an LOLR operation, much like the Federal Reserve enjoys.

Case Comment

Microsoft v. Commission: An Article 82 EC Analysis

Case T-201/04, 2007 E.C.R. 00000

Emily C. Walsh*

I. Introduction

On September 17, 2007, the European Court of First Instance (CFI)[1] rendered its highly anticipated judgment in *Microsoft v. Commission*.[2] In this judgment, the CFI upheld the March 2004 decision of the European Commission (the Commission), in which the Commission found Microsoft abused its market power in violation of Articles 82 and 84 of the Treaty Establishing the European Community (EC).[3] Microsoft breached Article 82 EC in two ways. First, Microsoft refused to provide technical information to the producers of competing operating systems, which would allow competitors to design software interoperable with the Windows PC operating system, and second, the corporation added a digital media player to its Windows operating system.

This Comment focuses on the CFI's determination that Microsoft infringed Article 82 EC provisions and examines whether the CFI acted within its authority under Article 82 EC.

Part II provides a background history of *Microsoft v. Commission* and discusses Microsoft's refusal to supply interoperability information and the "tying together"[4] of Windows with Windows Media Player. Part III examines European case law and the "exceptional circumstances" used to determine whether Microsoft's refusal to supply interoperability information to its competitors was abusive under Article 82 EC. Part IV analyzes the CFI's interpretation of the requisite "exceptional circumstances" and concludes the CFI acted within the purview of Article 82 EC when it found Microsoft abused its dominant position in the software industry by refusing to supply interoperability information to its competitors by bundling the Windows Media Player with the Windows operating system.

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1. The CFI is the second highest court within the European Union (EU).
2. Case T-201/04, Microsoft v. Commission 2007 E.C.R. 00000 (*Microsoft*).
3. Treaty Establishing the European Community, O.J. 2002 C325/1 *available at* http://eurlex.europa.eu/en/treaties/dat/12002E/htm/C_2002325EN.003301.html.
4. "Tying together" refers to the bundling of the Windows Media Player with the Windows operating system, and is discussed more fully in Part II, *infra*.

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II. Facts and Procedural Posture

In 1998, Sun Microsystems, Inc. (Sun)[5] filed a complaint with the Commission[6] against Microsoft Corp. (Microsoft)[7] pursuant to Article 3 of the Council Regulation No. 17 of February 1962, First Regulation.[8] Sun alleged Microsoft had a dominant position in the PC operating system market, and Microsoft withheld necessary information and technology that prevented Sun's workgroup server operation systems from fully interoperating with Microsoft's PC operating systems.[9]

In February 2000, the Commission independently launched an investigation related to Microsoft's Windows generation of client PC and workgroup server operating systems, as well as Microsoft's integration of its Windows Media Player into its Windows client PC operating system.[10] On March 24, 2004, the Commission issued its decision, finding Microsoft twice abused[11] its dominant position[12] in violation of Article 82 EC[13] and Article 54[14] of the Agreement of the European Economic Area (EEA). Microsoft violated these articles by refusing to supply and authorize the use of interoperability information[15] and by tying together the Windows client PC operating system and the Windows Media Player.[16] As a result, the Commission fined Microsoft €497,196,304 and imposed a number of additional remedies.[17] Microsoft

5. *Microsoft* at ¶ 2 (stating Sun Microsystems, Inc. is a company based out of the United States, which supplies servers and server operating systems).

6. *Id*. at ¶ 6 (noting the complaint that Sun filed against Microsoft).

7. *Id*. at ¶ 1 (describing Microsoft Corp. as a company based out of the United States that designs, develops, and markets software products for different computing devices).

8. EEC Council Regulation 17: First Regulation implementing arts. 85 and 86 of the Treaty, 1962 OJ (L 13/204) (prohibiting the abuse of a dominant position in the market to ensure competition will not distort the market).

9. *Microsoft* at ¶ 7 (discussing Sun's complaint against Microsoft).

10. *Id*. at ¶ 10.

11. *Id*. at ¶ 36 (holding Microsoft abused its dominant position by refusing to supply its competitors with interoperability information that would allow its competitors to develop and distribute products that compete with Microsoft's own products).

12. *Id*. at ¶ 21–30 (reporting the Commission found there are three separate worldwide product markets: client PC operating systems; workgroup server operating systems; and streaming media players. Of those three product markets, the Commission found Microsoft had a dominant position on two of them: client PC operating systems and workgroup server operating systems.).

13. Treaty Establishing the European Community, *supra* note 3.

14. Agreement on the European Economic Area art. 54, 1994 OJ (L 03/01) (outlining the requirements for abuse of a dominant position under the Agreement).

15. *Microsoft* at ¶¶ 36–42 (contending Microsoft's refusal to supply its competitors with "interoperability information" risks foreclosing competition and can be detrimental to technical development and consumer welfare).

16. *Id*. at ¶¶ 43–45 (finding Microsoft's bundling the Windows Media Player with the client PC operating system constitutes tying).

17. *Id*. at ¶¶ 22, 46–50 (assessing the penalties the Commission imposed on Microsoft. Among the remedies of the contested decision: the Commission required Microsoft to make the interoperability information available to any competitor that wanted to develop and distribute workgroup server operating systems, to offer a version of the Windows client PC operating system that did not include the Windows Media Player, and to establish a mechanism to assist the Commission in monitoring Microsoft's compliance with the contested decision.).

contested the Commission's findings that it abused a dominant position,[18] as well as the fine and remedies.[19] On December 22, 2004, the CFI denied Microsoft's request for a stay of the order, and ordered Microsoft to comply with the Commission's decision.[20] Microsoft appealed that decision.

Microsoft's request that the Commission's decision be annulled rested on three issues: (1) the use of interoperability information; (2) the tying together of the Windows Media Player and the Windows client PC operating system; and (3) Microsoft's obligation to appoint an independent monitor to ensure Microsoft's compliance with the contested decision.[21] This Comment focuses on the first two issues and their relation to Article 82 EC.

The CFI Upheld Microsoft's Violation of Article 82 EC

After examining the Commission's decision, the CFI agreed Microsoft violated Article 82 EC. Article 82 EC governs a company's unilateral conduct that may restrict market competition.[22] The Article prohibits "[a]ny abuse[23]. . . of a dominant position within the common market or in substantial part of it."[24] Article 82 EC applies only to companies that possess a dominant market position,[25] and requires the abuser use its dominant position "in a manner contrary to . . . competition on the merits."[26] The Court of Justice defines a dominant position under Article 82 EC as "a position of economic strength enjoyed by an undertaking which enables it to prevent an effective competition being maintained on the relevant market by affording it the power to behave in an appreciable extent independently of its competitors, its customers, and ultimately of the consumers."[27] Having a dominant position is not contrary to EU competition rules, unless that company abuses its position.[28] The CFI found Microsoft abused its dominant position and upheld the lower decision.

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18. *Id*. at ¶¶ 21, 30–31 (deciding Microsoft has held a dominant position on the client PC operating systems since at least 1996 and on the workgroup server operating system market since 2002. To determine the dominance in the PC operating systems market, the Commission considered that Microsoft's market shares are over 90 percent, it's market power has "enjoyed an enduring stability and continuity," there are significant barriers to market entry because of indirect network effects, and the network effects result (1) from users' preference for platforms that allow for a multitude of applications and (2) because software designers write applications for the most popular operating systems.).
19. *Id*. at ¶¶ 46–50.
20. Microsoft v. Comm. of the European Communities T-201/04R2, 2004, E.C.R. (Ct. First Instance 2004).
21. *Microsoft* at ¶ 83.
22. Neelie Kroes, *Tackling Exclusionary Practices to Avoid Exploitation of Market Power: Some Preliminary Thoughts on the Policy Review of Article 82*, 29 FORDHAM INT'L L.J. 593, 593 (2006).
23. COMP/C-3/37/792 at 146. The Court of Justice defined abuse as "an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition." *Id*.
24. Treaty Establishing the European Community, *supra* note 3.
25. Kroes, *supra* note 22 at 594.
26. Femi Alese, *Microsoft and the European Union's Antitrust Authority,* 238 N.Y.L.J. 4 (2007).
27. COMP/C-3/37.792 at 118.
28. Sue Ann Mota, *Hide It or Unbundle It: A Comparison of the Antitrust Investigations Against Microsoft in the U.S. and the EU*, 3 PIERCE L. REV. 183, 190 (2005).

1. The Refusal to Supply and to Authorize the Use of Interoperability Information

The CFI affirmed the degree of interoperability[29] required by the Commission. In the contested decision, the Commission examined interoperability under Council Directive 91/250/EEC,[30] which defines interoperability as the "ability to exchange information and mutually to use the information which has been exchanged."[31] In the *Microsoft* context, the CFI regarded interoperability as the ability of two software products to exchange information necessary to facilitate functionality "in all the ways envisaged."[32] Although the CFI regarded compatibility with Article 82 EC as paramount to compatibility with Directive 91/250/EEC,[33] the CFI found the Commission correctly determined the degree of interoperability required by Article 82 EC.

Part of the *Microsoft* decision hinged on Microsoft's refusal to license what it claimed was protected intellectual property (IP) rights. An IP right, like all other property rights, grants the holder the right to exclude others from using the property and allows the holder to profit from the value of the property.[34] Article 82 EC restricts the use of IP rights because in some circumstances a refusal to license an IP right may constitute abuse of a dominant position.[35] Article 82 EC prohibits abuses by only undertakings in a dominant position; absent a finding of dominance, Article 82 EC will not apply.[36] While courts have not decided the question of "dominance" directly, the threshold that constitutes market power generally is a market share of above 40 percent.[37] However, European Commissioner on Competition Neelie Kroes has stated that high market share alone is not sufficient to conclude a dominant position.[38] Instead, a detailed analysis is required to determine an undertaking's substantial market power.[39] Kroes

29. *Microsoft* at ¶ 37 (defining interoperability information as the "complete and accurate specifications for all the protocols [implemented] in Windows . . . operating systems and used by Windows . . . servers to deliver file and print services and group and user administrative services").

30. EU Directive 91/250/EEC Celex No. 391L0250 (*available at* http://www.scaramanga.co.uk/archives/directive-91-250-EEC.html).

31. *Id*. The Council Directive on the legal protection of computer programs affords copyright protection to the expression of computer programs but requires functional interconnection and interaction between a computer program and other components of a computer system, or interoperability. *Id*.

32. Microsoft, 2007 E.C.R. 00000 at ¶ 225.

33. *Id*. at ¶ 227 (calling Article 82 EC a "provision of higher rank than Directive 91/250").

34. Donna M. Gitter, *Strong Medicine for Competition Ills: The Judgment of the European Court of Justice in the IMS Health Action and Its Implications for Microsoft Corporation*, 15 DUKE J. COMP. & INT'L L. 153, 172 (2004) (arguing an inability to exclude others from using an IP right will destroy incentives to invest in the creation of IP).

35. *See, e.g.*, Case 238/87, AB Volvo v. Erik Veng (UK) Ltd. 1988 E.C.R 6211; Case 53/87, Consorzio italiano edlla componentistica di ricambio per autoveicoli and Another v. Renault, 1988 E.C.R. 6039.

36. Simon Chalkley, *International Licensing and Competition Law Considerations in Licensing Transactions Affecting the European Economic Area*, 927 P.L.I./ PAT. 167, 202 (2008).

37. *Id.* at 202 (noting the greater market power above 40 percent, the more likely the entity will be in a dominant position).

38. Kroes, *supra* note 22 at 594–95 (explaining while market share can provide a strong indication of dominance, a full economic analysis is necessary to determine the degree to which competitors can constrain the behavior of the allegedly dominant undertaking).

39. Kroes, *supra* note 22 at 594.

considers the market position of the undertaking, competitors, and buyers, as well as barriers to expansion and entry.[40] In the context of IP rights, a dominant firm can exclude third parties from its licenses,[41] and this right to exclude can have important effects on innovation.[42]

Dominance itself is not a violation of Article 82 EC, there must also be an abuse of the dominant position that precludes competition.[43] Article 82 EC does not define abuse but lists four examples: (1) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions; (2) limiting production, markets, or technical development to the prejudice of consumers; (3) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and (4) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which have no commercial connection with the subject of such contracts.[44] According to Commissioner Kroes, the objective of Article 82 EC is to protect competition and avoid consumer harm.[45]

European case law suggests there are two types of abuse: exclusionary and exploitative.[46] Exclusionary abuses are those which limit competitors' production, markets, or technical development, discrimination that places competitors at a disadvantage, or tying that prevents a competitor from entering a market.[47] Some examples of exploitative abuses include excessive pricing, unfair trading conditions, and product integration that places additional burdens on consumers.[48] In cases where the issue comprises a "refusal to deal," European courts have considered thoroughly whether the refusal would have "exclusionary effects and/or whether, given the relevant circumstances, the refusal can be justified."[49]

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40. *Id.*

41. *Volvo*, *supra* note 35 at ¶ 8.

42. *See* Christian Ahlborn, David S. Evans, & A. Jorge Padilla, *The Logic and Limits of the "Exceptional Circumstances Test" in Magill and IMS Health*, 28 FORDHAM INT'L L.J. 1109, 1136–37 (2005) (explaining that compulsory licensing may reduce the incentive to innovate in the long run, may increase short term competition, and may increase the ability of third parties to innovate).

43. *See* Chalkley, *supra* note 36 at 202 (2008); *see also Microsoft* at ¶ 229 (stating the finding of a dominant position does not in itself apply criticism to the undertaking concerned, but the undertaking has "a special responsibility . . . not to allow its conduct to impair genuine undistorted competition on the common market").

44. Treaty Establishing the European Community, *supra* note 3.

45. Kroes, *supra* note 22 at 595–96.

46. Maurtis Dolmans, Robert O'Donoghue & Paul-John Lowenthal, *Article 82 EC and Intellectual Property: The State of the Law Pending the Judgment in Microsoft v. Commission*, 3 COMPETITION POLICY INTERNATIONAL 107, 114 (2007), *available at* http://ssrn.com/abstract=987331; *see also* Kroes, *supra* note 22 at 595 (listing exclusionary, exploitative and discriminatory abuses but noting some abuses may both exclude and exploit or discriminate).

47. *See* Dolmans, O'Donoghue & Lowenthal, *supra* note 46 at 114; *see also* Kroes, *supra* note 22 at 597–98 (explaining exclusionary abuses can be non-price based, such as contractual tying, "naked" refusals to supply, and single-branding obligations, or price-based, such high stand-alone prices in comparison to a low bundled price for two products, high rebates on condition of single branding, predatory pricing, and combining a high upstream price with a low downstream price).

48. *See* Dolmans, O'Donoghue & Lowenthal, *supra* note 46 at 114.

49. James S. Venit, *Article 82: The Last Frontier—Fighting Fire with Fire?* 28 FORDHAM INT'L L.J. 1157, 1167 (2005).

A refusal to supply licenses may constitute abuse when the dominant undertaking "denies an actual or potential licensee access to an input to exclude it from participating in an economic activity."[50] Microsoft argued its refusal to supply interoperability information is not an abuse of a dominant position within Article 82 EC because the information is protected by IP rights.[51] Yet, the CFI found that although dominant undertakings are free to choose their business partners, sometimes a refusal to supply might constitute an abuse of a dominant position.[52] This portion of the decision will be discussed further in Part III.

The first charge against Microsoft involved Microsoft's refusal to supply and authorize interoperability information, or specifications necessary for its competitors to work with Windows. At the most basic level, computing takes place on a network, or group of computers, using Windows operating systems. Computer networks connect to a central server that enables the network to share information. Servers operate behind the scenes and allow user access to different functions, such as sharing files among multiple users and e-mails.[53] Workgroup servers are "low end" servers that link with PC clients.[54] Servers vary in size depending on the nature of tasks they perform,[55] but mainly they facilitate networking tasks. For operating systems of workgroup servers to be effective, they have to work with the PC operating systems.[56] For the efficient operation of these systems, there must be interoperability between the Client PC Windows operating system and the operating server system.[57] As the manufacturer of Windows, the dominant PC operating system, Microsoft can control the interfaces of the PC operating system, and reduce the interoperability of competitors' workgroup server operating systems.[58] Unless Microsoft provides its rivals with necessary interoperability information, competitors cannot align their products with Microsoft's products. This can cause a significant time lag in operating and leaves rivals without realistic operating alternatives.

The following example demonstrates how a lack of interoperability information can harm competitors. In Windows 2000, security services[59] are based on a protocol called Kerberos.[60]

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50. Daryl Lim, *Beyond Microsoft: Intellectual Property, Peer Production and the Law's Concern with Market Dominance*, 18 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 291, 293 (2008).

51. *Microsoft* at ¶ 312. Microsoft maintained the interoperability information was secret and protected by copyright and patents. *Id.*

52. *Id.* at ¶ 319.

53. Alese, *supra* note 26 at 2.

54. Kai-Uwe Kühn & John Van Reenen, *Interoperability and Market Foreclosure in the European Microsoft Case*, *in* CASES IN EUROPEAN COMPETITION POLICY: THE ECONOMIC ANALYSIS, 5 (B. Lyons ed., Cambridge University Press forthcoming), *available at* http://ssrn.com/abstract=1013929.

55. *Id.* at 9.

56. *Id.* at 5.

57. Alese, *supra* note 26 at 2.

58. Kühn & Van Reenen, *supra* note 54 at 5.

59. Security services include authentication and authorization.

60. Kerberos is an open security protocol that authenticates security users on a network. *See* http://web.mit.edu/Kerberos/ (last visited July 11, 2008).

Though Kerberos is a public protocol,[61] Microsoft added extensions for Kerberos in Windows 2000 that create interoperability problems.[62] As a result of this modification, when a Windows 2000 computer encounters a Kerberos "ticket,"[63] Windows 2000 will permit access only if the information appears in the Windows format, and a non-Windows 2000 server cannot process a "ticket" request in the Windows 2000 format.[64] Thus, if a network wants to use Windows 2000 on any computer, it needs to run Windows 2000 on *all* computers or the systems will not function properly.[65] This control and market dominance gives Microsoft the "power to exclude potential rivals that produce complementary products" by denying them access to the PC operating system.[66] In other words, by denying interoperability, Microsoft can make it difficult or impossible for non-Microsoft operating systems to communicate with Windows and thereby function correctly.

