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Bringing Justice to an Embattled Region - Creating and Implementing the Rules of the Road for Bosnia-Herzegovina

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Bringing Justice to an Embattled Region—Creating and Implementing the "Rules of the Road" for Bosnia-Herzegovina

By
Mark S. Ellis*

I.
INTRODUCTION

"If you want Peace, work for Justice."
—Pope Paul VI

In October 1992, the United Nations assembled a Commission of Experts to review, under the direction of Professor Cherif Bassiouni, evidence of violations of international humanitarian law in the former Yugoslavia, and to provide a detailed account of such evidence to the Secretary-General.[1] In the wake of continuing terror and death in Bosnia, and following several failed diplomatic efforts to end the war and prevent further atrocities, the United Nations (UN) Security Council was seeking a judicial solution to the alleged grave breaches of international humanitarian law occurring in the former Yugoslavia.

On February 22, 1993, based on the Commission's findings, the Security Council passed Resolution 808, authorizing the establishment of a Tribunal for the prosecution of persons responsible for serious violations of international humanitarian law committed in the territory of the former Yugoslavia since 1991.[2] According to the Resolution, the Secretary-General was to report on the proposed Statute of the Tribunal.[3] On May 25, 1993, the Security Council adopted

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1. *See generally Final Report of the United Nations Commission of Experts Pursuant to Security Council Resolution 780* (1992), U.N. SCOR, Annex, U.N. Doc. S/1994/674 (27 May 1994) [hereinafter *Final Report*].

2. *See* S.C. Res. 808, U.N. SCOR, 48th Sess., 3175th mtg. at 1, U.N. Doc. S/RES/808 (22 Feb. 1993) [hereinafter Resolution 808].

3. *Id.* The report was to focus "on all aspects of this matter, including specific proposals and where appropriate options for the effective and expeditious implementation of [the decision], taking into account suggestions put forward in this regard by Member States." *Id.* ¶ 2.

the Statute by a unanimous vote,[4] thus officially establishing the International Tribunal for the Prosecution of Persons Responsible for Serious Violations of International Humanitarian Law Committed in the Territory of the Former Yugoslavia Since 1991 (hereinafter "the Tribunal"). The eleven judges of the Tribunal were elected by the General Assembly in September 1993 and took office on November 17, 1993.[5] The Prosecutor took office on August 15, 1994.[6]

The Tribunal was the first international criminal tribunal ever established by the United Nations.[7] Because many believed that the process of ratification by member states would be too slow given the urgency and severity of the crisis,[8] the Tribunal was created by "order" of the Security Council.[9] That is to say, the Tribunal was established under Chapter VII of the United Nations Charter,[10] which provides the Security Council with the authority to respond to breaches of peace and acts of aggression.[11] Yet unlike the military tribunals of Nuremberg[12] and Tokyo,[13] which were established by the victorious powers of World War II, the Yugoslav Tribunal is part of an international security regime that functions on behalf of the entire international community. Thus, the Tribunal's mandate is much broader than the "victors' justice" associated with a military tribunal.

On one level, the Tribunal was established to ensure that violations of international humanitarian law, as witnessed in the former Yugoslavia, would cease

4. *See* S.C. Res. 827, U.N. SCOR, 48th Sess., 3217th mtg., at 1-2, U.N. Doc. S/RES/827 (25 May 1993) [hereinafter Resolution 827].

5. The elected judges were: Georges Michel Abi-Saab (Egypt), Antonio Cassese (Italy), Jules Deschenes (Canada), Adolphus Godwin Karibi-Whyte (Nigeria), Germain Le Foyer de Costil (France), Li Haope (China), Gabrielle Kirk McDonald (United States), Elizabeth Odio Benito (Costa Rica), Rustam S. Sidhwa (Pakistan), Sir Ninian Stephen (Australia), and Lal Chand Vohrah (Malaysia). *See General Assembly Fills Remaining Three Vacancies for Judges on International War Crimes Tribunal*, U.N. GAOR, 47th Sess., 111th Resumed mtg., U.N. Doc. GA/8500 (17 Sept. 1993).

6. Judge Richard Goldstone of South Africa was selected by the United Nations Security Council.

7. After World War I, the Treaty of Versailles called for the creation of an international tribunal, but it was never created. *See* Treaty of Peace Between the Allied and Associated Powers and Germany, art. 227, in 2 Bevans 43, at 136-37 (28 June 1919).

8. *See* International Tribunal for the Prosecution of Persons Responsible for Serious Violations of International Humanitarian Law Committed in the Former Yugoslavia Since 1991, 1994 U.N.Y.B. 83 [hereinafter 1994 Yearbook].

9. In its Resolution 808 (1993), the Security Council required the Secretary-General to provide for "the effective and expeditious implementation" of a tribunal. *Supra* note 2. Some Security Council members, as well as some Member States, felt that the Tribunal should be established by the General Assembly or by a multilateral treaty. *See* CHERIF BASSIOUNI & PETAR MANDRAS, THE LAW OF THE INTERNATIONAL TRIBUNAL FOR THE FORMER YUGOSLAVIA, (Transnational Publishers, Inc., 1946).

10. U.N. Charter, 59 Stat. 1031, T.S. No. 993 [hereinafter U.N. Charter].

11. "The Security Council shall determine the existence of any threat to the peace, breach of peace, or act of aggression and shall make recommendations, or decide what measures shall be taken in accordance with Articles 41 and 42, to maintain or restore international peace and security." *Id.* art. 39.

12. *See* Agreement for the Prosecution and Punishment of Major War Criminals of the European Axis, Aug. 8, 1945, 59 Stat. 1544, 82 U.N.T.S. 279 [hereinafter London Agreement].

13. *See* Special Proclamation by the Supreme Commander for the Allied Powers, Jan. 19, 1946, T.I.A.S. No. 1589, 4 Bevans 20: Charter dated Jan. 19, 1949, 4 Bevans 21; amended Charter dated Apr. 26, 1946, 4 Bevans 27 - 28.

and be effectively redressed.[14] Moreover, by ensuring a judicial process that was swift, fair, and consistent, it was also hoped that the Tribunal would dissuade parties to the conflict from perpetrating further crimes and thus "contribute to the restoration and maintenance of peace."[15] Finally, many believed that, as a non-state judicial body, the Tribunal would set a standard for ethical conduct that might influence the behavior of nation states in the future.[16]

II.
CONCURRENT JURISDICTION

In a departure from the model established at Nuremburg and Tokyo,[17] the Tribunal recognizes the right of national courts to decide cases according to the principle of universal jurisdiction.[18] Rather than adjudicating violations of international humanitarian law only by an international judge in an international proceeding, the Tribunal encourages countries from the former Yugoslavia to initiate domestic prosecution of arrested war criminal suspects.[19] Under its Statute, the Tribunal recognizes that domestic "national" courts have *concurrent jurisdiction* over violations of international humanitarian law.[20] A suspect may therefore be indicted by either the Tribunal or by a national court. The Tribunal does not monopolize the original jurisdiction of crimes committed in the former Yugoslavia,[21] nor was it ever intended to have exclusive jurisdiction over conflicts arising therein.[22] Although the Tribunal has *primacy* over national courts and may request that such courts defer to the competence of the Tribunal,[23] it does not deprive national courts of the right to conduct war crimes trials.

There are several reasons why the drafters of the Tribunal's Statute sought concurrent jurisdiction. First, they wanted national courts to assume responsibil-

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14. *Resolution 827*, *supra* note 4, Preamble.

15. *Id.*

16. *See id.*

17. The Nuremberg and Tokyo tribunals were created to *substitute* proceedings in the national courts. *See* London Agreement, *supra* note 12.

18. "The 'universality principle' recognizes that certain activities, universally dangerous to states and their subjects, require authority in all community members to punish such acts wherever they may occur, even absent a link between the state and the parties or acts in question." BUERGENTHAL & MAIER, PUBLIC INTERNATIONAL LAW IN A NUTSHELL (2d ed. 1990).

19. *See* VIRGINIA MORRIS & MICHAEL P. SCHARF, AN INSIDER'S GUIDE TO THE INTERNATIONAL CRIMINAL TRIBUNAL FOR THE FORMER YUGOSLAVIA 72 (Transnational Publishers, Inc., 1995).

20. "The International Tribunal and national courts shall have concurrent jurisdiction to prosecute persons for serious violations of international humanitarian law committed in the territory of the former Yugoslavia since 1 January 1991." *Statute of the International Tribunal*, art 9(1), U.N. SCOR, 48th Sess., Supp. Apr.-June, 1993 at 134; 32 I.L.M. 1192 (July 1993), U.N. Doc. S/25704, Annex 1 (1995) [hereinafter *Statute*].

21. *See Report of the Secretary-General*, ¶ 64, U.N. SCOR, 48th Sess., Supp. Apr.-June 1993, at 117, U.N. Doc. S/25704 (1995).

22. *See* BASSIOUNI & MANDRAS, *supra* note 9, at 229.

23. "The International Tribunal shall have primacy over national courts. At any stage of the procedure, the International Tribunal may formally request national courts to defer to the competence of the International Tribunal in accordance with the present statute and the Rules of Procedure and Evidence of the International Tribunal." *Statute*, *supra* note 20, art. 9(2).

ity over trials because they are often better suited to do so.[24] Second, national trials would minimize the costs to the UN.[25] Third, by allowing national courts to exercise prosecutorial discretion, national prosecutions could potentially play a role in the peace process.[26] Finally, unlike the Nuremberg and Tokyo tribunals, the Yugoslav Tribunal would have no means to apprehend suspects, except to rely on member states whose officials can physically bring accused persons before the Tribunal.[27]

A more troublesome issue remains on the question of deciding which suspects are to be tried by national courts, and which ones by the Tribunal. Although it was never intended that the Tribunal would handle all cases that arise in the former Yugoslavia,[28] a well-established method for selecting cases has yet to emerge.[29] Scholars have argued for a regime of "stratified-concurrent jurisdiction"[30] whereby the Tribunal prosecutes the "key players" while national governments focus on other defendants.[31] With its recent dismissal of fourteen "sound" indictments, the Tribunal seems to have accepted this approach.[32]

Even so, national courts may be in no position to conduct war crimes trials. Indeed, a state can ostensibly be immobilized in a post-conflict environment, and national courts may in this context be unable to render justice impartially. This is currently the case in Bosnia-Herzegovina.[33] As a consequence, the Tribunal has been careful to preserve its right to primacy over national trials which deal with international, as distinguished from ordinary, crimes.[34]

III.
JUDICIAL INCAPACITY AND FEAR OF ARBITRARY ARREST IN BOSNIA-HERZEGOVINA

The importance of the primacy doctrine was evident early on in Bosnia-Herzegovina. The Bosnian war formally ended in December 1995 when the governments of Serbia, Croatia, and Bosnia-Herzegovina signed the General

24. *See* BASSIOUNI & MANDRAS, *supra* note 9, at 313.

25. *Id.*

26. *Id.*

27. *See generally* LAWYERS COMMITTEE FOR HUMAN RIGHTS, PROSECUTING WAR CRIMES IN THE FORMER YUGOSLAVIA – THE INTERNATIONAL TRIBUNAL, NATIONAL COURTS AND CONCURRENT JURISDICTION: A GUIDE TO APPLICABLE INTERNATIONAL LAW, NATIONAL LEGISLATION, AND ITS RELATION TO INTERNATIONAL HUMAN RIGHTS STANDARDS (May 1995).

28. *Id.*

29. *Id.*

30. *See* Madeline H. Morris, Remarks at the Brussels Conference (July 20-21, 1996) (on file with the author).

31. *Id.*

32. *See* ICTY Press Release, Office of the Prosecutor, CC/PIU/314-E (May 8, 1998).

33. It can be easily argued that it was the complete failure of the judicial system to stem the atrocities in the former Yugoslavia that prompted the creation of the Tribunal. *See Resolution 827*, *supra* note 4.

34. *See Decision on the Defense Motion for Interlocutory Appeal on Jurisdiction*, Tadic Case, IT-94-1-T (ICTY Oct. 2, 1995) at para. 83.

Framework Agreement for Peace in Bosnia-Herzegovina[35] (hereinafter "Dayton Accords"). The Dayton Accords recognize the sovereign Republic of Bosnia-Herzegovina, as comprised of two autonomous entities: the Federation of Bosnia-Herzegovina[36] and the Republika Srpska.[37] The structure of the governmental bodies of the state of Bosnia-Herzegovina is premised on proportional representation among the Bosniac, Croat, and Serb groups.[38] The three political parties[39] that dominate decision-making in Bosnia-Herzegovina are also constructed along these ethnic lines, and each promotes a strong nationalist agenda.[40]

Since the end of the war in 1995, Bosnian Serbs, Muslims, and Croats have each waged, within their respective territories, an intense campaign to bring individuals suspected of committing war crimes to justice. Each of the three parties has maintained exhaustive, if not accurate, files on persons among the "other" group whom they "know" to be war criminals. They are eager to prosecute alleged war criminals, and consistently maintain their right to prosecute such individuals under the jurisdiction of their own national legal systems. The Tribunal recognizes this right.[41]

Yet, problems remain with the capacity of the national courts to prosecute persons accused of violating international humanitarian law. The Bosnian court system (both in the Federation and the Republika Srpska), cannot at this time guarantee a fair and politically unbiased judicial process. In Bosnia-Herzegovina, judges are still beholden to the political parties who elect them. There is no input from the legal community in the selection of judges, nor is there a non-political body that evaluates a candidate's qualifications. These same constraints exist for the judiciary in the Republika Srpska and are, in fact, exacerbated by the Republika Srpska's complete lack of a functioning democratic judiciary. Judges at every level have little or no independence from the political

35. UNITED NATIONS, GENERAL ASSEMBLY, SECURITY COUNSEL, GENERAL FRAMEWORK AGREEMENT FOR PEACE IN BOSNIA-HERZEGOVINA, U.N. Doc. A/50/790 – S/1995/999 (November 29, 1995) [hereinafter Dayton Accords].

36. The Federation is based upon the relationships among the Federation government, eight smaller cantonal governments (four Muslim-dominated cantons, two Croat-dominated cantons, and two mixed cantons), and smaller municipal governments. *See* Mark Ellis, *Bosnia-Herzegovina,* in WORLD ENCYCLOPEDIA OF PARLIAMENTS AND LEGISLATURES at 76 (Congressional Quarterly 1998).

37. The Republika Srpska has its own unicameral National Assembly. Together with the Federation, these entities make up the State of Bosnia-Herzegovina. *Id.*

38. *See generally* CONSTITUTION OF BOSNIA – HERZEGOVINA, §§ 5-6, *contained in* Dayton Accords, *supra* note 35, at 59, *reprinted in* 35 I.L.M. 75, 117 (1996).