A large portion of the case focused on whether Microsoft refused to supply and authorize use of interoperability information. Regarding the required level of operability, Microsoft argued that the lower court's decision required Microsoft to disclose information that would allow its competitors to create "functional equivalents" of the Windows operating systems.[67] These "functional equivalents" would result in systems that were essentially perfect substitutes for the Windows systems,[68] while Directive 91/250[69] only requires different operating systems be able to "function correctly" together.[70] According to Microsoft, the Commission wanted a degree of interoperability that could only occur if Microsoft allowed its competitors to copy or "clone" its products.[71] Furthermore, Microsoft attested the required interoperability could be achieved by methods already available.[72]

The CFI found Microsoft implemented measures that reduced interoperability of competing systems and refused to divulge the specifications necessary for rivals to interoperate with Windows.[73] Microsoft's definition of interoperability was incompatible with Directive 91/

61. *See* Thomas A. Lane, *Of Hammers and Saws: The Toolbox of Federalism and Sources of Law for the Web*, 33 N.M. L. REV. 115, 118 (2003) (explaining public protocols are openly published and a user need adopt them to perform a particular action).

62. Michael Froomkin, *Habermas@Discourse.Net: Toward a Critical Theory of Cyberspace,*116 HARV. L. REV. 749, 837 (2003).

63. *Id.* at 837 (defining a ticket as "a security token that allows a client to identify itself to other resources on the network").

64. Kühn & Van Reenen, *supra* note 54 at 12.

65. *See Id.* at 5; *see also* Froomkin, *supra* note 62 at 837 (explaining any networks that installed Windows 2000 on their desktops would also have to install Windows 2000 on their servers to have network security).

66. *See* Kühn & Van Reenen, *supra* note 54 at 5.

67. *Microsoft* at ¶ 129 (arguing the Commission's contested decision would require Microsoft to enable its competitors to create operating systems nearly identical to Windows).

68. *Id*. (asserting that creating functional equivalents of the Windows systems would create systems that are essentially identical to Windows systems).

69. EU Directive, *supra* note 30.

70. *Microsoft* at ¶ 211 (claiming Directive 91/250 requires different developers' operating systems to function together and that the contested decision goes beyond the "full interoperability" called for in Directive 91/250).

71. *Id*. ¶ 212.

72. *Id*. at ¶ 213.

73. Alese, *supra* note 26 at 3.

250.[74] In response to Microsoft's "functional equivalent" argument, the CFI held the Commission's decision would not permit competitors to "clone" Microsoft's products.[75] Instead, the disclosure would enable other products to understand "messages conveyed by Microsoft's relevant products."[76] The CFI wanted to allow other companies to develop products that could compete with Microsoft. To allow for competition, the decision assumes non-Microsoft operating systems can exchange specific messages on the same conditions as Windows operating systems.[77] To exchange specific messages, the operating systems need not function identically. Furthermore, Article 5 of the contested decision "does not require Microsoft to disclose implementation details to its competitors."[78] Lastly, the CFI held the existing methods of interoperability that Microsoft cited were insufficient for Microsoft's competitors to remain on the market.[79]

2. Tying Together Windows Media Player and the Windows Client PC Operating System

The second charge alleged that Microsoft's integration of its media player with the dominant Windows operating system constituted tying, which caused Microsoft to violate Article 82 EC.[80] Media players encode media content into digital media forms, making files transferable over the Internet and allowing for media streaming.[81] By bundling the Windows Media Player with the dominant Windows PC operating system, Microsoft secured a competitive advantage in a market that has "nothing to do with the actual quality of its product."[82] Technologically, the tying ensured the two products could not be dissociated without damaging the integrated system.[83]

The Commission and the CFI examined four factors to conclude Microsoft violated the "tying" portion of Article 82 EC: (1) the tied products must be two separate products; (2) the tying product must dominate the market; (3) consumers must not have a choice to obtain the tying product without the tied product; and (4) the practice in question must foreclose competition.[84] The CFI agreed with the Commission's analysis of the four factors and upheld that portion of the decision.

First, Microsoft's bundling Windows Media Player with its Windows operating system constituted tying because the two are wholly exclusive products. That is, one is a media player, and the other is a PC operating system. Second, Microsoft controlled 95 percent of the client

74. *Microsoft* at ¶ 138.

75. *Id*. at ¶ 141.

76. *Id*. at ¶ 141.

77. *Id*. at ¶ 237.

78. *Id*. at ¶ 241.

79. *Id*. at ¶ 139.

80. *Id*. at ¶ 850 (rejecting Microsoft's arguments regarding Article 82 EC).

81. Kühn & Van Reenen, *supra* note 54 at 28.

82. *Id*.

83. Alese, *supra* note 26 at 4.

84. *Microsoft* at ¶ 842 (outlining the requirements for a violation of Article 82 EC).

PC operating systems market,[85] giving it a dominant position.[86] Third, despite the disassociation of the two products, consumers did not have the choice of purchasing the Windows operating system without the Windows Media Player.[87] Microsoft did not offer the two products separately, though it was entirely possible to do so.[88] Fourth, the tying allowed Microsoft to foreclose competition. Consumers could not purchase Windows without simultaneously acquiring the Windows Media Player. Since the Windows PC operating system dominates the market, and since Windows Media Player cannot be uninstalled, Microsoft essentially coerced consumers into using the Windows Media Player[89] at the expense of competitors.

The CFI concluded Microsoft's bundling practice forecloses competition in the media players market.[90] The CFI examined the bundling of Windows and Windows Media Player from May 1999 and agreed with the Commission's finding that this bundling had significant consequences on competition. The CFI considered the unparalleled advantages bundling afforded Microsoft, including the ubiquity of Windows Media Player throughout the world, a disincentive for consumers to use third party media players, and a disincentive for OEMs to pre-install competitors' players on client PCs.[91] The bundling essentially afforded Windows Media Player an enormous presence on client PCs worldwide, unfairly giving the media player a level of market penetration corresponding to that of the Windows client PC operating system.[92]

The Windows Media Player automatically achieved this prominence without having to compete with other media players.[93] No third-party media player could achieve such a level of market penetration without having the advantage of distribution that Windows Media Player enjoys because of Microsoft's use of its Windows client PC operating system.[94] The bundling discouraged consumers from using a third-party media player because those with Windows Media Players pre-installed on their computers were less likely to use alternative media players, as they already had a media player.[95] Since the Windows client PC operating system is so

85. *Id*. at ¶ 940 (discussing Microsoft's share of the industry).

86. *Id*. at ¶ 854 (noting the Commission's position on Microsoft's role in the PC operating systems market. Also noting Microsoft did not dispute that fact).

87. *Id*. at ¶ 856.

88. *Id*. at ¶ 927. The CFI found numerous reasons why Microsoft does not have to bundle the two products. Since competitors, such as Apple and RealNetworks, develop and supply streaming media players without operating systems, it is not essential Microsoft tie the products together. Furthermore, there are versions of Microsoft's Media Player that can work with non-Microsoft operating systems. Lastly, consumers can download Windows Media Player from the Internet without the Windows PC operating system. *Id*.

89. *Id*. at ¶¶ 961–63 (declaring Microsoft contractually and technically coerced consumers into using the Windows Media Player).

90. *Id*. at ¶¶ 1054, 1069.

91. *Id*. at ¶ 1069.

92. *Id*. at ¶ 1038.

93. *Id*. at ¶ 1038.

94. *Id*. at ¶ 1039–46 (listing reasons why the bundled version of Windows and Windows Media Player had the "direct and immediate consequence" of preventing consumers from choosing one of Windows Media Player's competitors over the Windows Media Player).

95. *Id*. at ¶ 1041 (upholding the Commission's finding that the pre-installation of Windows Media Player discourages consumers from using an alternative media player).

pervasive, methods of distribution of the Windows Media Player other than bundling could not offset the Windows Media Player's ubiquity.[96] The CFI held that tying Windows Media Player with the dominant Windows client PC operating system makes Windows Media Player the platform of choice and therefore risks eliminating competition.[97] Therefore, the CFI upheld the Commission's ruling regarding Microsoft's violation of Article 82 EC.

III. European Case Law and the "Exceptional Circumstances Test"

The implications of this decision for software and computer companies, as well as other industries, have yet to be understood. Prior to *Microsoft*, the European Courts have never addressed the application of Article 82 EC in intellectual property cases involving patents.[98] There has been much debate on whether this judgment broadens the Commission's power to apply Article 82 EC to dominant undertakings. To determine if there has been a broadening of power, first we must examine how courts have applied Article 82 EC to dominant undertakings in the past using the exceptional circumstances test. The exceptional circumstances test developed over time in European case law, and is the way in which the CFI determined whether Microsoft violated Article 82 EC. Upon examination of the test and prior courts' applications, it is clear the CFI's approach in *Microsoft* was neither broad nor beyond the CFI's scope of authority.

The CFI began its analysis by examining previous European Court of Justice (ECJ) case law. In three important earlier cases, *Radio Telefis Eireann (RTE) and Independent Television Publications Ltd (ITP) v. Commission of the European Communities* (*Magill*),[99] *Oscar Bronner GmbH & Co. KG v. Mediaprint Zeitungs-und Zeitschriftenverlag GmbH & Co.* (*Bronner*),[100] and *IMS Health GmbH & Co. OHG v. NDC Health GmbH & Co. KG* (*IMS Health*),[101] the European courts decided that in certain "exceptional circumstances" there could be a violation of Article 82 EC for the dominant holder of an IP right not to license that right.[102]

A. *Magill*

In *Magill*, the ECJ required compulsory licensing of an IP right and set forth a standard for determining abuse of a dominant position.[103] This 1995 case concerned three television broadcasters that asserted copyrights in their TV program schedules to prevent Magill TV Guide, Ltd., the publisher of a comprehensive weekly television program guide, from listing their programs.[104] At the time there was no comprehensive weekly television program guide

96. *Id*. at ¶¶ 1049–53 (claiming other methods of distribution are not effective and foreclose competition).

97. *Id*. at ¶¶ 857, 1037.

98. Venit, *supra* note 49 at 1157 n.64.

99. Joined cases C-241/91P and 242/91, 1995 ECR I-743.

100. Case C-7/97, ECR I-7791 (1998).

101. Case C-418/01, ECR I-5039 (2004).

102. Harry First, *Strong Spine, Weak Underbelly: The CFI Microsoft Decision*, 2, *available at* http://ssrn.com/abstract=1020850.

103. Rita Coco, *Antitrust Liability for Refusal to License Intellectual Property: A Comparative Analysis and the International Setting,* 12 MARQ. INTELL. PROP. L. REV. 1, 15 (2008).

104. Commission Decision No. 89/205/EEC, O.J. L 78/43 (1989).

covering all three stations available to the Irish public.[105] The Commission held the three television broadcasters abused their dominant position and the CFI upheld that decision.[106] The ECJ decided a refusal to supply the copyrighted television program listings would constitute abuse only under "exceptional circumstances" where: (1) the product to which the refusal to supply relates was an indispensable input required for the marketing of a new product; (2) there was no justification for such refusal; and (3) the dominant company reserved for itself the secondary downstream market.[107] The central factor in *Magill* was the unjustified exclusion of a new product, a comprehensive weekly television guide, for which there was demand. The three television broadcasters' copyrighted program listings were indispensable input required for the program guides, which none of the TV broadcasters was capable of providing alone.[108] Therefore, the CFI's judgment "g[ave] specific content to the restriction of competition" by anchoring the competition in an "output restriction" that damage[d] consumers because of the unavailability of a novel product not provided by any of the dominant firms.[109]

B. *Bronner*

Bronner not only affirmed the "exceptional circumstances" conditions in *Magill*, it expanded the IP case law to "all refusals to share 'whatever' asset, as long as it is essential."[110]

Though *Bronner* did not involve IP licensing, it provided a framework for addressing all refusal to deal cases, regardless of the denied asset. In *Bronner,*[111] Mediaprint, an Austrian publisher with a large market share, operated a nationwide newspaper distribution network, the only home delivery distribution network in Austria. Oscar Bronner, the publisher of a rival newspaper, claimed he needed to access Mediaprint's newspaper distribution network so that his paper could adequately compete with Mediaprint. In its decision, the ECJ relied on *Magill*, reiterating that a refusal to supply access to the newspaper distribution network would be an abuse only "if such refusal would eliminate all competition."[112] Examining *Magill*, the ECJ found that to plead the existence of an abuse of dominant position, it was necessary the refusal of the upstream input was likely to eliminate all competition on the part of the person requesting the downstream market, the refusal was unjustified and the input was indispensable for the lack of any actual or potential substitute.[113] Using these criteria, the court found no abuse. The distribution network was not indispensable for Bronner to compete because there were other methods of newspaper distribution available.[114]

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105. *Id.*

106. *See id.*

107. Oscar Bronner GmbH & Co. KG v. Mediaprint Zeitungs-und Zeitschriftenverlag GmbH & Co., Case C-7/97, [1998] E.C.R. I-7791, [1999] 4 C.M.L.R. 112 (*Bronner*).

108. Venit, *supra* note 49 at 1172.

109. *Id.*

110. Coco, *supra* note 103 at 18.

111. *Bronner*, *supra* note 107.

112. Venit, *supra* note 49 at 1173.

113. *Bronner*, *supra* note 107.

114. *Id.* at ¶ 44 (finding there are no technical, legal, or economic obstacles that would make it impossible or unreasonably difficult for any other publisher to establish its own nationwide home-delivery system and use it to distribute its own newspapers).

C. *IMS Health*

Though there was some question as to the exclusivity of the *Magill* "exceptional circumstances" and an obligation to license IP rights, the ECJ subsequently confirmed the three conditions were not meant to be exclusive in *IMS Health*.[115] IMS Health created a brick-structured[116] data reporting service that tracked pharmaceutical sales in Germany. German copyright law protected the brick structure.[117] IMS Health's competitor tried to market a competing data reporting service using a similar structure to the copyrighted brick structure. In the lower court's decision, the Commission attempted to extend the "exceptional circumstances" criteria from *Magill* by requiring compulsory licensing when a dominant firm exploits IP rights and the complainant wants to offer a similarly structured data reporting service.[118] Yet the ECJ affirmed other European case law,[119] holding that for unilateral refusals to license copyrights to be abusive, the three cumulative conditions from *Magill* need be satisfied.[120] The court held it "sufficient, [but] not necessary, that the three conditions exist,"[121] although when they do exist they must be cumulative.[122] *IMS Health* explicitly applied the *Magill* and *Bronner* rulings[123] and agreed with the criteria those cases asserted.

Taken together, these cases establish that under the exceptional circumstances test, a refusal to grant access to "indispensable" IP rights to stimulate competition is an abuse that requires compulsory licensing when "the grant of a license must result in a 'new product,' the failure to grant that license must 'exclude any competition' and the refusal must not be 'objectively justified.'"[124] Courts typically evaluate these circumstances on a case-by-case basis with a thorough examination of the facts. "Indispensability implies that the input or information in question is essential for the exercise of a viable activity on the market for which access is sought."[125] To determine indispensability, *Bronner* required the Commission to examine whether the costs of duplication are so exorbitant they produced a barrier that would "deter[] any prudent undertaking from entering the market"[126] or whether there was no "actual or potential substitute in existence."[127] In *IMS Health* the ECJ decided that pursuant to *Bronner*, indispensability was defined as whether a competitor could use or create an "economically via-

115. Case C-418/01, IMS Health GmbH v. NDC Health GmbH, [2004] E.C.R. I-5039 (IMS v. NDC).

116. IMS tracked data on regional sales of pharmaceutical products throughout the world and reported this information to pharmaceutical laboratories. In Germany, IMS divided geographic areas into a grid of 1,860 separate segments, called bricks. Each brick corresponded to a designated geographic area in which IMS gathered data and created regional market reports for each brick. *Id*.

117. *Id*. at ¶¶ 37–38.

118. IMS Health v. Commission, Case T-184/01 R, [2001] E.C.R. II-3193.

119. *See* IMS v. NDC at ¶¶ 35–8 (affirming *Volvo*, *Bronner*, and *Magill*).

120. *Id*.

121. Coco, *supra* note 103 at 16.

122. *See IMS*, *supra* n.118.

123. Coco, *supra* note 103 at 17.

124. Ahlborn, Evans & Padilla, *supra* note 42 at 1122.

125. Dolmans, O'Donoghue & Lowenthal, *supra* note 46 at 127.

126. Oscar Bronner GmbH & Co. KG v. Mediaprint Zeitungs-und Zeitschriftenverlag GmbH & Co., Case C-7/97, [1998] E.C.R. I-7791, [1999] 4 C.M.L.R. 112. at p. 66.

127. *Bronner* at ¶ 41.

ble" substitute.[128] This required an examination of whether there were "technical, legal or economic obstacles" that made it difficult or impossible to create alternatives.[129] The Commission was required to examine whether there were any commercially feasible alternatives, and whether the cost or time lag of such alternatives was prohibitive.

As detailed above, the ECJ found an abuse of a dominant position where an undertaking desires to produce new products or services and where there is potential for high consumer demand. The ECJ found that only a refusal to grant a license prevented the creation of a new product in *Magill*, where there was no comprehensive weekly television program guide.[130] However, the Court did not establish guidelines to determine whether a product is "new." As a result, because "it is a matter of judgment whether a product is a 'new' one,"[131] the ECJ required that the refusal to supply merely must result in excluding competition.[132]

The final requirement is that the refusal to license must be unjustified to violate Article 82 EC. Generally, European case law provides little guidance as to what types of justifications are legitimate defenses.[133] In fact, "[t]here are few, if any, published cases in which a legitimate business justification for a refusal to supply has been accepted by the Courts or the Commission."[134] Despite sparse guidelines in case law, the test to determine if a refusal to license is justified is objective[135] and turns on the "dominant firm's behavior, rather than its intent."[136]

IV. The CFI's Analysis of *Microsoft* Under the "Exceptional Circumstances" Test

In making its decision, the CFI examined whether the circumstances identified in *Magill* and *IMS Health* were present here.[137] Microsoft argued the appeal must be analyzed in light of *Magill* and *IMS Health* and the criteria from those cases[138] had not been satis-

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128. IMS v. NDC at ¶ 28.