39. Although there are more than fifty-five political parties in Bosnia-Herzegovina, only three play a central role in Bosnian politics: the Croatian Democratic Union (HDZ) of Bosnia-Herzegovina, structured under the Croatian HDZ party led by Croatian President Franjo Tudjman; the Muslim Party of Democratic Action (SDA), led by Alija Izetbegovic; and Radovan Karadzic's Serbian Democratic Party of Bosnia-Herzegovina (SDSBiH). *See* Ellis, *supra* note 36, at 81.

40. The SDA is a party that has chosen Islam as the vehicle to strengthen Bosniac nationalism. The HDZBiH continues to push for an independent Herzeg-Bosna and ultimately supports a "Greater Croatia." The SDSBiH has been the primary advocate for an independent Republika Srpska, or reunification of Republika Srpska with Serbia. *See id.*

41. *See Statute*, *supra* note 20, art. 9, at 135.

parties, and the judiciary is even more politicized than its counterpart in the Federation.

Another problem with the Bosnian court system is that once judges are selected, they are often forced to supplement their meager salaries with "outside" work. Not only does this take away from time that should be devoted to judicial duties, but outside work places judges in a position where they may be forced to compromise their independent decision-making. In cases where a judge relies on other income, and ethical conflict of interest guidelines are vague or nonexistent, judges could be manipulated in their case adjudication. In addition, many of the cantonal and municipal judges are young and untrained. There is a desperate need for continuing legal education for judges.

Aside from the lack of an independent judiciary, other obstacles stand in the way of the successful prosecution of war criminals within the national courts. Generally speaking, computers, modern caseload management, and network systems are all but nonexistent within the court systems of Bosnia-Herzegovina. Also, there is a lack of cooperation between the Federation and the Republika Srpska on judicial matters, a lack of procedural laws to effectively prosecute and defend alleged war criminals, a lack of qualified defense attorneys, and an inability to monitor trials or subpoena witnesses.[42]

In spite of these obstacles, Bosnia's three main ethnic groups continued to escalate the race among each other to seek out, indict, or arrest citizens of the other ethnic groups for violating international humanitarian law. The turning point in this race came on February 6, 1996, when Bosnian authorities arrested two senior Serb officers, General Djordje Djukic and Colonel Aleksa Krsmanovic. The two had misread a signpost and inadvertently strayed into Federation territory near Sarajevo.[43]

Judge Richard Goldstone, Tribunal Prosecutor at the time, requested that both men be transferred to The Hague to determine if they should stand trial. Djukic, who had served as Chief of Logistical Operations for the Bosnian Serb forces, was subsequently indicted.[44] Though most within the Federation supported the Tribunal, they had little confidence that it could bring to justice more than a few of the thousands of individuals accused of atrocities. The Djukic arrest prompted new optimism among Bosnian Muslims that the international community would finally act to apprehend indicted war criminals.[45] Among Bosnian Serbs, the reaction was quite different. The arrests were viewed as an affront to all Serbs, and threatened to re-ignite the Bosnian war.[46]

The arrests also underlined a more fundamental problem. The fear of arrest by local authorities was interfering with a basic provision of the Dayton Ac-

42. *See* Mark S. Ellis, *Bringing War Criminals to Justice*, THE UNIVERSITY OF DAYTON CENTER FOR INTERNATIONAL PROGRESS, at 28 (1997).

43. Mike Corder, *Yugoslavia–War Crimes*, ASSOCIATED PRESS, March 3, 1996.

44. *Analysis and Opinion from the Balkan Institute,* THE BALKAN MONITOR, April 5, 1996, at 3.

45. Interview with Sven Alkalaj, Bosnian Ambassador to the United States.

46. These views were expressed to the author during a visit to Sarajevo in March, 1996. *See also* Chris Hedges, *Serbs Decry Arrests of Suspected War Criminals*, N.Y. TIMES, Feb. 7, 1996.

cords, which granted freedom of movement to all citizens in the territory of Bosnia-Herzegovina.[47]

IV.
THE ROME AGREEMENT

Politically, the ramifications of the Djukic and Krsmanovic arrests were significant. It was clear that rules needed to be established to ensure that arrests were based on legal grounds rather than political retaliation. On February 18, 1996, the international community convened a meeting in Rome among the signatories to the Dayton Accords. At this meeting, the parties[48] agreed to create a mechanism to enhance cooperation with the Tribunal.[49] In particular, they agreed to follow a set of guidelines when issuing an order, warrant or indictment against any individual suspected of violating international humanitarian law, as provided in Article IX of the Dayton Accords.[50] Henceforth, this provision of the Rome Agreement became known as the "Rules of the Road."[51]

Signed on February 18, 1996,[52] the Rules of the Road provision states, in part, that:

> Persons, other than those already indicted by the International Tribunal, may be arrested and detained for serious violations of international humanitarian law only pursuant to a previously issued order, warrant, or indictment that has been reviewed and deemed consistent with international legal standards by the International Tribunal. Procedures will be developed for expeditious decisions by the Tribunal and will be effective immediately upon such action.[53]

Thus, according to the Rome Agreement, authorities within Bosnia-Herzegovina, Croatia, and Serbia can only arrest and detain persons under two circumstances: (1) if an individual has already been indicted by the Tribunal for serious violations of international humanitarian law, or (2) if an indictment by one of the three parties has already been reviewed by the Tribunal and found to be consistent with international legal standards.[54]

It is important to note that the Tribunal was not enthusiastic about taking on the role of reviewing the files. In fact, during the negotiations of the Rules of the Road provision of the Rome Agreement, a number of people questioned whether the Office of the Prosecutor (OTP), had actually agreed that the Rules

47. *See Dayton Accords*, *supra* note 35, Annex 4; CONSTITUTION OF BOSNIA AND HERZEGOVINA, *supra* note 38, Art. II, § 4.

48. The parties included President Izetbegovic of Bosnia-Herzegovina; President Franjo Tudjman of Croatia; and President Slobodan Milosevic of Serbia.

49. *See* Office of the High Representative, Agreed Measures, February 18, 1996 [hereinafter Rome Agreement] at § 5, *Office of the High Representative website* (visited Sept. 8, 1999) <http://www.ohr.int/docu/d960218a.html>.

50. *Id.*

51. The term "Rules of the Road" was coined by then Secretary of State, Warren Christopher.

52. *See* Rome Agreement, *supra* note 49.

53. *Id.* § 5.

54. *See* Memorandum from the Office of the High Representative [hereinafter OHR Memo] [on file with the author].

of the Road provision was within the Tribunal's mandate.[55] There was also the real concern that the OTP simply did not have the resources to undertake this type of activity. The OTP knew that the Rules of the Road would require additional financial and personal resources, both of which the Tribunal did not possess. In addition, the OTP wanted to focus its efforts on the potential indictments within its own jurisdiction, not create a monitoring and authorization procedure for the parties' own prosecutorial exercises. After considerable pressure from the United States and other nations supportive of the Tribunal, the OTP reluctantly agreed to review the cases submitted to its office.[56]

Unfortunately, the initial reluctance by the OTP to embrace actively the Rules of the Road has persisted to the present day. Although the Tribunal's outgoing Chief Prosecutor Justice Louise Arbour has stated publicly that adherence to these provisions exemplifies the positive cooperation between local authorities,[57] the OTP has made it clear that it wants "sufficient resources" for a "workable long-term solution" for the Rules of the Road project.[58]

V.
AUTHORITY AND COMPLIANCE

On November 30, 1996, representatives of the Members of the Presidency of Bosnia-Herzegovina[59] met in Sarajevo to elaborate the conditions precedent to detaining alleged war criminals, as set forth in the Rome Agreement.[60] The parties agreed that on January 1, 1997, all case files involving persons suspected of committing serious violations of humanitarian law, including persons already detained on suspicion of war crimes or convicted of war crimes, were to be turned over to the Tribunal.[61] After January 1, 1997, the arrest or detention of persons suspected of war crimes will occur only *after* the Tribunal has reviewed the case file and established that there was sufficient evidence for prosecution in accordance with "international standards."[62]

Under the Rules of the Road Procedures, the parties are also obligated to provide the OTP with an immediate *estimate* of the number of cases they *expect* to submit for review, and a projected timeline for when the cases will be submitted.[63] Two of the three parties to the Rome Agreement have simply ignored their obligations. Only Bosnia has provided a detailed list of anticipated cases to

55. *See* Memorandum from Bill Stuebner to CEELI/CIJ (January 1, 1998) [hereinafter Stuebner Memo].

56. *Id.*

57. *See* Memorandum from Alain Norman to Mark Ellis 1, 2 (May 22, 1998) [hereinafter May 22nd Norman Memo].

58. *See* Memorandum from the OTP to CEELI/CIJ 1 (July 6, 1998) [hereinafter Blewitt Memo].

59. Jusuf Pusina, Martin Raguz and Nenad Radovic were the appointed representatives.

60. "Procedures and Guidelines for Parties for the Submission of Cases to the International Criminal Tribunal for the Former Yugoslavia Under the Agreed Measures of 18 February 1996" [hereinafter Rules of the Road Procedures].

61. *Id.* § 3.

62. *Id.* § 1, quoting Rome Agreement, *supra* note 49, § 5.

63. *Id.* § 3.

the OTP for review.[64] As of September 1998, Croatia and Serbia have yet to submit files. Indeed, the failure of both Croatia and Serbia to cooperate with the Tribunal represents the most problematic aspect of enforcing the Rules of the Road Procedures. Despite signing the Rome Agreement, neither party considers itself bound by the Rules of the Road.[65]

Yet, the obligation to comply arises out of several unambiguous and unequivocal mandates. First among them is Chapter VII of the UN Charter, which creates a binding obligation on all member states to implement decisions of the UN.[66] The Yugoslav successor states are also obliged to cooperate with the Tribunal pursuant to United Nations Security Council Resolution 827 (1993) which reads, in part, that:

> all states shall cooperate fully with the International Tribunal and its organs in accordance with the present resolution and the statute of the International Tribunal and that consequently all States shall take any measures necessary under their domestic law to implement the provisions of the present resolution and the statute, including the obligation of States to comply with requests for assistance or orders issued by a Trial Chamber. . . .[67]

Furthermore, Article 29 of the Tribunal's Statute provides that:

> 1. States shall cooperate with the International Tribunal in the investigation and prosecution of persons accused of committing serious violations of international humanitarian law.
> 2. States shall comply without undue delay with any request for assistance or an order issued by a Trial Chamber including, but not limited to:
>
> (a) the identification and location of persons;
> (b) the taking of testimony and the production of evidence;
> (c) the service of documents;
> (d) the arrest or detention of persons; and
> (e) the surrender or the transfer of the accused to the International Tribunal.[68]

VI.
SUBSTANTIVE LAW TO BE APPLIED

Under the Rules of the Road, only files providing evidence of a *serious violation* of *international humanitarian law*, as defined by the Tribunal's Statute, can be reviewed by the OTP. The term "international humanitarian law" means the rules applicable in armed conflict found in international agreements which have been agreed to by the parties in the conflict and are generally recognized principles of international law.[69] A "serious violation" means "any viola-

64. By April 1997, the Federation of Bosnia-Herzegovina had submitted to the Tribunal eight cases of persons who were currently detained on war crimes charges. In six cases, the OTP found sufficient evidence and ordered that the suspects remain in custody. In one case, insufficient evidence was found and the suspect was released. In one case, the OTP requested additional information. Discussion between Bosnian officials and the author in January 1998. *See also* OHR Memo, *supra* note 54.

65. This opinion was expressed to the author by the Embassy of Croatia in Washington, D.C., in April 1997.

66. *See* U.N. Charter, *supra* note 10.

67. Resolution 827, *supra* note 4, § 4.

68. *Statute*, *supra* note 20, art. 29.

69. MORRIS & SCHARF, *supra* note 19, at 54.

tion of the law of international armed conflict, sufficiently serious and committed with the requisite intent to be regarded as a crime."[70] In this context, the Tribunal's Statute contains four articles on the applicable substantive law.

Article 2 of the Tribunal's Statute provides that the Tribunal has jurisdiction over grave breaches of the Geneva Conventions of 1949.[71] "Grave breaches" are major violations of international humanitarian law punishable by any State under the principle of universal jurisdiction.[72] The State parties to the current conflict are bound by the Geneva Conventions by treaty obligation, which was ratified by the Socialist Federal Republic of Yugoslavia, and bound by the rules of state succession among the former republics of Yugoslavia.[73] Parties to the Conventions are required to apprehend persons alleged to have committed (or ordered the commission of) grave breaches of the Conventions and to bring them to justice.[74] Thus, the Tribunal can prosecute persons who commit (or order to be committed) certain acts against persons and property protected under the provisions of the relevant Geneva Conventions.[75] These acts include: willfully killing; inflicting torture or inhumane treatment, which includes biological experimentation; willfully causing great suffering or serious injury to body or health; unlawfully and wantonly destroying or appropriating property not justified by military necessity; compelling a prisoner of war or a civilian to serve in the forces of a hostile power; willfully depriving a prisoner of war or a civilian of the right to a fair and regular trial; unlawfully deporting, transferring or confining a civilian; and taking civilian hostages.[76] Article 2 of the Statute is relevant only to international conflict.[77]

Article 3 of the Tribunal's Statute provides the Tribunal with Jurisdiction over violation of the laws of customs of war.[78] Recognizing that the right to engage in war is not unlimited and that certain methods of war are prohibited, Article 3 codifies certain provisions contained in the 1907 Hague Convention.[79] Violations of laws or customs of war include the following acts: use of poisonous weapons or other weapons calculated to cause unnecessary suffering; wan-

70. U.N. Secretary-General letter to the President of the Security Council, U.N. Doc. S/2527 (10 February 1993).

71. Article 2 of the *Statute* essentially incorporates Article 147 of Geneva Convention IV.

72. *See Final Report*, *supra* note 1, ¶ 45.

73. *See* BASSIOUNI & MANDRAS, *supra* note 9, at 489.

74. Convention (IV) Relative to the Protection of Civilian Persons In Time of War, Aug. 12, 1949, art. 146, 75 U.N.T.S. 287.

75. *See Statute*, *supra* note 20, art. 2.

76. *Id.*

77. In the Tadic case, the Trial Chamber ruled that "the element of internationality forms no jurisdictional criterion of the offences created by Article 2 of the Statute of the International Tribunal." *Decision on the Defense Motion on the Jurisdiction of the Tribunal*, Tadic Case, IT-94-1-T (ICTY Aug. 10, 1993) at para. 53. The Appeals Chamber reversed the Trial Chamber and ruled that the provisions of the Geneva Conventions, as contained in Article 2, "apply to persons or objects protected only to the extent that they are caught up in an international armed conflict." *Decision on the Defense Motion on the Jurisdiction of the Tribunal*, Tadic case, IT-94-1-T (ICTY Oct. 2, 1995) at para. 81.