129. *Id*. at ¶ 28 (holding that according to *Bronner*, to establish economic obstacles, at the very least the creation of those products or services is not economically viable for production "on a scale comparable to that of the undertaking" that currently controls the product or service).

130. *Magill*, 1995 E.C.R. at I-824 (1995) 3 C.M.L.R. at 791.

131. Ahlborn, Evans, & Padilla, *supra* note 42 at 1125.

132. IMS v. NDC at ¶¶ 37–38.

133. Gitter, *supra* note 34 at 176.

134. *See* James S. Venit & John J. Kallaugher, *Essential Facilities: A Comparative Law Approach*, *in* INTERNATIONAL ANTITRUST LAW & POLICY: FORDHAM CORPORATE LAW 1994 315, 317 n. 6 (Barry Hawk, ed. 1995); *see also* John Temple Lang, *Defining Legitimate Competition: Companies' Duties to Supply Competitors and Access to Essential Facilities*, 18 FORDHAM INT'L L.J. 437, 522 (1994) (noting there is "relatively little case law" on what constitutes a legitimate business justification).

135. Lang, *supra* note 135 at 522 (declaring a dominant undertaking's intent is irrelevant).

136. Gitter, *supra* note 34 at 176–77.

137. *Microsoft* at ¶ 331.

138. *Id*. at ¶ 116. Microsoft argued the criteria required under *Magill* and *IMS Health* characterize a dominant undertaking's refusal to grant third parties a license as abusive are: (1) where the produce or service concerned is indispensable for carrying on a particular business; (2) where the refusal is liable to exclude all competition on a secondary market; (3) where the refusal prevents the emergence of a new product for which there is a potential consumer demand; and (4) where the refusal is not objectively justified.

fied.[139] Relying on those judgments, Microsoft claimed its refusal was not abusive and the Commission cannot order Microsoft to disclose interoperability information.[140] In the alternative, Microsoft argued the CFI should have examined the *Bronner* appeal to realize the criteria had not been satisfied in *Bronner* either.[141] Conversely, the Commission claimed *IMS Health* did not establish "an exhaustive list of exceptional circumstances."[142] Instead, the ECJ "established a list of criteria that was 'sufficient' to satisfy."[143] The Commission maintained that to determine whether the refusal to license was abusive, the CFI should have considered all the circumstances, which were not necessarily the circumstances identified in *Magill* and *IMS Health*.[144] Furthermore, even if the CFI chose to analyze the circumstances in light of *IMS Health*, the criterion was satisfied in *Microsoft*.[145] The Commission also disputed Microsoft's argument that the facts should be analyzed in terms of the criteria in *Bronner*. The Commission argued *Bronner* involved access to an infrastructure that required substantial investment, and therefore was not protected by IP rights. As a result, *Bronner* was not a "relevant point of comparison."[146]

In *Microsoft*, the CFI held an undertaking in a dominant position merely refusing to license an IP right to a third party does not constitute abuse of a dominant position within Article 82 EC.[147] It is only where "exceptional circumstances" exist there may be such an abuse.[148] The CFI found "exceptional circumstances" where "(i) the refusal relate[d] to a product or service indispensable to the exercise of a particular activity on a neighboring market; (ii) the refusal [wa]s of such a kind as to exclude any effective competition on the neighboring market; and (iii) the refusal prevent[ed] the appearance of a new product for which there is potential consumer demand."[149] Once a court finds those three circumstances are present, the refusal to license may violate Article 82 EC "unless the refusal is objectively justified."[150] The CFI also noted that for the refusal to constitute abuse, it is necessary to distinguish two markets, a market in which the dominant undertaking refusing to supply holds a dominant position, and a neighboring market in which the product or service is used in the manufacture of another product or for the supply of another service.[151]

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139. *Id.* at ¶ 112 (Microsoft maintained that the refusal must be analyzed as a refusal to license to third parties related to IP rights and because the Commission's decision imposes compulsory licensing).

140. *Id.*

141. *Id.*

142. *Id.* at ¶ 303.

143. *Id.* (asserting that to determine whether a dominant undertaking's refusal to supply constitutes an abuse, the Commission must examine the entire range of factors, particularly the economic and regulatory background).

144. *Id.* at ¶ 316.

145. *Id.* at ¶ 311.

146. *Id.* at ¶ 310.

147. *Id.* at ¶ 331.

148. Case T-201/04, Microsoft v. Commission, 207 E.C.R. 00000 at ¶ 331.

149. *Id.* at ¶ 332.

150. *Id.* at ¶ 333.

151. *Id.* at ¶ 335 (noting that the fact that the indispensable product is not marketed separately does not exclude the possibility of identifying a separate market).

The CFI first determined whether the circumstances from *Magill* and *IMS Health* were present in *Microsoft*.[152] If one or more of those factors were missing, the CFI would "assess the particular circumstances invoked by the Commission."[153]

A. The Indispensable Nature of the Interoperability Information

Microsoft contended the interoperability information required by the contested decision was dispensable because it was "economically viable" for Microsoft's competitors to develop and market their products without having access to Microsoft's technology.[154] Microsoft asserted the Commission made an error of law and fact on the issue of interoperability.[155] The error in law arose where the Commission used an "inappropriate, extraordinary and absolute standard" to determine whether competition could exist.[156] Microsoft criticized the Commission's assessment of interoperability because the Commission examined what was necessary to enable Microsoft's competitors to remain viable on the market.[157] The Commission's interoperability analysis, Microsoft argued, required "virtual identity" between Windows and competing operating systems.[158] Under the contested decision, if such a concept had to be accepted, "any technology would be indispensable."[159] Microsoft maintained the contested decision erred in fact because the Commission failed to account for other workgroup server operating systems on the market.[160] Furthermore, Microsoft argued there were five ways[161] to achieve interoperability between non-Microsoft server operating systems and Windows, and these methods were an alternative to disclosure because they allowed the different operating systems to "work well together."[162]

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152. *Id*. at ¶ 336.

153. *Id*. at ¶ 336. *See also id*. at ¶ 317 (asserting the Commission's three characteristics for abuse are (1) the information which Microsoft refuses to disclose to competitors relates to interoperability; (2) Microsoft uses its extraordinary power on the client PC operating systems market to eliminate competition on the adjacent workgroup server operating systems market; and (3) the conduct in question involves disruption of previous levels of supply).

154. *Id*. at ¶ 337.

155. *Id*. at ¶¶ 338–44.

156. *Id*. at ¶ 339.

157. *Id*. at ¶ 340.

158. Case T-201/04, Microsoft v. Commission, 207 E.C.R. 00000 at ¶ 340.

159. *Id*.

160. *Id*. at ¶¶ 343–44 (presenting evidence interoperability exists between different types of operating systems in Europe).

161. *Id*. at ¶¶ 345–46 (describing the methods of interoperability as the use of standard protocols, the addition of a software code to a Windows client PC or server operating system to allow communication with a non-Windows server operating system using communication protocols specific to the non-Microsoft operating system, the addition of a software code to a non-Microsoft server operating system to foster communication with a Windows client PC or server operating system using communication protocols specific to Windows, the use of a server operating system as a "bridge" between two different sets of communication protocols, and the addition of a "block" of software code to all the client PC and server operating systems in a network to allow communications between the different "blocks").

162. *Id*. at ¶ 345.

Conversely, the Commission countered Microsoft's allegations of error of law and fact by claiming Microsoft's disclosure of the interoperability information was indispensable for rivals to compete.[163] The Commission argued the indispensability criteria required an examination of the "degree of interoperability necessary to remain as a viable competitor on the market" and whether the information being withheld was the only "economically viable source for achieving" interoperability.[164] The Commission emphasized the importance of interoperability between workgroup server operating systems with client PCs and Microsoft's dominance on the client PC operating system market.[165] The Commission countered Microsoft's claim that the interoperability required "virtual identity" by arguing it was not indispensable Microsoft's competitors be able to reproduce the interoperability solutions, but they be able to achieve "an equivalent degree of interoperability by their own innovative efforts."[166] Furthermore, the five alternative methods of achieving interoperability Microsoft proposed were only "feasible" and did not constitute "viable substitutes to disclosure of the interoperability information at issue."[167]

After examining the arguments, the CFI rejected Microsoft's assertions of errors of law and fact. The Court stated that for rivals to compete viably with the Windows workgroup server operating systems, there must be interoperability on an equal footing.[168] The CFI affirmed the Commission's finding that "interoperability with the client PC operating system is of significant competitive importance in the market for workgroup server operating systems,"[169] and this interoperability was even more important in the case of Windows client PC operating systems.[170] The Court considered the Commission's findings that Microsoft's competitors encountered a series of problems because their workgroup server operating systems could not interoperate with Windows to the same degree as the Windows workgroup server operating systems.[171] The Court ultimately concluded Microsoft failed to establish that the Commission erred when it determined non-Microsoft workgroup server operating systems must be able to interoperate with Windows on "an equal footing" with Windows.[172] The CFI also found that the lack of such interoperability reinforced Microsoft's competitive position because it induced consumers to use Microsoft's workgroup server operating system in preference to that of Microsoft's rivals.[173] After considering both parties' arguments, the CFI concluded Microsoft failed to demonstrate that the interoperability information was not indispensable.

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163. *Id*. at ¶¶ 351–66.

164. *Id*. at ¶ 352.

165. *Id*. at ¶ 353.

166. *Id*. at ¶ 357.

167. *Id*. at ¶¶ 361–63.

168. Case T-201/04, Microsoft v. Commission, 207 E.C.R. 00000, at ¶¶ 230, 374.

169. *Id*. at ¶¶ 381–83 (finding computer programs are designed to communicate and function with other computer programs, particularly in network environments, and explaining the need to function together is particularly pressing in this case).

170. *Id*. at ¶ 386.

171. *Id*. at ¶¶ 414–20.

172. *Id*. at ¶ 421.

173. *Id*. at ¶ 422.

The CFI's analysis was completely supported by ECJ precedent and statute. The CFI analyzed interoperability in light of Directive 91/250EEC, which requires computer programs to communicate and function with other programs, particularly in a network setting.[174] Microsoft's refusal to supply interoperability information frustrated Directive 91/250EEC's purpose by slowing and sometimes preventing interoperability between its computer programs and that of its competitors. The CFI's finding the interoperability information indispensable is fully consistent with *Magill*, which held the television program listings were indispensable because the TV broadcasters needed the information to create a comprehensive program guide. Similarly, the interoperability information was essential for Microsoft's competitors to design and manufacture computer programs compatible with Microsoft's. The CFI's holding on indispensability factor of the exceptional circumstances test was fully consistent with precedent and statute.

B. Whether the Failure to License Eliminates Competition

Microsoft criticized the Commission's findings and argued the refusal did not exclude competition on a secondary market. Microsoft backed its argument using prior case law,[175] where the Court determined that refusal was likely to eliminate all competition and required "something close to certainty."[176] Yet, in the contested decision, the Commission referred to a mere "risk" of eliminating competition, a test that is not strict enough.[177] Microsoft also claimed market conditions would not permit foreclosure of competition,[178] and criticized the Commission's "artificially narrow" definition of the second product market as well as the methodology the Commission used to calculate the market share of operators in the second product market.[179]

The Commission asserted Microsoft's refusal to license risked eliminating effective competition on the secondary market for workgroup server operating systems.[180] The Commission claimed there was a "high likelihood that the risk will be realized in the near future" if Microsoft's conduct was not stopped.[181] The Commission rejected Microsoft's assertions and argued that Microsoft's refusal to disclose interoperability information harmed its competitors' capacity to meet consumer expectations and altered the conditions of competition.[182] The

174. *Id*. at ¶ 381.

175. Joined Cases 6/83 and 7/73, Commercial Solvents v. Commission [1974], ECR 223; Case 311/84 *CBEM* [1985] ECR 3261.

176. *See* Case T-201/04, Microsoft v. Commission, 207 E.C.R. 00000 at ¶¶ 437–39 (claiming the Commission's test was wrong in law, and the Commission should have applied a stricter test of whether there was a "high probability" of eliminating competition).

177. *Id*. at ¶ 439.

178. *See id*. at ¶ 441 (claiming it is common for European undertakings to have heterogeneous computer environments and consumers do not consider interoperability with Windows to be a determining factor when purchasing operating systems).

179. *See id*. at ¶¶ 443–52.

180. *Id*. at ¶ 454.

181. *Id*. at ¶ 455.

182. *Id*. at ¶¶ 463–75.

Commission disregarded Microsoft's criticism of the method it used to calculate market share altogether; all that mattered was that a risk of foreclosing competition in the market existed.[183]

Considering Microsoft's argument regarding the required test, the CFI held Microsoft's complaint was "purely one of terminology and is wholly irrelevant."[184] Prior case law used the phrases "risk of elimination of competition" and "likely to eliminate competition" interchangeably.[185] The Commission had great incentive to apply Article 82 EC in this case before the foreclosure of competition had become a reality.[186] The CFI pointed out the definition of a second market is "not based on the idea that there is a separate category of server operating systems exclusively implementing" file and print services or user and group administration services.[187] Instead, the workgroup server operating systems could carry out any number of other tasks, and the Commission did not define the second product market too narrowly.[188] Furthermore, Microsoft failed to demonstrate the method used by the Commission to calculate the market share in the second product market was inappropriate.[189] The CFI found Microsoft's refusal to share information confined its competitors' products to marginal positions or even made them unprofitable.[190] Therefore, Microsoft's refusal risked eliminating competition within the purview of Article 82 EC. The objective of Article 82 EC is to "maintain undistorted competition in the common market and, in particular, to safeguard the competition that still exists on the relevant market."[191] The CFI examined the competition in the same manner as the ECJ in *Bronner* and *IMS Health*: by identifying an upstream market, composed of the product, and a secondary, or downstream market, on which the product in question is used for the production of another product.

C. Whether the Refusal Prevented the Marketing of a New Product

Microsoft argued its refusal to provide interoperability information did not prevent a competitor's introduction of a new product for which there is unsatisfied consumer demand.[192] Microsoft and its competitors already had server operating systems on the market;[193] there were no new products in question, nor was there a demand for such a product.[194] The contested decision did not encourage the development of new products. Rather, the decision allows com-

183. *Id*. at ¶ 475.

184. *Id*. at ¶ 561.

185. *Id*.

186. *See* Case T-201/04, Microsoft v. Commission, 207 E.C.R. 00000 at ¶ 562 (explaining since the market is characterized by significant network effects, once competition is eliminated it would be difficult to reverse).

187. *Id*. at ¶ 485.

188. *Id*. at ¶¶ 485–99.

189. *Id*. at ¶¶ 533–57.

190. *Id*. at ¶ 593.

191. *Id*. at ¶ 561.

192. *Id*. at ¶ 621.

193. *Id*. at ¶ 622.

194. *Id*. at ¶ 624 (asserting the Commission merely claims that Microsoft's rivals could use the interoperability information to develop advanced features to their own products).

petitors' products to mimic the functionality of Microsoft products,[195] which only reduces innovation.[196] In addition, Microsoft denied that its refusal harmed consumers.[197]

The Commission rejected Microsoft's argument that the refusal to provide interoperability information did not prevent the appearance of a new product for which there was consumer demand. The Commission argued that under *IMS Health*, for a product to be new, it is sufficient for the concerned product to contain elements that result from the licensee's efforts.[198] However the Commission did not confine itself to *IMS Health*; it also examined the criteria of Article 82 EC, which prohibits abuses of a dominant position that limit technical development to the prejudice of consumers.[199] In addition, Microsoft's argument that the "new product" criterion was not satisfied was based on a misinterpretation of the case law.[200] The Commission explained proposed new products will respond to potential demand[201] and competitors will use the interoperability information to market improved products with added value over previous products.[202]

The CFI found there was a new product present.[203] In its decision, the CFI emphasized that Microsoft's prevention of the emergence of a new product must be considered under Article 82 EC. Because Article 82 EC prohibits abusive behaviors that limit products, markets, or technical developments to the detriment of consumers,[204] the circumstances under which *Magill* and *IMS Health* analyzed the appearance of a new product cannot be the only parameter to determine whether a refusal to license an IP right harms consumers.[205] The Court considered that Microsoft's refusal limited technical development and found that once the interoperability obstacles are removed, competitors would be able to develop distinguished workgroup server operating systems.[206] If Microsoft's competitors are able to use the interoperability informa-

195. *Id*. at ¶ 623.

196. Case T-201/04, Microsoft v. Commission, 207 E.C.R. 00000 at ¶ 627 (arguing the compulsory licensing ordered by the Commission will reduce innovation because Microsoft will have less incentive to develop new technology if it will have to share that technology with competitors).

197. *Id*. at ¶ 628 (citing a report in which no consumer claimed that it had been forced to use Windows as a result of the alleged refusal to disclose interoperability information).

198. *Id*. at ¶ 631.

199. *Id*. at ¶ 632 (asserting Microsoft's refusal was a "refusal to allow follow-on innovation," which would allow the development of new products).

200. *Id*. at ¶ 638.

201. *Id*. at ¶ 639.

202. *Id*. at ¶ 631.

203. *Id*. at ¶¶ 647–56 (explaining while there is not a specific "new" product at stake here, Microsoft's refusal to supply interoperability information to competitors prevented those competitors from developing and marketing operating systems with innovative features. The lack of this innovation could harm consumers by locking them into a homogeneous Windows solution and prevent the creation of new products.).

204. *Id*. at ¶ 643.

205. *Id*. at ¶ 647.

206. Case T-201/04, Microsoft v. Commission, 207 E.C.R. 00000 at ¶¶ 648–56 (considering that a lack of interoperability limited consumer choice and was therefore damaging to consumers).

tion, they will differentiate their products to "maintain a profitable presence on the market."[207] Finally, the CFI stated case law establishes that Article 82 EC pertains to both direct and indirect prejudices against consumers, such as impairing competition, which Microsoft did.[208] As detailed in Part II, the ECJ found a refusal to grant a license prevented a new product only in *Magill*, and the Court did not establish any guidelines to determine whether a product is "new." Yet, the CFI noted that in considering whether there is a new product, both *Magill* and *IMS Health* placed the analysis in the context of harm to consumers.[209] In this framework, the CFI drew a reasonable inference that Microsoft's refusal to license interoperability information could prevent third parties from creating new products and further homogenize the computer program industry. This could substantially harm consumers, as they would be left with fewer options. The lack of interoperability information could stifle innovation and increase Microsoft's dominance, which is precisely what Article 82 EC was enacted to prevent.