78. *See Statute*, *supra* note 20, art. 3.

79. *See* Convention Respecting the Laws and Customs of War on Land, Oct. 18, 1907, 36 Stat. 2277, 1 Bevans 631, § II, Chapter I [hereinafter 1907 Hague Convention].

ton destruction of cities, towns or villages, or devastation not justified by military necessity; attack or bombardment, by whatever means, of undefended towns, villages, dwellings, or buildings; seizure of, destruction, or willful damage done to institutions dedicated to religion, charity and education, the arts and sciences, historic monuments and works of art and science; and plunder of public or private property.[80]

The 1949 Geneva Conventions reiterate many of the rules found in the 1907 Hague Convention.[81] However, Article 3 confers on the Tribunal jurisdiction over violations not covered in Article 2, 4 or 5 of the Tribunal's Statute.[82] In essence, Article 3 is a "catch-all" clause to ensure that no serious violation of international human rights will go unpunished.[83] Thus, the Tribunal may prosecute persons for war crimes not expressly listed in Article 3 of the Statute, but they must be limited to war crimes which constitute, beyond any doubt, a breach of customary law.[84] Like the grave breaches provisions of the 1949 Geneva Conventions, the 1907 Hague Convention (and thus, Article 3 of the Tribunal's Statute), applies to only international conflicts.

Article 4 of the Tribunal's Statute deals with genocide.[85] Article 4 of the Statute reproduces Articles 2 and 3 of the Genocide Convention without change.[86] Genocide is a crime under international law regardless of whether it occurs in a time of peace or a time of war.[87] Genocide includes acts committed with the intent to destroy, in whole or in part, a national, ethnic, racial or religious group.[88] While the term is not used in Article 4, the policy of ethnic cleansing also includes acts which constitute genocide.[89] Individual acts which constitute genocide include: killing; causing serious bodily or mental harm; deliberately inflicting such poor living conditions as to bring about, in whole or in part, the group's physical destruction; imposing measures to prevent births within the group; and forcibly transferring children of the group to another group.[90] Each of these acts, alone or in combination, can constitute the crime of genocide.

Under the Tribunal's Statute, it is not necessary to *actually* commit genocide. *Conspiracy* to commit genocide, direct and public *incitement* to commit

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80. *Statute, supra* note 20, art. 3.

81. *See* MORRIS & SCHARF, *supra* note 19, at 63.

82. *Statute, supra* note 20.

83. The Statute's Article 3 provides a list of punishable violations, but notes that this list is not exclusive: "[s]uch violations shall include, *but not be limited to* . . . ." *Statute, supra* note 20, art. 3 [emphasis added].

84. *See* MORRIS & SCHARF, *supra* note 19, at 72.

85. *See Statute, supra* note 20, art. 4.

86. *See* Convention on the Prevention and Punishment of the Crime of Genocide, Dec. 9. 1948, 78 U.N.T.S. 277.

87. *See Statute, supra* note 20, art. 4.

88. *See id.*

89. *See Statute, supra* note 20, arts. 2, 3, and 5; *see also Indictment of Radovan Karadzic and Ratko Mladic*, The Srebrenica Case, IT-95-18-I, (ICTY Nov. 14, 1995), counts 1-2 (charging defendants with the crime of genocide based on their direction of ethnic cleansing campaign within Srebrenica).

90. *See Statute, supra* note 20, art. 4.

genocide, *attempt* to commit genocide, and *complicity* in genocide are all punishable under the Statute.[91]

Article 5 of the Tribunal's Statute provides the Tribunal with jurisdiction over crimes against humanity. The following acts, when committed during armed conflict, whether that conflict is international or internal in character, and directed against any civilian population, are considered crimes against humanity: murder; extermination; enslavement; deportation; imprisonment; torture; rape; persecutions on political, racial and religious grounds; and other inhumane acts.[92]

Crimes against humanity are distinguished from war crimes against individuals in the sense that crimes against humanity must be widespread or demonstrate a systematic character.[93] In addition, crimes against humanity are generally considered to be very grave crimes that "shock the collective conscious."[94] As the Tribunal observed in the *Erdemovic* case:

> Crimes against humanity are serious acts of violence which harm human beings by striking what is most essential to them: their life, liberty, physical welfare, health, and/or dignity. They are inhumane acts that by their extent and gravity go beyond the limits tolerable to the international community, which must perforce demand their punishment. But crimes against humanity also transcend the individual because when the individual is assaulted, humanity comes under attack .... It is therefore the concept of humanity as victim which essentially characterizes crimes against humanity.[95]

VII.
RULES OF THE ROAD GUIDELINES AND PROCEDURES

The detailed process for implementing the Rules of the Road is found in the "Procedures and Guidelines for Parties for the Submission of Cases to the International Criminal Tribunal for the Former Yugoslavia Under the Agreed Measures of 18 February 1996"[96] [hereinafter "Rules of the Road Procedures"]. Each local authority determines how to proceed with a case prior to its submission to the Tribunal. In Bosnia-Herzegovina, a criminal case often begins with a complaint made to the police. The police then undertake a preliminary investigation and prepare for the prosecutor a "criminal report" on the allegations.[97] If the evidence is deemed insufficient, the prosecutor will request the Investigating Judge (Magistrate) to open a more extensive investigation. The Investigating Magistrate may collect new and old statements and order scientific tests to deter-

91. *Statute, supra* note 20, art. 4.

92. *Id.* art 5.

93. *See Decision of Trial I – Review of Indictment Pursuant to Rule 61*, Vukovar Hospital Case IT-95-13-R61 (ICTY April 3, 1996) at para. 30. *See also* Secretary-General's Report, *supra* note 1, ¶¶ 74 – 84, (indicating that a single act could qualify as a crime against humanity, so long as there is a link with widespread or systematic attack against a civilian population).

94. *See Sentencing Judgment*, Erdemovic case IT-96-22-T (ICTY Nov. 29, 1996), at para. 27.

95. *Id.* para. 28.

96. *See* Rules of the Road Procedures, *supra* note 60.

97. A criminal report is generally a police report given to the prosecutor, containing the following information: the alleged suspect's summary of crimes and citation of relevant code problems; description/statement of the criminal act(s); and attachment of all relevant documents.

mine whether the file should be returned to the prosecutor for a decision on whether to indict. Because the suspect has not been indicted, this proceeding is still regarded as a preliminary proceeding. Although the file *may* be sent to the OTP for review prior to the actual indictment, this clearly is not the most desirable route.[98] One scholar familiar with the process has argued that to ensure that a file is legally sound, it is better to have completed the indictment.[99]

If an indictment includes violations of international humanitarian law, the court that has jurisdiction over the case is *required to* submit a request for review to the OTP within 24 hours.[100] The OTP will not undertake a review if the guilt or innocence of the suspect has already been determined by a national court.[101] Nor will the OTP review a case file in which the suspect has been charged with a common crime under the national penal code (*e.g.*, murder).[102]

The OTP does not review the relevance of any charges based on domestic law. The OTP's own guidelines pay deference to local authorities in describing how a suspect will be charged:

> Responsibility and control of the cases will remain at all times with the authorities of the party concerned, and the cases will be subject to the *law of the territory concerned.* The Prosecutor of the International Tribunal will not seek to make any recommendations to the parties as to what future action they should take under that law in an individual case [emphasis added].[103]

If a charge is based on domestic law but also constitutes a violation of international law under the Tribunal's jurisdiction, the domestic charge will be reviewed through the Rules of the Road process under the applicable provision of international law.[104]

Files are to be submitted confidentially, in writing, to the OTP through the Tribunal in The Hague, or to one of the OTP liaison offices in Zagreb, Sarajevo, or Belgrade.[105] Submitting a list of suspects' names, without accompanying case files, is not sufficient for Tribunal review, and does not constitute submission of cases to the Tribunal.[106] Thus far, files submitted by the Federation have been sent from Bosnia to the Bosnian representative in The Hague.[107] The facts disclosed in the file must constitute a serious violation of international law, as defined within the Tribunal's Statute.[108] Any case that does not fall within

98. When the OTP receives a file that is in the preliminary stage (*i.e.*, pre-indictment), there is often insufficient evidence accompanying the file. *See* Report from Ken Bresler, CEELI/CIJ Legal Specialist to CEELI/CIJ Washington, D.C., September 23, 1997 [hereinafter *Bresler Report*] [on file with the author].

99. *See id.* para. 2.

100. Rules of the Road Procedures, *supra* note 60, § 4.

101. *Id.* § 14.

102. *Id.*

103. *Id.* § 15.

104. Because of the problems experienced by Bosnian prosecutors in compiling files based on the Rules of the Road Procedures, CEELI/CIJ has completed a draft manual entitled, "Rules of the Road: Users' Manual for Preparing Cases for Submission to the International Criminal Tribunal for the Former Yugoslavia" May 22, 1998 [hereinafter Manual] [on file with the author].

105. Rules of the Road Procedures, *supra* note 60, § 4.

106. *See* OHR Memo, *supra* note 54.

107. Discussions with Alain Norman, CEELI/CIJ Legal Specialist to The Hague.

108. Rules of the Road Procedures, *supra* note 60, § 9.

the Tribunal's jurisdiction is returned to the submitting party.[109] Summaries of the file and all key documents contained in the file are to be translated into English.[110] The OTP may also require additional evidence from the party making the request,[111] although to date, this has not occurred.

A file must contain copies of all witness statements, protocols, and other evidentiary documents, including a copy of the order, warrant, or indictment for each suspect; copies of all witness statements; a summary of the personal history of the suspect, including details of physical description and present whereabouts and the length of time, if any, he or she has spent in custody; a summary of the procedural steps, if any, already taken in the case, including the basis under national law for any investigation, warrant, or arrest and details of any criminal proceedings, including cases against the co-accused which have also been submitted for review; a summary of the circumstances of the crime; a summary of the available evidence; and the name, address, and contact details of the person in charge of the case.[112]

It is possible for the file to contain allegations against two or more persons. In this case, there must be sufficient evidence supporting the allegations against *each* suspect.[113] Evidence contained in the file must have been obtained by methods consistent with internationally protected human rights (*i.e.*, not by torture), and which do not cast substantial doubt on its reliability.[114]

Once received by the OTP, the files are kept in strict confidence. The files are kept in locked and secured areas and access is restricted.

VIII.
The Role of the OTP Under the Rules of the Road

When reviewing a case file, the OTP must determine whether there is credible and reliable evidence, available from at least one direct source, on two essential matters:

> (a) whether a serious violation of international humanitarian law within the Tribunal's jurisdiction has been committed; and (b) whether the person against whom the allegations are made is the person responsible for this violation.[115]

In the process of reviewing a case, the OTP focuses solely on the file and its supporting evidence. The OTP does not debate the merits of a particular case, nor enter into any correspondence, except regarding points of clarifications and requests for additional information from the party who submitted it.[116]

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109. *Id.*

110. *Id.* § 5. The fact is that none of the files submitted so far has been translated first by the parties (discussions between CEELI/CIJ legal specialists and the author).

111. Rules of the Road Procedures, *supra* note 60, § 7.

112. *Id.* § 5. The file submitted is actually a copy. The original is kept by the party who created the file.

113. *Id.* § 10.

114. *Id.* § 11.

115. *Id.* §§ 9, 10, 13.

116. *Id.* § 20.

The OTP will inform the requesting party (in writing) whether, consistent with international legal standards, sufficient evidence has been provided to show reasonable grounds for believing that the suspect has committed a serious violation of international humanitarian law.[117] The OTP will also inform the party whether it intends to take steps under the Tribunal's Rules to secure the arrest or detention of the suspect, or to request the national courts to defer to the competence of the Tribunal.[118] The OTP needs only to find reasonable grounds for *one* charge to justify the detention of the suspect.[119]

In ascertaining whether the proposed warrant or indictment is consistent with international legal standards, the OTP employs the same criteria formulated and used for the prosecution of cases before the Tribunal.[120] Under Rule 47(A) of the Tribunal's Rules,[121] an indictment may be presented to the court if the prosecutor is "satisfied that there is sufficient evidence to provide reasonable grounds for believing that a suspect has committed a crime within the jurisdiction of the Tribunal."

A prosecutor shall prepare an indictment "upon a determination that a *prima facie* case exists,"[122] and a trial judge will determine if "a *prima facie* case [in fact] exists."[123] For the purpose of reviewing an indictment, a *prima facie* case "is understood to be a credible case which would (if not contradicted by the Defense), be sufficient basis to convict the accused of the charge."[124] In determining whether a *prima facie* case exists, the OTP makes several assumptions, including the following:

1. The OTP accepts the available evidence as unchallenged and most favorable to the national prosecution;
2. The OTP accepts the national prosecution evidence without regard to questions of admissibility or credibility unless the material is so obviously incredible and unreliable as not to constitute evidence;
3. The OTP draws all available inferences in favor of the national prosecution; *and*
4. The OTP accepts all reasonable national prosecution hypotheses, even if potential alternative hypotheses consistent with the innocence of the accused also exist.[125]

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117. *Id.* § 7(a).

118. *Id.* § 7(b).

119. Although this "one-charge" rule has been adopted by the OTP, the UNHCR has stated that *all* charges must be approved by the OTP. *See* OHR Memo, *supra* note 54.

120. *See* Rules of the Road Procedures, *supra* note 60, § 12.

121. *See* INTERNATIONAL TRIBUNAL FOR THE PROSECUTION OF PERSONS RESPONSIBLE FOR SERIOUS VIOLATIONS OF INTERNATIONAL HUMANITARIAN LAW COMMITTED IN THE TERRITORY OF FORMER YUGOSLAVIA SINCE 1991, RULES OF PROCEDURE AND EVIDENCE, U.N. Doc. IT/32/Rev. 9 (1996) [hereinafter Rules].

122. *See Statute*, *supra* note 20, art. 18(4).

123. *See id.* art. 19(1).

124. *Confirmation of the Indictment*, Kordic et al. (Lasva River Valley) Case IT-94-14-1 (ICTY Nov. 10, 1995).

125. Discussion between the author and representatives of OTP in January 1997.

For the prosecutor, "sufficient evidence" is not synonymous with "conclusive evidence" or "evidence beyond a reasonable doubt."[126] The evidence must provide "reasonable grounds," as determined by a reasonable or ordinary prudent person, to believe the suspect committed a crime within the jurisdiction of the Tribunal.[127] Thus, the facts must raise a "clear suspicion" that the suspect is guilty of the crime. To ascertain the truth of his suspicions, the OTP must act with "caution," impartiality and diligence as would a reasonable, prudent prosecutor.[128]

It is important to note that in reviewing the files, the OTP acts in an "advisory capacity only," and does not make any recommendation to the parties as to what future actions should be taken on any individual case.[129] The role of the OTP is really a limited one – it simply reviews the files and determines whether the evidence contained in the file is sufficient by international legal standards to justify the arrest or indictment of the suspect. In effect, the OTP acts as a "clerk" to the national prosecutor. The OTP neither interviews witnesses nor hears representations from the party, nor does it issue reasoned opinions.[130] Moreover, the OTP does not determine whether the national police and national prosecutor have observed "international legal standards" in preparing a case, or whether provisions of the domestic criminal law are consistent with "international legal standards."