D. The Absence of Objective Justification

Microsoft argued its refusal to supply interoperability information was objectively justified because Microsoft holds IP rights and does not want its competitors to use Microsoft technology to compete with the software giant.[210] In addition, Microsoft claimed the Commission established a new balancing test that was a radical departure from previous tests.[211] Under such a balancing test, dominant undertakings have less incentive to invest in innovation, as they must share their developments with competitors.[212] Microsoft also criticized the Commission for failing to provide guidance to dominant undertakings to determine whether "preserving their incentives to innovate can justify a decision to retain their intellectual property for their own use."[213] In addition, the Commission provided no indication of how it administered the test and how it should be applied in the future.[214]

The Commission rejected Microsoft's objective justification it had IP rights in the concerned technology. According to the Commission, such a justification is unacceptable under *Magill*, which involved compulsory licensing of a copyright.[215] In *Magill*, the contested decision called for the compulsory licensing of a copyright for the companies concerned, yet the ECJ denied the refusal was objectively justified.[216] The CFI considered the ECJ upheld the compulsory licensing of a copyright, regardless of the dominant firm's IP rights, and decided to subject *Microsoft* to the same compulsory licensing. Further, Microsoft failed to prove how a

207. *Id.* at ¶ 658.

208. *Id.* at ¶ 664.

209. *Id.* at ¶¶ 647–48.

210. *Id.* at ¶ 665 (maintaining Microsoft has invested in designing its communication protocols and is rewarded with commercial success).

211. *Id.* at ¶¶ 669–70 (contending the Commission considered a refusal to supply information protected by IP rights in violation of Article 82 EC if the positive impact on the level of innovation in the whole industry outweighed the negative impact of the dominant undertaking's incentives to innovate).

212. *Id.* at ¶¶ 670–71.

213. *Id.* at ¶ 671.

214. *Id.*

215. *Id.* at ¶ 678.

216. Case T-201/04, Microsoft v. Commission, 207 E.C.R. 00000.

compulsory license would reduce its incentive to innovate.[217] The Commission denied having adopted a new test for determining an objective justification.

The CFI noted the burden of proving an objective justification falls to Microsoft, and the Commission must demonstrate that Microsoft's justification is unacceptable.[218] As its sole justification, Microsoft asserted that IP rights covered the relevant communication protocols. Yet, the Court found that under *Magill* and *IMS Health*, a refusal to license an IP right is not an objective justification.[219] In addition, Microsoft failed to prove that disclosing the interoperability information would have a negative impact on its incentives to innovate.[220] The CFI also disregarded Microsoft's argument that the Commission applied a new balancing test.[221]

As was done in *Magill* and *IMS Health*, the CFI first determined whether there were exceptional circumstances present, before determining whether Microsoft's refusal to disclose the interoperability was objectively justified. Since Microsoft could not offer an objective justification and the exceptional circumstances criteria were satisfied, the CFI correctly found Microsoft to be in violation of Article 82 EC.

The CFI's *Microsoft* decision has been met with mixed reviews. When the decision was published, Thomas Barnett, Assistant Attorney General for the Antitrust Division of the U.S. Department of Justice, issued a press release in which he stated, "[T]he standard applied . . . by the CFI, rather than helping consumers, may have created a legal precedent that, at least from the DOJ's perspective, may have the unfortunate consequence of harming consumers. . . ."[222] However, sentiment differs in Europe. On the day the CFI judgment was read in court, Commissioner Kroes issued a public statement in which she stated the judgment was a "bittersweet" victory against Microsoft.[223] Kroes stated,

> [T]he court has confirmed the importance of interoperability for consumer choice and innovation in high tech industries. If competitors are unable to make their products "talk to" or work properly with a dominant company's products, they are prevented from bringing new innovative products onto the market, and customers are locked into the products of the existing provider. Consumers want interoperable products, and companies that want to meet consumers' demands should be able to provide them.[224]

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217. *Id*. at ¶ 680.

218. *Id*. at ¶ 688.

219. *Id*. at ¶ 689.

220. *Id*. at ¶ 697.

221. *Id*. at ¶¶ 704–10 (finding Microsoft's argument about the new evaluation test was based upon a misreading of the contested decision. The Commission established the exceptional circumstances from *Magill* and *IMS Health* were present, and then considered Microsoft's objective justification outweighed the exception circumstances).

222. U.S. Department of Justice Press Release, September 17, 2007, *available at* http://www.usdoj.gov/atr/public/press_releases/2007/226070.htm.

223. Commission Press Release, SPEECH/07/539 *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/539&format=HTML&aged=1&language=EN&guiLanguage=en. The judgment is "bittersweet because the Court has confirmed the Commission's view that consumers are suffering at the hands of Microsoft."

224. *Id*.

The disparate opinions likely stem from different antitrust philosophies and approaches in the United States and the European Union. In 1998, 20 U.S. states and the District of Columbia brought proceedings against Microsoft under the Sherman Act.[225] Microsoft violated the Sherman Act by tying Internet Explorer to the Windows operating system and for unlawfully monopolizing the operating system market and the web browser market. The U.S. Court of Appeals for the District of Columbia Circuit held Microsoft monopolized the operating system market for personal computers[226] but did not violate the browser market.[227] The Court remanded the tying issue.[228] After the Court of Appeals gave its judgment, Microsoft settled with the DOJ. Microsoft agreed to allow its Windows server operating systems to interoperate with its PC operating systems and to grant third parties licenses to do the same. Furthermore, Microsoft agreed to let original equipment manufacturers (OEMs) activate or eliminate access to its middleware, including the Windows Media Player. All government action ended against Microsoft in 2004.

In contrast, the European Union has taken a more aggressive approach to Microsoft's antitrust violations.[229] This may stem from a fundamental difference in treatment of trade secrets: The U.S. "treats trade secrets with the same deference as IP rights," whereas EU policy makers do not believe trade secrets deserve the same level of protection as IP rights.[230]

An interesting difference between the U.S. and EU cases is that in the U.S. Microsoft did not have to "unbundle its own applications software from Windows operating systems."[231] The district court noted "it is not a proper task for the court to undertake to redesign products."[232] As a result, in the U.S. Microsoft had to hide its browser, while in the EU Microsoft had to remove the Windows Media Player from its operating system and license interoperability information to its competitors.

While the differing antitrust approaches to Microsoft in the U.S. and the EU may account for the converging views on the *Microsoft* case, perhaps there is another cause.

Is there, as Barnett suggests, a reason to be concerned with the standard the CFI applied? Briefly, no. Though the ramifications of this decision may extend "well beyond the world's largest software maker to other high-technology companies,"[233] this case does not mark a serious break with ECJ precedents, nor is it an expansion of the CFI's Article 82 EC authority. To argue otherwise would be unfounded.

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225. 15 U.S.C. §§ 1–2 (1991).

226. United States v. Microsoft Corp., 253 F.3d 34, 52–54 (D.C. Cir. 2001).

227. *Id*. at 80.

228. *Id*. at 84.

229. Mota, *supra* note 28 at 194.

230. Katarzyna A. Czapracka, *Antitrust and Trade Secrets: The U.S. and the EU Approach*, 24 SANTA CLARA COMPUTER & HIGH TECH. L.J. 207, 208–9 (2008).

231. Mota, *supra* note 28 at 189.

232. N.Y. v. Microsoft Corp., 224 F. Supp. 2d 76, 158 (D.D.C. 2002).

233. Kevin J. O'Brien & Steve Lohr, *Microsoft Ruling May Bode Ill for Other Companies,* N.Y. TIMES, Sept. 18, 2007*, available at* http://www.nytimes.com/2007/09/18/technology/18soft.html?_r=2&oref=slogin&pagewanted=print &oref=sln.

The CFI held, consistent with ECJ case law in *Magill* and *IMS Health*, that "a simple refusal, even on the part of an undertaking in a dominant position, to grant a license to a third party cannot in itself constitute an abuse of a dominant position within the meaning of Article 82 EC."[234] Only when the refusal is accompanied by the exceptional circumstances outlined in *Magill* and *IMS Health* can a refusal be characterized as abusive.[235] If the exceptional circumstances are present, the refusal to license may violate Article 82 EC "unless the refusal is objectively justified."[236] If one or more of the "exceptional circumstances" are missing, the CFI will examine the Commission's additional characteristics for abuse.[237] Those characteristics are:

(1) The information that Microsoft refuses to disclose to competitors relates to interoperability; (2) Microsoft uses its extraordinary power on the client PC operating systems market to eliminate competition on the adjacent workgroup server operating systems market; and (3) the conduct in question involves disruption of previous levels of supply.[238]

The CFI acknowledged the exceptional circumstances were not the only criterion to determine whether there has been a violation of Article 82 EC, if one or more of the factors are missing. This is wholly consistent with *IMS Health*, where the ECJ held that for a refusal to be abusive, "it is sufficient that three cumulative conditions be satisfied. . . ."[239] Thus, the three exceptional circumstances should not be the only factors considered. However, if the exceptional circumstances are considered, all three conditions must be satisfied for a violation of Article 82 EC. In *Magill* and *IMS Health,* the ECJ never held the exceptional circumstances were the only circumstances applicable to refusal cases.[240] As we have seen, the CFI examined Microsoft and the Commission's arguments in light of the exceptional circumstances. Since the exceptional circumstances applied, the CFI never addressed the additional circumstances raised by the Commission, and the CFI did not indicate if the refusal would have been abusive under those additional circumstances. Even though the Commission used a balancing test and evaluated the refusal under different criteria, the CFI used the "exceptional circumstances" test and found it was satisfied. The CFI did not adopt a new legal standard; it simply followed ECJ precedent in determining whether Microsoft's refusal to supply interoperability abused a dominant position under Article 82 EC.

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234. Case T-201/04, Microsoft v. Commission, 207 E.C.R. 00000 at ¶ 691.

235. *Id*.

236. *Id*. at ¶ 333.

237. *Id*. at ¶ 336.

238. *Id*. at ¶ 317.

239. IMS v. NDC at ¶ 38.

240. Frank L. Fine, *The CFI Decision in Microsoft: What Are Its Implications for Dominant Firms?* 273 CORPORATE COUNSEL'S INT'L ADVISOR 1, 4 (2008).

V. Conclusion

As the CFI demonstrated, whether an Article 82 EC infringement is found turns on the court's interpretation of the "exceptional circumstances" criteria. This is not a new legal standard for the application of Article 82 EC in refusal to license intellectual property cases. The CFI's decision complies fully with ECJ precedent set forth in *Magill*, *Bronner*, and *IMS Health*. One can speculate which standard the CFI would have employed if the exceptional circumstances were not satisfied, but an alternate test was not necessary. It is too early to determine the complete impact of the *Microsoft* judgment on the international community. The judgment may open the door to more aggressive antitrust policies, or might modify the way the Commission enforces Article 82 EC. While the full ramifications may not be known for years, one thing is certain: In *Microsoft*, the standard used to determine a violation of Article 82 EC remained static.

Stawski v. Stawski

43 A.D.3d 776, 843 N.Y.S.2d 544, 44 (2007)

The New York Supreme Court, Appellate Division, held that the public policy favoring parties deciding their own interests through contractual arrangements applies to prenuptial agreements duly executed in foreign jurisdictions absent a showing of fraud, overreaching, or misrepresentation.

I. Holding

In *Stawski v. Stawski*[1] the Supreme Court of New York, Appellate Division, First Department, New York County, affirmed a Supreme Court judgment enforcing a prenuptial agreement executed in Germany.[2] The court held prenuptial agreements executed in foreign countries should be given the same presumption of legality as other contractual agreements, barring the plaintiff's showing of fraud, concealment of facts, misrepresentation, or other forms of deception.[3]

II. Facts and Procedural History

The plaintiff, Lili Stawski, was an American citizen who married the defendant, Axel Stawski, a German citizen.[4] The claim involved a prenuptial agreement the parties executed in Frankfurt Germany in 1974, prior to their 1975 marriage.[5] At the time the agreement was executed, the 22-year-old plaintiff was pursuing a graduate degree at New York University.[6] She spoke German as a second language, functionally but not proficiently.[7] The plaintiff and the defendant executed the agreement while they were staying with the defendant's family in Frankfurt.[8]

The agreement provided each spouse would retain ownership of all property held at the time of marriage or thereafter.[9] The defendant's father's lawyer drafted the agreement in German.[10] An official representative of a German Notar (a public official with specialized training beyond law school) explained the consequences of the agreement to the plaintiff in English.[11]

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1. 43 A.D.3d 776, 843 N.Y.S.2d 544 (2007).
2. *Id.* at 776.
3. *Id.* at 777.
4. *Id.* at 776.
5. *Id.*
6. *Id.* at 776–77.
7. *Id.*, dissenting opinion at 784.
8. *Id.* at 781.
9. *Id.* In German law, this optional marital regime is called *Gütertrennung*. *See* §1414 Bürgerliches Gesetzbuch (Civil Code).
10. *Id.* at 776, 786.

After ensuring the plaintiff understood the agreement, the representative proceeded with its execution.[12] The plaintiff executed the agreement voluntarily, under no signs of duress.[13] After the marriage, the plaintiff abided by the agreement, maintaining a separate bank account and keeping her real property in her own name.[14]

Over 30 years later, the plaintiff petitioned the Supreme Court, New York County, to set aside the prenuptial agreement on the grounds the plaintiff executed the agreement without understanding the consequences[15] and the defendant overreached and was in a position of "great influence and advantage"[16] at the time the parties signed the agreement. The Special Referee of the Court,[17] Marian Lewis, denied the claim, holding the agreement enforceable in light of evidence demonstrating the plaintiff understood the document before execution.[18] The plaintiff appealed.

III. Discussion

A. Standard of Review

The standard of review in this case was outcome determinative. "The decision of the fact-finding court should not be disturbed upon appeal unless it is obvious that the court's conclusions could not be reached under a fair interpretation of the evidence.[19] This especially holds true when the findings of fact rest in large measure on considerations relating to the credibility of witnesses."[20] Since the plaintiff and the defendant presented differing testimony in regard to the plaintiff's understanding of the agreement and the conduct of the defendant and his family, the lower court decided the case based mainly on witness credibility.[21] As a result, the Appellate Division decided whether or not the special referee based her decision on a fair interpretation of the evidence.[22] The court ruled she did.

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11. *Id.* at 776–77.
12. *Id.* at 776.
13. *Id.* at 777.
14. *Id.*
15. *Id.*
16. *Id.*, dissenting opinion at 782.
17. *Com. Litig. in New York State Courts*, N.Y. PRAC. § 30:11 (2d ed.) (defining a special referee as a person who determines the issues presented, resolves conflicting testimony and resolves credibility issues).
18. *Id.* at 779–80.
19. *Id.* at 777 (quoting Thoreson v Penthouse Intl., 80 N.Y.2d 490, 495, 606 N.E.2d 1369 (N.Y. Ct. App. 1992)).
20. *Id.*
21. *Stawski*, 43 A.D.3d at 777.
22. *Id.*

B. Burden of Proof

The court stated a prenuptial agreement was subject to the same analysis as any other contract.[23] The court reiterated a main public policy tenet of contract law favoring "individuals ordering and deciding their own interests through contractual arrangements."[24] To overcome this presumption of enforceability, plaintiffs must demonstrate fraud, overreaching by the party seeking to enforce the agreement, concealment of facts, or another form of deception.[25]

The plaintiff's burden is difficult. Here, the plaintiff contended she did not have a sufficient understanding of the agreement before execution, because of the defendant and his family's overreaching.[26] The specific facts alleged by the plaintiff include her limited understanding of the German language[27] and the official representative of the Notar receiving employment through the defendant's father.[28] As a result, the plaintiff contends the Notar did not provide her with an adequate understanding of the agreement,[29] presumably because he had a vested interest in the deal being executed.

The trial court and majority[30] of the Appellate Division decided the evidence put forth by the plaintiff failed to fulfill her burden of proof.[31] The trial court believed the testimony of the Notar's representative,[32] who testified he translated the document and explained the ramifications to the plaintiff.[33] He further stated execution was allowed only after the plaintiff satisfied him that she attained a full understanding of the agreement.[34] Given these facts, the trial court ruled the plaintiff did not satisfy her burden of proof.[35]

C. Enforceability of Foreign Contracts

The rule of enforcement applicable to domestic contracts applies to foreign contracts.[36] While contract parties should understand an agreement before executing it, a party that is negligent or careless in signing legally binding documents should not be given the benefit of the

23. *Id.*
24. *Van Kipnis v. Van Kipnis*, 43 A.D.3d 71, 76–77 (2007).
25. *Stawski*, 43 A.D.3d at 777.
26. *Id.*, dissenting opinion at 780–81.
27. *Id.* at 784.
28. *Id.* at 781.
29. *Id.*, majority opinion at 776–77.
30. In his dissent, Judge Saxe concluded the plaintiff satisfied her burden of proof, because of the facts that the agreement was signed while the parties were visiting the defendant's parent's home in a foreign county and the plaintiff did not have her own independent legal adviser at the time the prenuptial agreement was executed. *Id.* at 783.
31. *Id.* at 777.
32. *Id.* at 779.
33. *Id.* at 776.
34. *Id.*
35. *Id.* at 779.
36. *Id.* at 777.

doubt, especially when that party is sophisticated.[37] By incorporating this language, the trial court implied the plaintiff was to abide by the contract even if she did not fully understand the agreement due to her own negligence, barring any deception of the part of the defendant.[38]

The plaintiff claimed she executed the agreement as a result of the defendant's fraud.[39] She testified someone informed her the document was meant to protect the defendant in the event of bankruptcy.[40] Later, the plaintiff could not identify this adviser.[41] The trial court rejected this allegation of fraud[42] and instead gave more credibility to the Notar's representative's testimony[43] that he read the document to the plaintiff in English and she understood the document before signing the contract.[44] In affirming, the Appellate Division stated the lower court fairly interpreted the evidence, while rejecting the fraud allegation.[45]

IV. Conclusion

The Appellate Division's holding relied on the credibility of the representative of the Notar's testimony.[46] The court gave deference to the special referee on this matter,[47] because she was in a better position to assess witness credibility, having heard the testimony of all witnesses firsthand. In concluding reliance on the representative's testimony was a "fair interpretation of the evidence,"[48] the Appellate Division demonstrated its willingness to accept the credibility of third-party witnesses who are not directly interested in the enforcement of a contract.[49]

Furthermore, the court stressed foreign prenuptial agreements are contracts and should be treated as such.[50] Therefore, the policy favoring legality of contractual agreements between parties, barring a showing of fraud, deception or duress, should be applied to foreign prenuptial agreements.[51] Parties claiming they did not know the effects of a document they signed, especially in the cases of sophisticated individuals, do not fulfill this burden.[52] Instead, a party must demonstrate clearly there was fraud, deceit, or duress.

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37. *Stein-Sapir v. Stein-Sapir*, 52 A.D.2d 115, 117, 382 N.Y.S.2d 799 (1976).
38. *Stawski*, 43 A.D.3d at 778–79.
39. *Id.* at 779.
40. *Id.*
41. *Id.*
42. *Id.*
43. *Id.*
44. *Id.* at 777.
45. *Id.* at 777, 779.
46. *Id.* at 779.
47. *Id.* at 777.
48. *Id.*
49. *Id.* at 779.
50. *Id.* at 777.
51. *Id.*
52. *Id.* at 778–79.

The court places a heavy burden on those wishing to rescind prenuptial agreements. Not only will the party seeking nonenforcement have to demonstrate poor conduct by the other party,[53] but the court will also usually believe witnesses who were not parties to the agreement over a plaintiff.[54] That being said, future couples entering into prenuptial agreements will be more likely to spend additional resources to understand the entire agreement before execution if they have the expectation such agreements will be enforced unless there is clearly demonstrated misbehavior in execution by one of the parties.

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53. *Id.* at 777.

54. *Id.* at 779.

Laval un Partneri Ltd v. Svenska Byggnadsarbetareforbundet

Case C-341/05, *Laval un Partneri Ltd v. Svenska Byggnadsarbetareforbundet*, [2007] ECR ___ (18 December 2007)

The European Union (EU) Court of Justice held that a Swedish trade union was precluded from using a blockade to force a Latvian company to negotiate pay rates for posted workers and to sign a collective agreement that laid down more favorable conditions than those provided for by legislative provisions.

I. Holding

In *Laval un Partneri Ltd v. Svenska Byggnadsarbetareforbundet*,[1] the EU Court of Justice interpreted Articles 12 and 49 of the Treaty Establishing the European Community[2] and Directive 96/71/EC[3] as precluding a trade union in one Member State from blockading worksites to force a service provider established in another Member State to negotiate and sign collective agreements. It was found that these Articles prohibited workers in one Member State from forcing employers established in another Member State to sign agreements giving the workers more favorable conditions than those provided by the controlling legislative provisions.[4] The Court also held when a prohibition exists in a Member State against trade unions undertaking collective action to set aside a collective agreement between other parties, Articles 49 EC and article 50 EC of the Treaty preclude the prohibition's being subject to a condition that the collective action relate to terms and conditions of employment to which the national law applies directly.[5]

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1. Laval un Partneri Ltd v. Svenkska Byggnadsarbetareforbundet, Case C-341/05, [2007] ECR ___ (18 December 2007) (*Laval*).

2. *See* Consolidated Version of the Treaty Establishing the European Community, Nov. 10, 1997, 1997 O.J. (C 325):

   > Article 12 states, "Within the scope of application of this Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited. The Council, acting in accordance with the procedure referred to in Article 251, may adopt rules designed to prohibit such discrimination."
   >
   > Article 49 states, "Within the framework of the provisions set out below, restrictions on freedom to provide services within the Community shall be prohibited in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended."
   >
   > The Council may, acting by a qualified majority on a proposal from the Commission, extend the provisions of the Chapter to nationals of a third country who provide services and who are established within the Community." Following the Court's practice, references to that treaty will take the form "Art. 12 EC."

3. See Council Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services, 1997 O.J. (L18) (EC).

4. *Laval* at ¶ 1.

5. *Id*. at ¶ 2.

II. Facts

Laval un Partneri Ltd (Laval) is a Latvian company that posted approximately 35 workers to Sweden to work on the construction of school premises in Vaxholm.[6] L&P Baltic Bygg AB (Baltic), a company incorporated under Swedish law, operated these building sites.[7] Laval held Baltic's entire share capital until the end of 2003.[8] Laval signed collective agreements with the Latvian building sector's union in September and October 2004,[9] but was not bound by any agreements with the Swedish building and public works trade unions, Svenska Byggnadsarbetareforbundet ("Byggnads") and Svenska Byggnadsarbetareforbundet avdelning 1, Byggettan (local branch no. 1 of Byggnads, "Byggettan"), or the electricians' trade union, Svenska Elektrikerforbundet ("Elektrikerna").[10]

In June 2004, Laval and Byggettan began negotiating for Laval to sign the Swedish agreement.[11] Although the typical European practice is to complete the negotiation of a collective agreement before discussion of wages and other terms and conditions of employment, Byggettan agreed to Laval's request to have the wages and the other terms and conditions of employment defined at the same time as the negotiations for signing the Swedish agreement.[12] Three months later, in September 2004, Byggettan demanded Laval sign the collective agreement and guarantee an hourly wage of SEK 145, equivalent to approximately 16 euros.[13] Byggettan threatened collective action if Laval did not accede to its requests.[14]

As a result of the unsuccessful negotiations between Byggettan and Laval, Byggettan contacted Byggnads to initiate collective action.[15] On November 2, 2004, the members of Byggnads began a blockade of the Vaxholm site by preventing the delivery of goods onto the property, placing pickets at the worksite, and prohibiting Latvian workers from entering the site.[16] The liaison office's[17] head of legal affairs sent a letter to Laval on December 2, 2004, stating Laval had to speak to the management and labor in the construction sector.[18] However, in December 2004, Laval still refused to sign the collective agreements at the mediation meeting and at the conciliation hearing.[19] As a result, on December 3, 2004, other unions, including

6. *Id*. at ¶ 27.

7. *Id*.

8. *Id.*

9. *Id*. at ¶ 28.

10. *Laval* at ¶ 2. In 2006, 31 local sections of Byggnads, containing 128,000 carpenters, builders, masons, parquet lawyers, workers in the construction and road sector, and plumbers, made up this union. Approximately 87 percent of building sector workers are affiliated with Byggnads. *Id*. at ¶ 17.

11. *Id.* at ¶ 29.

12. *Id.*

13. *Laval* at ¶ 30.

14. *Id.*

15. *Id.*

16. *Id.* at ¶ 34.

17. In Sweden, the liaison office required by Directive 96/71/EC, art. 4, is called Arbetsmiljoverket.

18. *Id.*

19. *Id*. at ¶ 36.

Elektrikerna, initiated sympathy actions.[20] As a result of this blockade, Swedish undertakings belonging to this union could no longer provide services to Laval.[21] On March 25, 2005, after other sympathy actions began, Baltic was declared bankrupt.[22]

III. Procedural History

At the end of November 2004, Laval spoke to the liaison office to determine whether there was a minimum wage it had to pay.[23] On December 2, 2004, the liaison office informed Laval the legislative minimum requirements applied to foreign workers posted in Sweden and labor and management should negotiate the wage issues.[24] Five days later, Laval commenced proceedings before Arbetsdomstolen—the Swedish labor court[25]—against Byggnads, Bygettan, and Elektrikerna, seeking a declaration that both the original blockade and the subsequent sympathy actions affecting the worksites were illegal.[26]

On April 29, 2005, Arbetsdomstolen decided to refer two questions to the Court of Justice for a preliminary ruling.[27] Since a National Court must refer a case to the Court of Justice only if it "considers a decision on the question to be necessary to enable it to give judgment," the unions argued this reference was unnecessary.[28] The unions sought to have the case dismissed on the bases of lack of relationship between the questions referred and the facts of the case and lack of merit.[29] The Court responded, however, that the questions referred to it do bear on the subject matter of the main case and, as such, the dispute is a real dispute in relation to the facts.[30] The Court reasoned any assessment of facts is a matter for the national court and the national court has the responsibility to determine the need for a preliminary ruling.[31] Further, the Court explained the limited circumstances under which it may refuse to rule on a

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20. *See Laval* at ¶ 37. *See also* ARCHIBALD COX, DEREK CURTIS BOK, ROBERT A. GORMAN & MATTHEW W. FINKIN, LABOR LAW 635-40 (14th ed. 2006) (describing sympathy actions as strikes initiated by workers separate from the main strikers who stop working to express their support or sympathy for the primary strikers).

21. *Id.* at ¶ 38.

22. *Id.*

23. *Laval* at ¶ 35.

24. *Id.*

25. *Id. See also* STIG STROMHOLM, AN INTRODUCTION TO SWEDISH LAW 281 (1981) (defining Arbetsdomstolen as the Swedish labor court, a special court for the settlement of disputes concerning collective agreements or the relationship between employers and employees).

26. *Laval* at ¶ 39.

27. *See id.* at ¶ 40. *See also* CHRIS VINCENZI & JOHN FAIRHURST, LAW OF THE EUROPEAN COMMUNITY125-49 (3d ed. 2002) (explaining national courts may ask the Court of Justice to clarify an interpretation of Community law to ensure the courts in their country effectively and uniformly apply Community legislation and to prevent divergent interpretations of these laws).

28. *Id.* at 134 (discussing the necessity of referring cases to the Court of Justice).

29. *Laval* at ¶ 43. The unions claimed there was no link between the questions referred and the facts of the case in the main proceedings. The unions also argued the other disputed purpose in the proceedings was for Laval to improperly circumvent Swedish law. The unions further argued Laval sought to escape its obligation to adhere to Swedish legislation, and, by relying on the Treaty and Directive 96/71/EC, Laval took advantage of the Community law.

30. *Id.* at ¶¶ 45–49.

31. *Id.*

question referred to it by a national court.[32] Because the Court concluded the dispute in *Laval* concerned the terms and conditions of employment for Latvian workers posted to Sweden and that, after the blockade, the posted workers returned to Latvia, the Court concluded the situation in *Laval* did not comport with any of those exceptions.[33] As a result, the unions' claim that this matter was artificial and lacked subject matter jurisdiction was denied.[34]

IV. The Court's Analysis

The first issue the Court addressed was whether Articles 12 EC and 49 EC and Directive 96/71/EC could be interpreted as precluding a trade union, in a Member State in which the terms and conditions of employment concerning the matters referred to in Article 3(1) of the Directive[35] are contained in legislative provisions, from forcing a provider of services established in another Member State to enter into negotiations with it on the rates of pay for posted workers and to sign a collective agreement that results in more favorable conditions.[36]

Directive 96/71/EC does not allow the host state to make provision of services conditional on observance of terms and conditions of employment that go beyond the mandatory rules for minimum protection.[37] Although the Swedish government recognizes a fundamental right to strike, this right is still subject to restrictions, including the provisions in Article 49 EC and Directive 96/71/EC.[38] Allowing trade unions in host states to take collective action to force other Member States to sign collective agreements would make Sweden less attractive for employers.[39] Such an action would thus be considered a restriction on the workers' Article 49 freedom to provide services in any Member State throughout the EU.[40] According to case law,[41] restricting freedom to provide services is warranted only if it pursues a legitimate objec-

32. *Id.* The only circumstances in which the Court may refuse to rule on a question referred by a national court are (1) where the interpretation of Community law that is sought bears no relation to the facts of the main action or its purpose, (2) where the problem is hypothetical, or (3) where the Court does not have the factual or legal material necessary to give a useful answer to the questions submitted to it.

33. *Id.*

34. *Id.*

35. *See* Directive 96/71/EC, art. 3 (guaranteeing workers from one Member State posted in another Member State maximum work periods and minimum rest periods; minimum paid annual holidays; minimum pay rates including overtime; health, safety and hygiene at work; protective measures for pregnant women, children and young people; nondiscriminatory treatment).

36. *Laval* at ¶ 53.

37. *Id.* at ¶ 79.

38. *Id.* at ¶ 89.

39. *Id.* at ¶ 99.

40. *Id.*

41. *See* Case 220/83, Commission of the European Communities v. France [1986], ECR 3663 (holding that the freedom to provide services can be restricted only by provisions for the social good); *see also* Francis J. Conte, *Sink or Swim Together: Citizenship, Sovereignty, and Free Movement in the European Union and in the United States*, 61 U. MIAMI L. REV. 331, 355 (2007) (explaining the European Court of Justice tends to enhance free movement of employment and stating the ECJ applies a proportionality measure, which requires Member States' measures that interfere with freedoms be "no broader than necessary" to achieve their legitimate objectives).

tive compatible with the Treaty and is justified by overriding reasons of public interest.[42] Because the Community needs harmony, the rights under the provisions of the EC treaty must be balanced against the objectives pursued by social policy.[43] Here, although the objective was to protect workers, the Court concluded the collective action caused work obstacles that could not be justified with regard to such an objective.[44] The laws of the European Community[45] would have allowed such action only to force the employer to comply with their rules on minimum pay by appropriate means.[46]

Next, the Court addressed whether Articles 49 EC and 50 EC preclude a Member State's prohibition against trade unions undertaking collective action to set aside or amend a collective agreement between other parties from being subject to the condition that the collective action must relate to the Member State's national law concerning terms and conditions for employment.[47] The Court reasoned the freedom to provide services implies abolishing any discrimination against a service provider on account of its nationality or of the fact it is established in another Member State.[48] Discrimination arises when different rules are applied to comparable situations or when the same rule is applied to different situations.[49]

The Court concluded discrimination existed in this case insofar as undertakings with collective agreements were treated in the same manner as national undertakings that have not concluded collective agreements.[50] The only sound justifications for discriminatory practices are public policy, public security, or public health.[51] Here, the discrimination was to allow trade unions to ensure all employers in Sweden paid wages and applied other terms and conditions of employment commensurate to other Swedish employers; to create a climate of fair competition, these considerations are not considered adequate justification for the discrimination.[52]

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42. *Laval* at ¶ 101.

43. *Id.* at ¶ 104. Although the right to take collective action, a fundamental right, falls outside the scope of Article 49 EC and Directive 96/71/EC, various instruments—such as the European Social Charter of 1961 (529 U.N.T.S. 89, *entered into force* Feb. 26, 1965); the Community Character of the Fundamental Social Rights of Workers of 1989; and the Character of Fundamental Rights of the European Union of 2000 (2000/C 364/01)— do recognize this right.

44. *Id.* at ¶ 108.

45. Directive 96/71/EC, art. 3; *see* arts. 12 and 49. These laws proscribe discrimination throughout the EU and set out the minimum requirements employees in the EU must receive. They also stress the importance of the free movement of goods, services, and capital.

46. *Laval* at ¶ 109.

47. *Id.* at ¶ 112.

48. *Id.* at ¶ 114.

49. *Id.* at ¶ 115. *See* Finanzamt Köln-Altstadt v. Schumacker, Case C279/93, [1995] ECR I225, ¶30 (stating discrimination can arise only through applying different rules to comparable situations or applying the same rule to different situations).

50. *Laval* at ¶118.

51. *Id.* at ¶ 117.

52. *Id.* at ¶ 119.

V. Conclusion

In *Laval*, the European Union Court of Justice held Article 49 EC and Article 3 of Directive 96/71/EC precluded a Swedish trade union from using a blockade to force a Latvian company to negotiate pay rates for posted workers and to sign a collective agreement that laid down more favorable conditions than those provided for by legislative provisions.[53] The Court also held Articles 49 EC and 50 EC ban a prohibition against collective action from being subject to the condition that the collective action must relate to terms and conditions of employment to which the national law directly applies.[54]

One week prior to deciding *Laval*, the Court decided another case of notable importance. In *International Transport Workers' Federation v. Viking ABP* (*Viking*),[55] the Court considered a dispute between the International Transport Workers' Federation (ITF), the Finnish Seamen's Union (FSU), and the Viking Line ABP (Viking) concerning threatened collective action to deter Viking from reflagging its vessel, from the Finnish flag to that of Estonia or Norway.[56] As a result of monetary concerns, Viking sought to reflag the *Rosella* to another country to enable Viking to pay lower wages than those it was required to pay if the ship sailed under the Finnish flag.[57] The unions resisted this reflagging and sent a circular to all of its affiliates to refrain from negotiating with Viking.[58] The Court concluded Article 43 EC[59] covers collective action initiated by a trade union, such as that taken by FSU and ITF, against a private undertaking, such as Viking, in order to induce that undertaking to enter into a collective agreement, which deters the private undertaking from exercising freedom of establishment.[60] Further, the Court held Article 43 EC conferred on private undertakings rights they can rely on against a trade union.[61] The Court then stated Article 43 EC restricts collective action that seeks to encourage a private company registered in a Member State to enter into an agreement with a trade union

53. *Id.*

54. *Id.*

55. C-438/05, International Transport Workers' Federation v. Viking Line ABP [2007], ECR __ (Ct. of Appeal, Dec. 11, 2007) (herein known as *Viking*).

56. *Viking* at ¶ 1.

57. *Id.* at ¶¶ 6-11.

58. *Id.* ¶ 12.

59. *See* Consolidated Version of the Treaty Establishing the European Community, Nov. 10, 1997, 1997 O.J. (C 325). Article 43 states,

> Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.
>
> Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the chapter relating to capital.

60. *Id.* at ¶ 1.

61. *Id.* at ¶ 2.

in that state and then force the private undertaking to apply the terms negotiated in that collective agreement to a subsidiary in another Member State.[62]

Both *Laval* and *Viking* signify the strength of unions in Europe.[63] The cases explain the right to strike is fundamental in the European Union.[64] In *Laval*, the Court's explanation of the effect of the blockade on the Swedish economy indicates the power of unions to completely shut down a project to achieve its objectives.[65] In *Viking*, the Court acknowledged the effect of the FSU and ITF's blockade on Viking's ability to negotiate with workers in other countries in the EU.[66] These decisions imply unions are strong organizations that are capable of greatly affecting their Member States.