Unless the OTP decides to transfer the case within the Tribunal's jurisdiction, responsibility and control of the cases being reviewed remain with the authorities of the party concerned.[131] The cases will also remain subject to the law of the territory concerned.[132] The OTP may request additional information from the party about availability of evidence that would be needed to prove complex elements of a crime that has been shown to have occurred.[133]

Communications between the OTP and the prosecutor are confidential, with the exception being that the results of OTP reviews are provided to the Office of the High Representative.[134] These results are not released to the other parties to the Agreement. Consequently, the response issued by the OTP after reviewing a file is straightforward and quite limited. Under Rules of the Road procedures, the OTP will deliver one of seven standard findings to the requesting party.[135] These include:

126. *Confirmation of the Rajic Indictment*, Rajic (Stupni Do) Case IT-95-12-I (ICTY Aug. 29, 1995).

127. *Id.*

128. *Id.*

129. Rules of the Road Procedures, *supra* note 60, § 15.

130. *Id.* § 20.

131. *Id.* § 15.

132. *Id.*

133. *Id.* § 19.

134. The Office of the High Representative is responsible for overseeing the implementation of the Dayton Accords. Mr. Carl Bildt from Sweden was the first representative; he was replaced by Mr. Carlos Westendorp, formerly the Spanish Ambassador to the United Nations.

135. Rules of the Road Procedures, *supra* note 60, § 16. The copy of the file is not returned; the only response is in the form of a letter.

The first response indicates that the evidence contained in the file is sufficient according to international legal standards.[136] Unless the Tribunal assumes jurisdiction over the proceeding, the national courts can initiate or continue criminal proceedings, including prosecution.

The second response indicates that the evidence contained in the file is *not* sufficient according to international legal standards.[137] This usually occurs because the file fails *both* to identify clearly the individual to be charged and to specify the nature of the charges.[138] It could also mean that the charges were not proportional to the crime. For instance, if evidence showed that a military commander caused the shelling of a *single* house and the national court indicted him or her for crimes against humanity, the charge would be excessive, despite the strong evidence regarding the commander's actions. Under this scenario, arrest or detention of the person is prohibited.

The third response is to request further information from the submitting party.[139] This usually means that supporting information such as witness statements and evidentiary documents has not been provided. There may be an indictment, but it is not accompanied by supporting information. Before the OTP makes a final determination, the local authority may submit, as requested, new evidence or information.[140] In addition, any new evidence obtained by the local authorities during the review process that is relevant to the case can be submitted to the OTP.[141] Even after a file has been reviewed and returned, the local authorities may *resubmit* the file and request reconsideration by the OTP based on new evidence that supports the allegation made in an active case file.[142]

The fourth response indicates the Tribunal's intention to seek deferral of the case from the national court to the jurisdiction of the Tribunal.[143]

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136. *Id.* app. B § A, which reads: "I return this case, the Prosecutor having taken the view that for the purposes of determining whether criminal proceedings should be continued/initiated at this stage, the evidence is *sufficient* by international standards to provide reasonable grounds for believing that the person who is the subject of the report, namely . . . has committed a serious violation of international humanitarian law."

137. *Id.* app. B § B, which reads: "I return this case, the prosecutor having taken the view for the purposes of determining whether criminal proceedings should be continued/initiated at this stage, the evidence is *insufficient* by international standards to provide reasonable grounds for believing that the person who is the subject of the report, namely . . . has committed a serious violation of international humanitarian law."

138. Memorandum from Alain Norman to Mark Ellis (Apr. 29, 1998) [hereinafter April 29th Norman Memo] [on file with the author].

139. *See* Rules of Road Procedures, *supra* note 60, app. B § C, which reads: "I refer to the case against . . . (NAME) . . . submitted to the Prosecutor for review on . . . (date). The Prosecutor is unable to form a view on the sufficiency of evidence without the following *further information*: I shall therefore be obliged if you will make this information available to the Prosecutor as soon as possible."

140. *See id.* § 19.

141. *See* Manual, *supra* note 104, at 10.

142. Rules of the Road Procedures, *supra* note 60, § 20.

143. *Id.* app. B § D, which reads: "I refer to the case against . . . (NAME) . . . submitted to the Prosecutor for review on . . .(date). In all the circumstances, the Prosecutor considers that this is a case which should be prosecuted before the International Criminal Tribunal, and in relation to the national investigation and criminal proceedings, he *intends to seek deferral* to the competence of the International Tribunal. A formal application for deferral is currently being prepared, and will be

The fifth response indicates that the facts presented in the file do not reveal a crime within the jurisdiction of the Tribunal.[144]

The sixth response indicates that the suspect may be an important *witness* in proceedings before the Tribunal and should therefore be detained by the party for that purpose.[145]

The final response indicates the OTP's opinion that there is insufficient evidence to continue proceedings on charge "A," but sufficient evidence to initiate new proceedings on charge "B."[146]

Once a file is returned to the "submitting" party, questions arise concerning the degree to which local authorities are constrained by OTP decisions. While the OTP maintains that its decision is only advisory, the Office of the High Representative ("OHR") maintains otherwise. The OTP Guidelines state:

> In these cases, the Prosecutor of the International Tribunal acts in an *advisory capacity only*, and does not take decisions. Responsibility and control of the cases will remain at all times with the authorities of the party concerned . . . the Prosecutor of the International Tribunal will not seek to make any recommendations to the parties as to what future action they should take under that law in an individual case.[147] [emphasis added].

Nevertheless, the OHR, which has primary responsibility for implementing the Dayton Agreement,[148] maintains that OTP decisions are *binding* and that local authorities may proceed with the arrest and trial of a suspect *only* if the OTP concurs based on its review of the file. The lack of clarity regarding the authority of OTP findings became apparent when local authorities chose to proceed with a case even though the OTP determined that there were insufficient

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presented to a Trial Chamber in due course. In the meantime, the Prosecutor requests, under Rule 40 of the Tribunal's Rules of Procedure and Evidence, that the national authorities take all necessary measures to prevent the escape of . . . (NAME) . . . injury to or intimidation of victims or witnesses, or the destruction of evidence."

144. *Id.* app. B § E, which reads: "I return this case, the Prosecutor having taken the view that the facts do not reveal a crime within the jurisdiction of the International Tribunal, and that the case therefore does not fall within the category of cases upon which he can properly advise."

145. *Id.* app. B § F, which reads in part: "I return this case, the Prosecutor having taken the view that for the purposes of determining whether criminal proceedings should be continued/initiated at this stage, the evidence is *sufficient* by international standards to provide reasonable grounds for believing that the person who is the subject of the report, namely . . . (NAME) . . . may have committed a serious violation of international humanitarian law." While the Prosecutor is content that the case should continue to be dealt with by the national courts, he does consider that . . . (NAME) . . . may be an important *witness* in proceedings before the International Tribunal, and requests that he be informed of any anticipated change in the status of . . . (NAME) . . . as a detained person.