The blockade in *Laval* strongly indicates unions are still very powerful in Europe, especially in Sweden.[67] Unlike the United States, where union strength has diminished considerably due partly to employer resistance to unions,[68] Swedish unions remain powerful and hold a prominent place in the workforce.[69] Further, although the unions ultimately lost their case, the Court in *Laval* exhibited union power by presenting several possible justifications for their strike.[70] The Court considered the public interest justifications for the strike and concluded using collective action to ensure a minimum number of terms and conditions for employment falls within the objective of protecting workers.[71] However, the Court ultimately concluded the obstacles the strikes created were too severe to achieve that objective.[72] As a result, the Court provided guidance for future unions to consider when they choose to strike.

Furthermore, the *Laval* decision has several implications for the posted workers throughout the European Union.[73] By protecting future posted workers from nationality based discrimination, the Court may have included more incentive for workers in one Member State to go to another Member State to work. Perhaps this mobility of workers will increase diversity in EU member countries and provide societal benefits along with the economic benefits.

Elyssa Renee Koeppel

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62. *Id.*

63. *Laval*; *Viking.*

64. *Laval* at ¶¶ 89, 91; *Viking* at ¶ 25.

65. *Laval* at ¶ 38 (noting the unions' boycott resulted in the bankruptcy of Baltic, a Laval subsidiary).

66. *Viking* at ¶69.

67. *See* STROMHOLM, *supra* note 25, at 279 (explaining in Sweden about 95 percent of all manual workers and about 80 percent of all nonmanual employees belong to unions, which is one of the highest organization rates in the Western world).

68. *See* Steven Greenhouse, *Sharp Decline in Union Members in '06*, N. Y. TIMES, Jan. 26, 2007 (providing statistics and reasoning for the dramatic decline in union membership in the United States).

69. *See* BRIAN BERCUSSON, EUROPEAN LABOUR LAW 44 (1996) (stating Sweden has a powerful labor movement and relatively low open unemployment).

70. *Laval* at ¶ 49.

71. *Id.*

72. *Id.*

73. *See generally* Vokler Meier, *Economic Consequences of the Posted Workers Directive*, 55 METROECONOMICA No. 4 at 409, 410 (2004) (describing the incredible impact of foreign posted workers on the economies of Member States throughout the EU).

Gulf Petro Trading Company Inc. v. Nigerian National Petroleum Corp.

512 F.3d 742 (5th Cir. 2008)

The U.S. Court of Appeals for the Fifth Circuit held the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards precludes U.S. courts, when operating under secondary jurisdiction, from obtaining subject matter jurisdiction over claims seeking to vacate, set aside, or modify a foreign arbitral award through a collateral attack based on state or federal law.

I. Holding

In *Gulf Petro Trading Company Inc. v. Nigerian National Petroleum Corp.*,[1] the Fifth Circuit Court of Appeals affirmed the dismissal of plaintiff's complaint by the U.S. District Court for the Eastern District of Texas.[2] Adopting the district court's reasoning and acknowledging the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention or "the Convention")[3] was controlling,[4] the court ruled the allegations by the plaintiff, Gulf Petro Trading Company (Gulf Petro), of violations of the Racketeer Influenced and Corrupt Organizations Act (RICO)[5] and state law amounted to collateral attacks on the Final Award. The claims were consequently barred by the New York Convention, which removes from courts of secondary jurisdiction subject matter jurisdiction over collateral attacks on an arbitral Final Award.[6]

II. Facts and Procedural Posture

In 1993, Petrec International (Petrec) and Nigerian National Petroleum Corporation (NNPC) entered into a joint-venture agreement ("the agreement"), which called for the formation of a jointly capitalized Nigerian company, Petrec (Nigeria) Limited (PNL) and required NNPC to provide access to all areas needed to conduct the salvaging operations pursuant to the agreement.[7] Significantly, the agreement provided for arbitration of any disputes arising out of the agreement.[8] After NNPC failed to afford capital and access to PNL, Petrec initiated arbi-

1. 512 F.3d 742 (5th Cir. 2008) (*Nigerian National*).
2. 2006 U.S. Dist. LEXIS 86493 at *1 (E.D. Tex. 2006).
3. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38, entered into force June 7, 1959, entered into force for the United States Dec. 29, 1970. The Convention is implemented in the United States by 9 U.S.C. §§ 201 *et seq*.
4. *Nigerian National*, 512 F.3d 742 at 744.
5. 18 U.S.C. §§1961 *et seq.* (2006).
6. *Nigerian National,* 512 F.3d at 747–50.
7. *Id.* at 744. The government of Nigeria owned NNPC and Gulf Petro owned Petrec.
8. *Id.*

tration proceedings against NNPC with the Chamber of Commerce and Industry of Geneva in 1998.[9] Although the panel, in a Partial Award, initially determined Petrec had standing to pursue its claims and NNPC had failed to provide PNL with capital, on October 9, 2001, the panel issued a Final Award, which held Petrec lacked capacity to maintain its claims.[10] The panel apparently found that because Petrec had not been incorporated until February 28, 2000, there existed no entity with which NNPC could originally have entered into a joint-venture agreement.[11]

Petrec challenged the Final Award in Switzerland's federal court, claiming the award violated Swiss arbitration law and public policy,[12] but the Swiss court upheld the panel's decision.[13] Petrec next filed a lawsuit in the Northern District of Texas,[14] asking the court to uphold the intermediary Partial Award, but the district court granted NNPC's motion to dismiss, and the Fifth Circuit affirmed the dismissal.[15] However, in September 2005, Gulf Petro allegedly uncovered a letter, dated March 18, 2002, revealing the details of a $25 million bribe paid to the arbitration panel[16] and discovered one of the arbitrators engaged in undisclosed communications with NNPC.[17] With this new information, Gulf Petro brought the instant action in the Eastern District of Texas,[18] where NNPC again prevailed on a motion to dismiss.

III. Discussion

Although Gulf Petro originally sought outright vacatur of the Final Award, it conceded on appeal the claim was properly dismissed for lack of subject matter jurisdiction.[19] In conceding, Gulf Petro implicitly agreed the New York Convention was controlling and the Fifth Circuit agreed.[20] Examining the issues *de novo*, the Fifth Circuit first discussed the New York Convention's rules in detail,[21] and a unanimous court recognized the Convention's main purpose is "clearly the autonomy of international arbitration."[22] The court further explained the Conven-

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

13. *Nigerian National*, 512 F.3d at 744.

14. *See* Gulf Petro Trading Company, Inc., v. Nigerian National Petroleum Corp., 288 F. Supp. 2d 783, 783 (N.D. Tex. 2003).

15. *Nigerian National,* 512 F.3d at 744–75.

16. *Id.*

17. *Id.*

18. 2006 U.S. Dist. LEXIS 86493, at *1.

19. *Nigerian National*, 512 F.3d at 746.

20. *Id.*

21. *Id.* at 746–49 (referring to Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38, entered into force June 7, 1959, entered into force for the United States Dec. 29, 1970. The Convention is implemented in the United States by 9 U.S.C. §§ 201 *et seq*.).

22. *Id.* at *3 (*citing* FOUCHARD, GAILLARD, GOLDMAN ON INTERNATIONAL COMMERCIAL ARBITRATION 250 (Emmanual Gaillard & Savage Gaillard eds. 1999)).

tion provides two separate "regimes for the review of arbitral awards":[23] (1) one for courts of primary jurisdiction or countries "in which, or under the law of which, the award was made"; and (2) another for courts of secondary jurisdiction or "other countries where recognition and enforcement are sought." Under the Convention, courts sitting in secondary jurisdictions have extremely limited review of arbitral awards; essentially, "parties can only contest whether that [country] should enforce the arbitral award."[24] Because the Fifth Circuit was sitting as a secondary jurisdiction court, it examined Gulf Petro's claims in light of the relevant limits imposed by the Convention.[25]

A. Collateral Attacks on a Final Arbitral Award

Gulf Petro argued the relief it sought was subtly different from vacatur, due to the RICO and state law claims that arose from the alleged arbitrator bribery and favoritism.[26] The Fifth Circuit disagreed, based on *Corey v. New York Stock Exchange*[27] and *Decker v. Merrill Lynch, Pierce, Fenner & Smith*.[28] Although these cases dealt with domestic rather than international arbitration, the court found instructive their principles concerning impermissible collateral attacks on arbitral Final Awards.[29]

Corey and *Decker* both involved arbitration falling under the Federal Arbitration Act (FAA or "the Act"),[30] which subjects arbitral awards to limited judicial review.[31] As a result the petitioners in *Corey* and *Decker* refused to seek relief under the Act and instead brought suit directly against their adversaries, alleging deprivations of fair arbitration proceedings resulting from prejudicial arbitrators.[32] However, because the FAA provides an exclusive remedy for petitioners seeking to challenge arbitration awards,[33] the petitioners' lawsuits in *Corey* and *Decker* were nothing more than "impermissible collateral attack[s] on the [awards themselves]."[34]

As in *Corey* and *Decker*, the Fifth Circuit determined that a specific body of law—here, the New York Convention—governed the Final Award between Gulf Petro and NNPC.[35] Similar to the petitioners in those cases, Gulf Petro alleged wrongdoing in the arbitral proceedings and attacked the arbitrators' credibility, but did not specifically attack the Final Award itself.[36]

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23. *Nigerian National*, 512 F.3d at *746.
24. *Id.* at 746.
25. *Id.*
26. *Id.* at 749–50.
27. 691 F.2d 1205 (6th Cir. 1982).
28. 205 F.3d 906 (6th Cir. 2000).
29. *Nigerian National*, 512 F.3d at 747–48.
30. 9 U.S.C. §§ 1 *et seq.* (1990).
31. *Nigerian National*, 512 F.3d at 747–48.
32. *Id.* at 747–49.
33. *Id.* at 747; *see also* 9 U.S.C. §§ 2, 10–12 (2006).
34. *Nigerian National*, 512 F.3d at 747; *see also Corey*, 691 F.2d at 1211–12.
35. *Nigerian National*, 512 F.3d at 746.
36. *Id.* at 748–49.

This forced the Fifth Circuit to examine the relationship "between the alleged wrongdoing, purported harm, and arbitration award."[37] Under this inquiry, the Fifth Circuit sought to determine whether the harm Gulf Petro complained of was caused by the *impact* of the arbitrator's alleged misconduct on the award itself.[38] If so, the court would be forced to conclude the complaint was nothing more than a collateral attack on the Final Award and forbidden by the New York Convention.[39]

Gulf Petro argued because it did not attempt to relitigate the facts and defenses raised in the arbitration proceeding, its claims of arbitral misconduct were not collateral attacks on the Final Award.[40] The court disagreed, noting Gulf Petro's relief sought was the very damages denied by the arbitration panel.[41] Moreover, although the petitioners in *Corey* and *Decker* did not attempt to relitigate facts and defenses concerning their arbitration proceedings, the Sixth Circuit found both claims were collateral attacks on the arbitration awards, which persuaded the Fifth Circuit.[42] Ultimately, the court indicated Gulf Petro's harm did not result from the arbitrator's partiality; rather, it resulted from the effect this partiality had on the Final Award.[43] This was the very essence of a collateral attack on a Final Award.[44]

B. Dismissal for Lack of Subject Matter Jurisdiction

Gulf Petro also argued that by granting NNPC's motions to dismiss, the federal courts were creating an "arbitration exception" to federal subject-matter jurisdiction.[45] Primarily, Gulf Petro argued a motion to dismiss for lack of subject-matter jurisdiction was inappropriate.[46] Attempting to distinguish *Corey* and *Decker*, Gulf Petro noted the complaints in those cases were dismissed for a failure to state a claim upon which relief could be given and also on summary judgment, but not for lack of subject-matter jurisdiction.[47] The Fifth Circuit, however, considered this distinction irrelevant.[48] The court found the significance in those cases rested in the Sixth Circuit's analysis and definition of collateral attacks on arbitration awards.[49] There-

37. *Id.* (adopting the Sixth Circuit analysis).

38. *Id.*

39. *Id.*

40. *Nigerian National,* 512 F.3d at 749.

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *Nigerian National*, 512 F.3d at 751.

46. *Id.* Gulf Petro's motion was governed by FED. R. CIV. P. 12(b)(1).

47. *Nigerian National,* 512 F.3d at 751.

48. *Id.*

49. *Id.* ("This argument misapprehends the significance of *Corey* and *Decker* to the instant case, which lies in the reasoning employed by the Sixth Circuit in concluding that the claims asserted were collateral attacks on arbitration awards, and not in the final dispositions of the cases themselves."), *Nigerian National*, 512 F.3d at 751.

fore, because the court found Gulf Petro's claims to be collateral attacks on an arbitral award, the New York Convention mandated their dismissal.[50]

The Fifth Circuit further emphasized its conclusion did not create a categorical exception to federal subject matter jurisdiction, because its holding was limited to cases determined to be collateral attacks on foreign arbitral awards under the framework of *Corey* and *Decker*.[51] The court's holding did not preclude the availability of criminal prosecutions under relevant statutes.[52] Additionally, lawsuits that relate minimally to arbitration were not reached under this decision.[53]

The court briefly theorized that the doctrine of *res judicata* would have allowed recognition of the Final Award and afforded NNPC affirmative defenses to Gulf Petro's federal and state law claims.[54] Because Gulf Petro essentially accused NNPC of "suborn[ing] the corruption of the panel,"[55] *res judicata* would not afford NNPC the protections otherwise afforded by the Convention.[56] Finally, the court summarily dismissed Gulf Petro's contention that relief was not available in Switzerland.[57]

IV. Conclusion

The United States signed the New York Convention on December 29, 1970.[58] The Convention seeks to strengthen international arbitration by eliminating unnecessary post-agreement litigation.[59] It mandates strict recognition of arbitral awards[60] and is "one of the most widely ratified treaties in history."[61] Indeed, due to the Convention, many firms engaged in international business now incorporate into their contracts arbitration clauses.[62]

The New York Convention allows only courts sitting in primary jurisdictions to set aside or modify arbitral awards.[63] Conversely, courts sitting in secondary jurisdictions may only

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50. *Nigerian National*, 512 F.3d at 751.
51. *Id.*
52. *Id.*
53. *Id.*
54. *Id.*
55. *See Nigerian National*, 512 F.3d at 752.
56. *Id.* (explaining there was "more at work" than *res judicata*, which prevented the court from utilizing the doctrine in NNPC's favor). *Id.*
57. *Nigerian National*, 512 F.3d at 752 (noting Gulf Petro already attempted, and failed, to procure relief from Switzerland).
58. *See* Sandra Jin Lee, *Is Sky Reefer in Jeopardy? The MLA's Proposed Changes to Maritime Foreign Arbitration Clauses*, 72 WASH. L. REV. 625, 632 (1997).
59. *Id.*
60. *Id.*
61. Christopher Tate, *American Forum Non Conveniens in Light of the Hague Convention on Choice-of-Court Agreements*, 69 U. PITT. L. REV. 165, 166 (2007).
62. *Id.*
63. *Nigerian National*, 512 F.3d at 746.

review whether to enforce the arbitral award.[64] In either scenario, U.S. courts must abide by Chapter Two of the FAA,[65] which formally adopted the New York Convention into federal law.

Once a party establishes an arbitration award from another country or governed by the laws of another country, a U.S. court sits in secondary jurisdiction concerning all matters that relate to that award.[66] At that point, any party wishing to substantively challenge the terms of an award must fit within the framework provided by *Corey* and *Decker*.[67] If a party's claims amount to nothing more than disguised collateral attacks, a U.S. court must dismiss the claims for lack of subject matter jurisdiction.[68] Going forward, this holding serves as a warning to all U.S. companies seeking to govern their disputes under international arbitration, because federal courts will be extremely hesitant to correct supposed injustices that have already been settled in foreign jurisdictions.

Joseph Mogelnicki

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64. *Id.*

65. 9 U.S.C. § 201 (1990).

66. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38, entered into force June 7, 1959, entered into force for the United States Dec. 29, 1970.

67. *Nigerian National*, 512 F.3d at 750–51.

68. *Id.*

Bohn v. Bartels

2007 U.S. Dist. LEXIS 91182 (S.D.N.Y. Dec. 11, 2007)

Pursuant to both Rule 12(b)(2) of the Federal Rules of Civil Procedure and the doctrine of *forum non conveniens*, the federal District Court for the Southern District of New York dismissed the personal injury claims arising out of an incident that occurred in Portugal between two American citizens.

I. Holding

In *Bohn v. Bartels*,[1] the Southern District of New York held there to be a lack of personal jurisdiction over one of the two main defendants based on insufficient contacts with the forum state. The court also held Portugal was a more appropriate forum than New York, based on the lesser degree of deference due to the plaintiff's choice on the facts of this case, the adequacy of the foreign forum, and the balance of public and private factors shifting away from New York.

II. Facts/Background

The plaintiff, Rita Bohn, was a teacher of U.S. military children, employed by the U.S. Department of Defense on the Lajes Air Force Base in Portugal.[2] Defendant Michael Bartels was a member of the Air Force stationed at the same base, who drove the vehicle that struck Bohn on March 2, 2003, as she was crossing the street with her two daughters and a student.[3] At the time of this incident, Fidelidade, a Portuguese insurance company,[4] insured Bartels. All claims arose from this accident.

After the incident, Bohn was stationed in Japan and Bartels moved to New York to attend the State University of New York at Oneonta.[5] On February 21, 2006, Bohn filed suit in the Southern District of New York, claiming negligence on Bartels's part at the time of the incident.[6] Two days later, Bohn filed a separate suit in Portugal.

Fidelidade sought dismissal on three grounds: first, the district court lacked personal jurisdiction under Rule 12(b)(2) of the Federal Rules of Civil Procedure; second, Bohn failed to

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1. 2007 U.S. Dist. LEXIS 91182 (S.D.N.Y. Dec. 12, 2007) (*Bohn*).
2. *Id*. at 2.
3. *Id*.
4. At the time of the incident, Bartels's insurance company was Companhia de Seguros Mundial-Confianca, S.A. However, by the time Bohn filed her claim, Companhia de Seguros Fidelidade-Mundial, S.A. was the legal successor of the previous insurer and, thus, might be held liable for this incident. As in the opinion of the court, Fidelidade will refer to both defendant insurers for the purposes of brevity and clarity. *Id.* at *1–3 nn1 & 2.
5. *Id.* at 3.
6. *Bohn,* 2007 U.S. Dist. LEXIS 91182 at 3.

state a cause of action under Rule 12(b)(6) of the Federal Rules of Civil Procedure;[7] and finally, New York was an inconvenient forum, while an adequate alternative forum existed in Portugal.[8] The court found New York lacked personal jurisdiction over Fidelidade, which in turn made analyzing the motion to dismiss for failure to state a cause of action unnecessary.[9] The court also made its dismissal of the case against Bartels conditional on his submission to the jurisdiction of the Portuguese court.[10]

III. Court Analysis

A. Rule 12(b)(2)—Lack of Personal Jurisdiction

In a court's consideration of a Rule 12(b)(2) motion, the plaintiff bears the burden of proving, by a preponderance of the evidence,[11] that the court has jurisdiction over the defendant.[12] The court applied a two-step process to analyze whether a court has personal jurisdiction over a defendant. First, the court must look to state law to determine the adequacy of personal jurisdiction. If the state law affords the court jurisdiction, it must determine whether this exercise of personal jurisdiction is consistent with constitutional standards of due process.

The New York Civil Practice Law and Rules provide for general jurisdiction in section 301 and specific jurisdiction in section 302.[13] Bohn conceded there to be no general personal jurisdiction over Fidelidade, but claimed this was a case of specific jurisdiction under section 302(a)(1).[14]

Bohn's argument rested on the "contracts anywhere" clause of CPLR 302(a)(1), which allows the court to exercise personal jurisdiction over a nondomiciliary who contracts outside of the state to supply goods or services to New York, as long as the claim arises from the contract.[15] The plaintiff asserted it would be reasonable for Fidelidade to expect suit to arise in the United States, because of the large percentage of the many Americans stationed on base who

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7. *Id.* at 4; FED. R. CIV. P. 12(b)(2).

8. *Bohn,* 2007 U.S. Dist. 91182 at 4.

9. *Id*. Although the court found an in-depth analysis of the constitutionality of personal jurisdiction unnecessary, because the argument did not survive state-law scrutiny, it stated in dicta that personal jurisdiction may be exercised only if there are "minimum contacts" and "purposeful availment." The court held even if the claim survived the state-level analysis, the contracts in New York were "fortuitous" and thus insufficient for jurisdiction under the constitutional right to due process.

10. *Id.* at 38.

11. *Bohn*, 2007 U.S. Dist. LEXIS 91182 at 5; *see* A.I. Trade Fin., Inc. v. Petra Bank, 989 F.2d 76, 79–80 (2d Cir. 1993).

12. *Id.* at 4; *see* In re Magnetic Audiotape Antitrust Litig., 334 F.3d 204, 206 (2d Cir. 2003) (*per curiam*); *see also* Metro. Life Ins. Co. v. Robertson-Ceco Corp., 84 F.3d 560, 566 (2d Cir. 1996).

13. *Bohn*, 2007 U.S. Dist. LEXIS 91182 at 6.

14. N.Y. CPLR 302(a)(1) (2008). The statute states, "acts which are the basis of jurisdiction. As to a cause of action arising from any of the acts enumerated in this section, a court may exercise personal jurisdiction over any nondomiciliary, or his executor or administrator, who in person or through an agent: (1) transacts any business within the state or contracts anywhere to supply goods or services in the state." *Id.*

15. *Bohn*, 2007 U.S. Dist. LEXIS 91182 at 7 (quoting Sirius Am. Ins. Co. v. SCPIE Indem. Co., 461 F. Supp. 2d 155, 161 (S.D.N.Y. 2006)).

have cars, and the issuance of an insurance policy to a domiciliary of New York fits the "contracts anywhere" provision, thus creating amenability to suit in New York.[16]

The court pointed out, however, that Bohn's argument rested on no case law holding directly a foreign insurer is subject to personal jurisdiction based on its obligation to defend the insured in New York and found Bohn's suggested analogies too distant. Likening the case at hand to those that permit jurisdiction based on the nondomiciliary giving a guarantee payable in New York fails, according to the court, because the promises in those contracts specifically direct their payments to New York, while Fidelidade's contract did no such thing.[17] The court held the "contracts anywhere" provision did not apply and, even if it did, there lacked sufficient connection between Fidelidade's contacts and Bohn's claim to assert jurisdiction. Looking to the totality of the circumstances, the court continued to reference the Portuguese nature of the policy, the residence of the insured, and the company, all of which provide a smooth transition to the discussion of *forum non conveniens*.

B. *Forum Non Conveniens*

The principle behind the doctrine of *forum non conveniens* is that a "court may resist imposition upon its jurisdiction even when jurisdiction is authorized."[18] Whether to dismiss based on the doctrine is analyzed on a case-by-case basis and is ordinarily granted upon the finding the plaintiff's chosen forum imposes a heavy burden on the defendant or the court and the plaintiff has failed to offer any other specific reasons for the choice of venue. The party who moves to dismiss based on *forum non conveniens* bears the burden of proof.[19]

The Second Circuit has established a three-part analysis to determine a *forum non conveniens* claim, including the degree of deference awarded to the plaintiff's choice of forum, the adequacy of the proposed alternative forum, and the balancing of private versus public interests.[20]

There is usually a strong presumption in favor of the forum chosen by the plaintiff, which may be overcome if it is shown the choice was made for "forum-shopping reasons."[21] The deference to the plaintiff moves on a "sliding scale," which can be limited based on the analysis of several factors that mainly center on the generosity in treatment of the plaintiff or the possible inconvenience to the defendant.[22]

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16. *Id*. at 8.
17. *Id*. at 8–9.
18. *Bohn*, 2007 U.S. Dist. LEXIS 91182 at 14.
19. *Id.* at 15 (citing Aguinda v. Texaco, Inc., 303 F.3d 470, 476 (2d Cir. 2002)).
20. *Id.*; *see* Norex Petroleum Ltd. v. Access Indus., Inc., 416 F.3d 146, 153 (2d Cir. 2005).
21. *Bohn*, 2007 U.S. Dist. LEXIS 91182 at 15 (citing Piper Aircraft Co. v. Reyno, 454 U.S. 235, 255–56 (1981)).
22. *Id*. at 17. Factors include: "the convenience of the plaintiff's residence in relation to the chosen forum, the availability of witnesses or evidence to the forum district, the defendant's amenability to suit in the forum district, the availability of appropriate legal assistance, and other reasons relating to convenience or expense." Iragorri v. United Techs. Corp., 274 F.3d 65, 71 (2d Cir. 2001 (en banc)) (*Iragorri*).

Bohn—a resident of Texas living in Japan—claimed her choice deserved deference, because the United States as a whole was her home forum and should thus be chosen over Portugal. She chose New York, she claimed, because Bartels resided there. In response, the court found multiple reasons to limit deference to her choice on the sliding scale. First, the court said that Bohn, as a citizen residing outside the United States, may be given less deference than one who resides in his or her home country. Second, the United States' connection to the suit was weaker than that of Portugal.[23] The court articulated some of the factors speaking to a diminished deference to be (1) the court's jurisdiction over only one of the defendants,[24] (2) its complete lack of personal jurisdiction over one of the defendants, (3) difficulty in producing evidence and witnesses in New York, and (4) the already progressing case in Portugal. Therefore, the court granted some degree of deference, but not the "high degree" of evidence the plaintiff sought.

In considering the suitability of an alternative forum, the court observed the party moving to dismiss the case bears the burden of showing such a forum exists.[25] Adequacy includes the amenability of the defendants to service of process and permitted litigation.[26] The court stated, without contest from Bohn, that Portugal was an appropriate forum, given the origin of the cause of action and the pending litigation there. Given Bohn's intentional second filing in Portugal, the plaintiff had a hard time truly opposing the suitability of the forum.

Finally, in balancing private versus public interests, the court analyzed the factors relevant to each type of interest to establish Portugal to be the more appropriate forum. First, the court characterized the analysis of private interests as a balance of the hardships on the defendant if the present forum is maintained versus the hardships on the plaintiff of dismissal in this forum. The factors include:

> the relative ease of access to sources of proof; availability of compulsory process for attendance of unwilling, and the cost of obtaining attendance of willing, witnesses; possibility of view of premises, if view would be appropriate to the action; and all other practical problems that make trial of a case easy, expeditious and inexpensive . . . [27]

In applying these factors, the court said that, regardless of the decided venue, the litigation would likely be costly and inconvenient for the parties. Looking at the transitory nature of the two parties, the more important witnesses' location in Texas, the less influential witnesses residing in Portugal, and the potentially inflated cost of expert retention in Portugal, the court said the private factors in totality spoke to the case remaining in New York. Even though translation would be costly in either jurisdiction, the court saw the possible necessity of a visit to the

23. *Bohn*, 2007 U.S. Dist. LEXIS 91182 at 20.

24. In addition, the court noted that had the New York forum been so convenient, Bohn would not have likely filed in Portugal as well.

25. *Id.* at 23.

26. *Id.*

27. *Bohn*, 2007 U.S. Dist. LEXIS 91182 at 25 (quoting *Iragorri*, 274 F.3d at 73–74).

scene of the crash as weighing for New York, despite Bohn's disagreement on this point,[28] while the overall expense of two simultaneous cases weighed for Portugal. The private interest balancing thus weighed in favor of New York's retaining the case.

However, in analyzing the public interests, where the court weighs the justice and efficiency of the forum selection,[29] the court held the factors considered to speak directly to Portugal. The factors by which the court addresses the public interest included the interest in jurors deciding disputes of significance to their community, affected communities viewing the suit if they so desire, local forums deciding their own controversies, and the desire to avoid pitfalls that can accrue from a case that requires resolution of conflicts of law and substantive law issues being heard in a foreign state.[30]

The court set the tone of its analysis of the public interest factors by stating "although the parties are United States citizens, this case is at heart a Portuguese one."[31] The interests of Portugal in its local traffic laws and in resolving an incident occurring in its territory are greater than the interests of New York in resolving a personal injury action arising out of an accident outside of New York. Although the claim against Fidelidade was dismissed in New York, the outcome of the case against Bartels may affect the company, and thus the two cases should be tried in the same court in a step toward cohesion, efficiency, and fairness.

Compiling the analysis of the lesser degree of deference to Bohn's choice and the strength in the public interest factors favoring dismissal, the court found Portugal was "significantly preferable" to New York and granted Bartel's motion to dismiss based on the doctrine of *forum non conveniens*.[32]

IV. Conclusion: Implications of the *Bohn* Case

The court found a lack of personal jurisdiction over Fidelidade that, in turn, made analyzing the claim for failure to state a cause of action unnecessary. The court dismissed the case against Bartels based on *forum non conveniens* conditional on his submission to the jurisdiction of the court in the Portuguese action.[33]

Bohn attempts to draw closer to a bright-line rule about American parties engaged in foreign incidents, possibly in spite of long-arm statutes provided in state law. Although it declares the determination of whether New York or Portuguese law applies to the instant case "unnecessary and premature," the court notes the importance of considering the conflict of laws in eval-

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28. *Id.* at 29. Bohn claims the photographs of the scene of the crash are more sufficient in review of the case than actually visiting the location, as the location may have changed since the accident. The court recognized the possibility the location changed but also sided cautiously in resting the case on plaintiff's photographs, saying they may be insufficient.

29. *Id.* at 24.

30. *Id.* at 31–32.

31. *Bohn*, 2007 U.S. Dist. LEXIS 91182 at 32.

32. *Id.* at 37 (quoting *Iragorri*, 274 F.3d at 74–75).

33. *Id.* at 38.

uation of the public interest factors of a *forum non conveniens* claim.[34] Therefore, even in the early stages of a case with possible international implications, courts must still consider the potential for conflicts of laws between the United States and the foreign jurisdiction.

While *Bohn* continues the trend of making the analysis very fact driven and case specific,[35] the treatment of a case between two Americans residing in a foreign country may speak strongly for the adjudication in the foreign court to which they subjected themselves. This case may promote a necessary awareness of foreign laws (i.e., traffic regulations) among our foreign-residing citizens.

Carrie V. Hardman

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34. *Id.* at 35–36.

35. *See* Williams v. Green Bay & W.R. Co., 326 U.S. 549, 557 (1946); *see also* BlackRock Inc. v. Schroeders PLC, 2007 U.S. Dist. LEXIS 39279 at 6 (S.D.N.Y. May 30, 2007) (citing Walpex Trading Co. v. Yacimientos Petroliferos Fiscales Bloivanos, 712 F. Supp. 383, 392–93 (S.D.N.Y. 1989)); In re Bridgestone/Firestone Inc., 212 F. Supp. 2d 903, 906 (D. Ind. 2002); Kattenbach v. Demoulas, 822 F. Supp. 43, 45 (D. Mass. 1993).

C v. D

[2007] EWCA Civ 1282, [2007] ALL ER (D) 61 (December)

The English Court of Appeal, Civil Division, upheld a lower court ruling that a choice of seat for arbitration was also a choice of forum regarding the law to be applied to that arbitration and that the proper law of the contract to refer disputes to arbitration could not constitute an "agreement to the contrary" under the English Arbitration Act 1996.

I. Holding

In *C v. D*,[1] the Court of Appeal, Civil Division, of England upheld the order of the lower court and denied defendant's motion to have New York law, instead of English law, control the arbitration hearing in an insurance contract case. The court held although the Bermuda Form[2] was written with New York choice of law, the fact the form called for London to be the place of arbitration was determinative to show the parties had agreed to English law to govern arbitration disputes.[3] It was uncontested the award could be challenged under English law and the court stated if any arbitration award could be challenged under New York law as well, it would be "a recipe for litigation and confusion which cannot have been intended by the parties."[4]

The court also ruled that while the English Arbitration Act 1996 (the Act) allowed parties to contract out of its nonmandatory provisions, the arbitration clause of the contract did not count as an "agreement to the contrary" under the Act.[5] Section 4(5) of the Act allows for a choice of law provision to list specific choices of law that cannot apply, but that was not done in this situation.[6]

II. Facts and Procedural Posture

The defendant was the liability insurer of the claimant, a New Jersey corporation.[7] The claimant had an insurance policy with an aggregate limit of $100 million excess of $190 million.[8] The policy also covered any subsidiary, associated company, or affiliate, which came to be 303 companies incorporated outside the United States.[9]

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1. [2007] EWCA Civ 1282.
2. *See* C v. D [2007], EWCA Civ 1282, at ¶ 1 (explaining the Bermuda Form is the specific type of form contract used for liability insurance purposes).
3. *Id.* at ¶ 16.
4. *Id.*
5. *Id.* at ¶ 20.
6. *Id.* at ¶ 19.
7. *Id.* at ¶ 2.
8. *Id.*
9. *Id.*

The contract was written on the Bermuda Form, which is a standard form contract that resulted from the liability insurance crisis of the mid-1980s.[10] At that time, American courts had expanded insurance coverage and broadened tort liabilities past what insurers had contemplated when they issued the policies.[11] In response to this situation, many policymakers shifted the decision-making process during disputed claims from the United States to London.[12]

The contract in this case called for disputes arising under the policy to be decided in London and provided that "any decision made would be a complete defense to any attempted appeal or litigation."[13] Under a section titled "Governing Law and Interpretation," it was stated "this policy shall be governed by and construed in accordance with the internal laws of the State of New York."[14]

While the policy was in effect, there were multiple claims made against it and the claimant paid the expenses. The claimant then sought an indemnity from the insurance carrier, which the carrier refused to pay. This refusal caused the claimant to begin an arbitration proceeding against the insurance carrier in London.

The defendant asserted four main defenses to the action, the first of which related to the scope of Endorsement 5 of the policy; the second related to late notice; the third correlated to misrepresentations and the nondisclosure prior to the beginning of the insurance; and the last was the "paediatric defense," which consisted of the contention the claimant had breached the duty of good faith and fair dealing under New York law or had violated public policy in relation to the alleged promotion by the claimant of the use of its product by children.[15]

The Tribunal decided to hear the first three defenses and defer the "paediatric defense" until later in the proceedings, because if a full award was ordered for the policy limit for one of the first three reasons, then the fourth would have no bearing on the final outcome.[16]

After a hearing where 16 witnesses testified, the tribunal issued a partial award, which dismissed the first three defenses and ordered interest and costs.[17] At that hearing English law was applied. The defendant carrier claimed this was a "manifest disregard of New York law" and thus the award should be reviewable by any U.S, Federal District Court that had jurisdiction over the parties.[18] This argument was rejected by the lower court and defendant appealed.

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10. *See id.* at ¶ 1. *See also* RICHARD JACOBS, LORELIE S MASTERS & PAUL STANLEY, LIABILITY INSURANCE IN INTERNATIONAL ARBITRATION: THE BERMUDA FORM 21 (2004) (showing the basic structure of the Bermuda Form).
11. *Id.*
12. *Id.*
13. *Id.* at ¶ 2.
14. *Id.*
15. *Id.* at ¶ 4.
16. *Id.* at ¶ 5.
17. *Id.* at ¶ 6.
18. *See* 9 U.S.C. § 10 (showing the federal law the defense relied upon to have the award be reviewable).

III. The Court's Analysis

A. First Consideration

The court took the view that "by choosing London as the seat of arbitration, the parties must be taken to have agreed that proceedings on the award should be only those permitted by English law."[19] The appellant never argued English law could not apply, but argued New York law could apply as well.[20] The court recognized if this were true, it would create a severe risk for conflicting opinions, where each party would race to get a judgment in the jurisdiction that had laws that favored it. The court quickly summed up with "an agreement as to the seat of arbitration is analogous to an exclusive jurisdiction clause."[21]

B. Second Consideration

Next, the court addressed the question of whether there was an "agreement to the contrary" under the English Arbitration Act 1996 that allowed the parties to contract out of a nonmandatory provision.[22] Here the court referred to section 4(5) of the Act, which said a choice of law provision will be nonmandatory only if the parties are agreeing what law not to apply, not what law will control.[23] The court went on to say that in this situation the decision to have the seat of arbitration in London showed English law controlled, because there was a closer connection to that law than there was to New York law, even though the contract was written to abide by New York law.[24]

C. Remedy

The court upheld the anti-suit injunction put in place by the trial court, preventing the defendant from challenging the decision in a U.S. court.[25] While doing this, the court expressed deference to the U.S. courts but decided it was important to uphold the injunction, so that parties can have a legitimate expectation the Bermuda Form will be enforced.[26] The court noted this was a situation where in the future it is equally likely the plaintiff and defendant will want to appeal a decision. Therefore, it is in the interest of all parties with similar future contracts to prevent a party from appealing a final judgment in a different jurisdiction.[27] The award of costs by the trial court was reversed.[28]

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19. *See* C v. D at ¶ 16.
20. *Id.*
21. *Id.* at ¶ 17, quoting A v. B (No. 2) [2007] 1 All ER (Comm) 633).
22. *Id.* at ¶ 19.
23. *See* Arbitration Act 1996 (of England) 1996 ch. 23 [17 June 1996].
24. *See* C v. D at ¶ 22.
25. *Id.* at ¶ 30.
26. *Id.*
27. *Id.*
28. *Id.* at ¶ 31 and ¶ 33 (explaining that at the trial level, costs were awarded on an indemnity basis instead of a standard basis). While that ruling was based on some precedent, it was overruled, because the court had received only short oral arguments and because the case presented a novel issue with each side having a legitimate expectation that they were correct. Because of this, the court overturned the order for indemnity costs.

IV. Conclusion

Given the current and growing level of globalization, it is imperative corporations have access to insurance. When dealing with claims between corporations of different countries, disputes are bound to arise that could be litigated in a number of different forums. In order to keep a readily available supply of affordable insurance, it is important for companies to know where they will be forced to litigate when awards are being challenged and what the laws of those places are. If each party were able to litigate in the place more favorable to it, then there would be a rush to file suit in different areas, and courts would constantly issue decisions that conflicted with each other. This decision by the Court of Appeal, Civil Division, gives certainty and a bright-line rule to those who draft contracts in the future to follow.

As the court notes, the reason the Bermuda Form was created was to take the damages decision out of the hands of American judges and juries, which were ordering too large claims, and to transfer it to English arbitration tribunals, which were considered fairer to the corporations.[29] By using this form contract, the parties are implicitly incorporating the framework of the English Arbitration Act 1996, which outlines the types of challenges that can be brought to the tribunal's decision.[30] Though the act allows for "agreement[s] to the contrary," which would allow the parties to contract out of nonmandatory portions of the act, the court here correctly decided that simply forming the contract under New York substantive law was not enough to qualify as an "agreement to the contrary."[31] If that were so, then an award delivered by an English court could be challenged both in London, under English law, and New York, under state or federal law.[32] This point was conceded by the appellant. It is just the type of confusion the Bermuda Form was created to prevent.[33]

Carl Falotico

29. *Id.* at ¶ 1.
30. *See* Arbitration Act 1996 (of England) 1996 ch. 23 [17 June 1996].
31. *See* C v. D at ¶19.
32. *Id.* at ¶ 16.
33. *Id.*

Akzo Nobel Chemicals Ltd v. Commission

Case T-253/03 and T-125/03 2007 ECR __, __ (Ct. First Instance Feb. 26, 2007, and Sept. 17, 2007)

The European Union's Court granted the International Bar Association's (IBA) application to intervene in order to use oral procedural methods to establish its interest in the case after the European Commission's refusal to recognize legal professional privilege in the documents seized in an investigation. The court declined to extend the privilege to communications with in-house counsel

.I. Holdings

In *Akzo Nobel Chemicals Ltd v. Commission of European Communities*,[1] the Court of First Instance granted the International Bar Association's (IBA) motion for leave to intervene on behalf of the applicants.[2] The court believed the IBA had the proper authority to intervene according to Article 40 of the Statute of the Court of Justice,[3] given the IBA established its interest in the outcome of this case.[4] Nonetheless, since the IBA did not file for permission to intervene until after the six-week period permitted in Article 115(1) of the Rules of Procedure of the Court of First Instance,[5] the IBA was allowed to advocate on behalf of the applicants only during oral procedure and was allowed to receive the Report for the Hearing to do so.[6]

In the decision granting the IBA's application to intervene, the Court of First Instance was silent about whether privilege was still inapplicable to the documents at issue.[7] However, seven months later, the court held that legal professional privilege did not apply to these documents.[8] The court excluded the application of privilege to statements made to in-house counsels because in-house counsels are legal advisers bound to their clients through the employment relationship.[9]

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1. Case T-253/03, Akzo Nobel Chemicals Ltd v. Commission, 2007 ECR __, ¶ 19 (Ct. First Instance Feb. 26, 2007) (hereinafter *February Decision*).
2. *Id*.
3. Statutes of the Court of Justice, art. 40, cited in *February Decision* at ¶ 19.
4. *Id*. at ¶ 11.
5. Rules of Procedure of the Court of First Instance, art. 115(1), cited in *February Decision* at ¶ 19.
6. *February Decision* at ¶ 19.
7. *Id*. at ¶ 19.
8. Case T-125/03, Akzo Nobel Chemicals Ltd v. Commission, 2007 ECR __, ¶ 137, 169 (Ct. First Instance Sept 17, 2007) (hereinafter *September Decision*).
9. *Id*. at ¶ 167.

II. Facts and Procedural Posture

The applicants are two corporations that were established in Surrey, United Kingdom.[10] Those corporations are Akzo Nobel Chemicals Ltd and Akcros Chemicals Ltd.[11]

The defendant is the Commission of the European Communities (Commission).[12] In January 2003, the Commission required the applicants submit to an investigation,[13] the purpose of which was to discover evidence of anticompetitive practices.[14] Subsequently, in February 2003, on-site investigations of the applicants' Eccles, Manchester, premises took place.[15] The Commission found and took copies of many documents.[16]

The applicants believed several of these documents were protected by legal professional privilege.[17] A disagreement arose between the applicants and defendants about the treatment of five of the documents.[18] While two of the documents, known as Set A, were placed in a sealed envelope, the officials in charge did not believe the other three documents, known as Set B, were covered by privilege.[19] The Set A documents consist of a memorandum and a copy of the memorandum containing information gathered by the general manager while having internal discussion with other employees.[20] The Set B documents were copied by Commission officials and placed in the file without first being inserted in a sealed envelope because the Commission believed these documents were not covered by privilege.[21] The three Set B documents consisted of handwritten notes made by Akcros Chemicals' general manager during discussions with employees that then were used to prepare the Set A memorandum, as well as two e-mails between Akcros Chemicals' general manager and Akzo Nobel's coordinator for competition law.[22]

The applicants requested on numerous occasions that the confidentiality of the documents be preserved.[23] In April 2003, before the Court Registry, the applicants sought an annul-

10. *February Decision* at ¶ 2.
11. *Id*. at ¶ 1.
12. *Id*.
13. *Id*.
14. *Id.*
15. *Id.* at ¶ 2.
16. *Id.*
17. *Id*.
18. *Id*.
19. *Id*. *See also September Decision* at ¶ 73 (explaining the set of two documents was known as Set A and the second composed of three documents was known as Set B).
20. *Id*. at ¶ 6 (conveying the memorandum was created for the purpose of obtaining outside legal advice in connection with Akzo Nobel's competition law compliance program and it was impossible to tell on the spot whether privilege should apply to these documents).
21. *See February Decision* at ¶ 2; *see also September Decision* at ¶ 80 (describing for an applicant to prove that a document is subject to privilege, it must inform the Commission of the author of the document and to whom it was intended, describe the respective duties and responsibilities of each, and refer to the objective and context under which this document was written).
22. *February Decision* at ¶ 8.
23. *Id*. at ¶ 3.

ment of the decision to have the companies and their subsidiaries submit to this investigation.[24] Next, in May 2003 before the Commission, the applicants requested the documents' confidentiality be maintained.[25] However, the applicants received an unfavorable decision.[26] On July 30, August 7, August 18, and November 25, 2003, respectively, the Council of the Bars and Law Societies of the European Union (CCBE), the Algemene Raad van de Nederlandse Orde van Advocaten (the Netherlands Bar), the European Company Lawyers Association (ECLA), and the American Corporate Counsel Association (ACCA) sought intervention on behalf of the applicants.[27] On February 20, 2006, the IBA sought to intervene.[28]

The issue before this court was whether the application by the IBA to intervene would be granted, so the IBA could support the applicants in their quest to have the Commission's May 8, 2003, decision annulled, which refused to allow for legal professional privilege to apply to the three documents seized under Article 14(3) of Council Regulation Number 17.[29,30] The court subsequently decided the issue of professional privileged documents on September 17, 2007, when it consolidated the previous requests made by Akzo Nobel Chemicals Ltd and Akcros Chemicals Ltd.[31]

III. The Court's Analysis

A. The IBA's Motion to Intervene

As an initial matter, the court addressed that the right to intervene in this forum is open not just to Member States and institutions of the European Communities, but also to any person who can demonstrate an interest in the result of the case.[32] In particular, representative associations can intervene to protect their members' interests.[33] An association can get involved in a case if it represents a substantial number of constituents who participate in the concerned area, its purpose includes protecting its members' interests, the case raises questions impacting the functioning of this sector, and its members' interests may be affected in an appreciable way by the judgment of the case.[34]

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24. *Id*.
25. *Id*. at ¶ 4.
26. *Id*.
27. *Id*. at ¶ 6.
28. *Id*. at ¶ 8.
29. Art. 14(3), Council Regulation No. 17 of 6 February 1962, [1962] O.J. 13/204 (Special English Edition 1959–1962), cited in *February Decision* at ¶ 1. Note that Regulation No. 17 was replaced, effective May 1, 2004, by Council Regulation (EC) No. 1/2003, [2003] O.J. (L 1) 1.
30. *February Decision* at ¶ 1; *see also September Decision* at ¶ 76 (demonstrating Regulation No. 17 gave the Commission wide investigative powers for proceedings regarding competition, including business records).
31. *September Decision* at ¶¶ 137, 169.
32. *February Decision* at ¶ 14.
33. *Id*. at ¶ 15.
34. *Id*.

Specifically, the court held the IBA successfully established its interest in the outcome of this case and thus had standing to intervene pursuant to Article 40 of the Statute of the Court of Justice.[35] The IBA was permitted to intervene for three reasons.[36] First, the court found the IBA was an organization that represents an appreciable number of practitioners in this area.[37] Specifically, it represents 20,000 individual lawyers, of whom 3,000 were in-house counsel; 195 Bars; and various company lawyers' associations.[38] Second, the IBA's Constitution demonstrates that one of its goals is to protect its members' interests.[39] According to Article 1(2) and (3) of the IBA's Constitution,[40] its object is to help legal associations and their members improve the profession's organization, to assist members of the legal professional globally, and to enhance its legal services to the public.[41] Third, it is appropriate for the IBA to intervene in this judgment because it involves issues of confidentiality about communications between a lawyer and his or her client, directly impacting both the functioning of the IBA's members and the sector of the legal community.[42]

For these reasons, the court gave the IBA permission to intervene.[43] However, since the IBA failed to intervene within the six-week period provided for in Article 115(1) of the Rules of Procedure of the Court of First Instance,[44] the IBA's participation was limited to submission during oral procedure, according to Article 116(6) of the rules.[45] In this decision, no new ruling was made on the applicant's request for confidential treatment of the documents.[46]

B. Privilege for Communications with In-House Counsel

Although the court did not rule in its February decision on whether privilege applied to the three documents taken from the companies' Manchester premises, it was possible that by allowing the IBA to intervene, the applicants' request would be granted.[47] In 1982, the European Court of Justice, in *Australian Mining and Smelting (Europe) Ltd v. Commission*,[48] held legal professional privilege could be applied to written communications between lawyers and

35. Statutes of the Court of Justice, art. 40, cited in *February Decision* at ¶ 19.

36. *Id*. at ¶¶ 16–18.

37. *Id*. at ¶ 16.

38. *Id.*

39. *Id*. at ¶ 17.

40. International Bar Association Constitution, art. 1(2), (3), cited in *February Decision* at ¶ 17.

41. *Id*.

42. *Id*. at ¶ 18.

43. *Id*. at ¶¶ 16–18.

44. Rules of Procedure of the Court of First Instance, art. 115(1), cited in *February Decision* at ¶ 19.

45. Rules of Procedure of the Court of First Instance, art. 116 (6), cited in *February Decision* at ¶ 19.

46. *Id*. at ¶ 19.

47. *Id*. at ¶ 19.

48. Case 155/79, [1982] ECR 1575.

clients only if two conditions were met.[49] The conditions were: (1) the communications at issue were made with the purpose and interest of client's rights of defense and (2) the communications were between independent lawyers, meaning those not bound to the client through employment.[50] The Commission adhered to this rule because it believed it could not force member states to make statements between in-house counsel and clients privileged if they did not do so through domestic law.[51]

Although the Court of First Instance allowed the IBA to intervene on behalf of the applicants, ultimately, on September 17, 2007, after consolidating all previous *Akzo Nobel Chemicals Ltd and Akcros Chemical Ltd v. Commission* suits, this court refused to apply legal professional privilege to the three documents known as Set B.[52] The Set B documents consisted of correspondence between the General Manager of Akcros Chemicals and a member of Akzo Nobel's legal department.[53] The court readily determined the Set B documents, in particular the handwritten notes, were not protected by legal professional privilege. This was after the court concluded privilege did not attach to the Set A memorandum, which was based upon these notes.[54]

Legal professional privilege, according to Article 14(3) Regulation 17,[55] applies only to situations in which the lawyer is independent of the client and not bound to the client through an employment relationship.[56] The communication here was between in-house lawyers who were bound to their clients through an employment relationship, so these documents could not be protected under legal professional privilege, despite the applicants' claim to the contrary.[57] Thus, the court dismissed this action and ordered the applicant bear three-fifths of their own costs relating to these proceedings and three-fifths of the costs incurred by the Commission relating to this suit.[58] Similarly, the court ordered the Commission bear two-fifths of the costs of these proceedings and two-fifths of the costs incurred by Akzo Nobel Chemicals and Akcros Chemicals.[59]

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49. *See* Simon Holmes & Gordon Christian, *United Kingdom: The Akzo Nobel Judgment—European Court Continues to Deny Legal Privilege to In-House Lawyers*, PLC CROSS-BORDER SERVICE (2007), *available at* http://www.mondaq.com/article.asp?articleid=55810 (explaining privilege has been governed by a rule set out in a 26-year-old case) (hereinafter Holmes & Christian).

50. *Id*. (depicting there are two requirements for privilege to apply).

51. *See id*. (illustrating because not all European member states have protected documents by in-house counsel, the Commission felt its rule must exclude in-house attorneys).

52. *September Decision* at ¶¶ 135, 136, 140, 179 (depicting the Set B documents consisted of handwritten notes taken by the General Manager of Akcros Chemicals during sessions with lower-level employees, which were used to prepare the memorandum that has been referred to as the Set A documents, and e-mails exchanged with members of the applicant's legal department).

53. *Id*. at ¶ 179.

54. *Id*. at ¶ 135, 140.

55. Council Regulation No.17, art. 14(3), *supra* note 29, cited in *February Decision* at ¶ 1.

56. *September Decision* at ¶ 166.

57. *Id*. at ¶ 154, 167 (describing that in Italy, France, Luxembourg, Finland, and Austria, legal professional privilege is not granted to in-house lawyers, despite other Member States' application of legal professional privilege to in-house lawyers).

58. *Id*. at ¶ 188.

59. *Id*.

IV. Conclusion

Despite the court's decision, the Commission should change its stance and recognize that in-house counsel's current role in ensuring compliance with the law is very different from its role in 1982.[60] In fact, as a member of the CCBE expressed, it is unfortunate the scope of professional privilege has not been applied to in-house counsel who are bar or law-society members and as such are subject to professional duties of confidentiality under national rules.[61] It is illogical professional privilege does not extend to in-house counsel merely because of their different employment status.[62] Not only is a failure to extend privilege illogical, but it is unsustainable and runs counter to the Commission's goal of increasing European companies' cultural compliance.[63]

The decision on the merits has already been appealed to the Court of Justice.[64] There is strong support in the community of Europeans for extending privilege to apply to in-house counsel and therefore, even if an appeal does not achieve the results the applicants seek, it is likely it will not be the last case to raise this issue.[65]

Marisa Aronson

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60. Holmes & Christian, *supra* note 51 (expressing that today in-house lawyers play a key role in ensuring laws are followed).

61. *See* Sweet & Maxwell Limited and Contributors, *Lawyers Condemn European Judgment in Akzo Nobel Case*, COMPANY LAW. 372 (2007) (discussing the court should have taken the opportunity to expand the scope of professional privilege) (hereinafter Sweet & Maxwell).

62. *Id*. (explaining the role of in-house counsel has evolved since 1982 and because of this change, in-house lawyers deserve the same level of protection as other attorneys); *see also* Holmes & Christian, *supra* note 51 (noting the difference between in-house lawyers and other attorneys is that in-house lawyers are considered nonindependent lawyers).

63. *See* Sweet & Maxwell, *supra* note 63 (describing that it is disappointing the court has not fixed this problem and made in-house lawyers and other attorneys subject to the same standards).

64. Case 550/07P: Appeal brought on 8 December 2007 by Akzo Nobel Chemicals Ltd and Akcros Chemicals Ltd against the judgment of the Court of First Instance delivered on 17 September 2007 in Case T-253/03: Akzo Nobel Chemicals Ltd v. the Commission of 9 February 2008, 2008 O.J. (C37) 19 (explaining the applicants want the European Court of Justice to set aside the September 17, 2007, judgment of the Court of First Instance).

65. Holmes & Christian, *supra* note 51 (noting Akzo will not likely end the battle for in-house counsel to obtain the same protection from disclosure of their work product that other attorneys have).

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