146. *Id.* app. B § G, which reads in part: "I return this case, the Prosecutor having taken the view that for the purposes of determining whether criminal proceedings should be continued/initiated at this stage, the evidence is *insufficient* by international standards to provide reasonable grounds for believing that the person who is the subject of the report, namely . . . (NAME) . . . may have committed the serious violation of international humanitarian law with which he has been charged, namely . . . (CRIME X) . . . However, the Prosecutor does consider that the evidence is *sufficient* by international standards to justify proceedings for . . . (CRIME Y)."

147. Rules of the Road Procedures, *supra* note 60, § 15.

148. Dayton Accords, *supra* note 35, Annex 10.

grounds to do so.[149] It was only at this point that the OHR, in a statement to the press, made its position known. The OHR noted:

> [In trying the case] . . . the responsible authorities breached their legal obligations to prosecute only those crimes where the Tribunal has found sufficient evidence under international standards.[150]

Representatives of the OHR also state that the relevant authorities in Bosnia-Herzegovina, including the Human Rights Chamber of Bosnia-Herzegovina, have unequivocally supported the position that the OTP's response is legally binding.[151] The OHR believes that although the OTP's decision is not a binding decision of the Tribunal, under its own Rules, it is binding to the three parties who signed the Rome Agreement and agreed to adhere to the decisions of the OTP.[152] Furthermore, since it is the OHR that ultimately has authority over the implementation of the Rome Agreement, it has concluded that the OTP's decisions will be binding.[153]

IX.
COMMITTING RESOURCES TO IMPLEMENT THE RULES OF THE ROAD

Since early in the conflict, the government of Bosnia-Herzegovina had been documenting atrocities committed in the country. In 1993, shortly after the Tribunal was created, Bosnian officials began forwarding "hundreds"[154] of investigative files to The Hague in anticipation that the Tribunal would initiate indictments. Yet, these files were disorganized and often incomplete in part because the war was still raging in Bosnia-Herzegovina, but also because the Tribunal, still in its infancy, was unable to provide clear guidance regarding file preparation. In addition, a shortage of resources left the Tribunal ill-equipped to review case files simply to determine whether or not they met the required evidentiary standards. This problem became manifest in the Tribunal's early reluctance to shoulder the burden of implementing the Rules of the Road, and later in the fact that "Rules of the Road files" were given a low priority within the OTP's administrative structure.[155]

In 1997, the United States Department of State asked the American Bar Association Central and East European Law Initiative (CEELI)[156] to assist the

149. The case was against Veselin Cancar and decided by the Sarajevo Cantonal Court. The OTP found that the evidence was insufficient by international standards for Mr. Cancar to be charged with serious violations of international humanitarian law. However, Mr. Cancar was subsequently charged, tried, and convicted of the very crimes for which the OTP found a lack of evidence to prosecute. *See* OHR Press Statement (January 28, 1998) [on file with the author].

150. *Id.*

151. Memorandum from Peggy L. Hicks, the Office of the High Representative, to CEELI (May 25, 1998) [hereinafter Hicks Memo].

152. *Id.*

153. *Id.*

154. The exact number of files submitted is not known.

155. Discussion with CEELI/CIJ Legal Specialists.

156. For a description of CEELI, *see supra* note *.

Tribunal in reviewing the Rules of the Road files.[157] In June 1997, through its Coalition for International Justice (CIJ),[158] CEELI sent a team of three American attorneys[159] to The Hague to assist the OTP in reviewing files. CEELI/CIJ has since deployed two additional teams of attorneys to review the files.[160]

The CEELI/CIJ attorneys reviewed selected files and gave preliminary recommendations based on whether or not previously-issued orders, warrants, or indictments met international legal standards. It is important to note that the role of the CEELI/CIJ attorneys was to conduct a *preliminary* review of the files, much like a clerk would do for a judge. The final review and decision regarding the appropriate course of action remained with the OTP.

X.
THE FILES

When the first team of CEELI/CIJ legal specialists arrived in The Hague in June 1997, there were approximately 400 "original files" to review.[161] Under the Rules of the Road, the OTP had identified 348 dossiers on named individuals and 17 "crime folders." Already, the OTP had begun review of 44 files. The OTP completed its review and informed the parties who submitted the files of its decisions. The first team of CEELI/CIJ legal specialists started its review with approximately 153 of the original files. There are, however, an unknown number of additional files that have yet to be categorized.[162] This has turned out to be one of the more perplexing issues facing the Rules of the Road project. Because the files were not adequately categorized, the actual number of files is still a mystery. For instance, one member of the OTP estimates that there is actually a backlog of over 1,000 files. Based on a preliminary review, the number of files ranges from 400 to 500, with the total number of suspects estimated at between 600 to 700.[163]

The number of files notwithstanding, the file content seems to be fairly similar. The bulk of charges reviewed to date focuses on relatively low-level military and paramilitary soldiers, and the facts are rather straightforward. The files describe atrocities and human rights violations that occurred in a particular village, region, or concentration camp. Typically, the files are composed of

157. The meeting took place between Ambassador William Montgomery and Mark S. Ellis, Executive Director of CEELI. Ambassador Montgomery was then the Special Advisor to the President and Secretary of State on Implementation of the Bosnian Peace Settlement.

158. CIJ is a tax exempt 501(c)(3) organization created by CEELI to assist the Tribunal.

159. The three attorneys were Michael Johnson, Scott Gordon, and Kenneth Bresler.

160. The second team included attorneys T. Gregory Motta, Susan Axelrod, and Mark Summers, who were sent to The Hague in October, 1997. The third team included T. Gregory Motta, Thomas Marjenson, Diane Giaculone, and Mark Summers. They arrived in The Hague in May, 1998, for a two-month stay.

161. 1,000 suspects were suspected to be identified in the current and future files. *See* April 29th Norman Memo, *supra* note 138.

162. Memorandum from Diane Giaculone, CEELI/CIJ Legal Specialist, to CEELI/CIJ Washington (June 4, 1997) [hereinafter Giaculone Memo] [on file with the author].

163. *Id.*

"exit interviews."[164] For instance, files may include witness statements accusing a soldier of committing violations of international humanitarian law.[165] These statements are generally from volunteer investigators and are written in a "narrative stream of consciousness." As a result, many files list names, but do not identify the basis of the witnesses' knowledge, nor do they provide corroborating physical evidence of the suspect's alleged acts.[166]

Although the files vary in size (generally 25 to 100 pages in length),[167] they tend to focus on single individuals.[168] Several relate to more than one named individual and/or to one or more apparent crimes. For instance, during the most recent review, 11 out of 59 files contained more than one suspect.[169] These tend to be the largest files. They involve discrete criminal offenses committed by multiple persons. Many files contain little or no information. Others contain information about persons not covered under the Rules of the Road mandate. That is, a Rules of the Road file on Mr. X also contains witness statements referring to acts by Mr. Y, who was not originally identified as a Rules of the Road suspect.[170]

A number of files contain accusations against political figures, such as parliamentary or party leaders.[171] These individuals tend not to have a formal military background, but are alleged to have committed crimes against humanity (*i.e.*, "waging an unjust war").[172] These files tend to focus on the more complicated legal basis of command responsibility.[173]

Several files target military personnel, including former leaders of the Yugoslav National Army, who assumed command positions in the Republika Srpska Army.[174] These files are quite extensive – some exceed several thousand pages – and tend to focus on atrocities that occurred in a specified geographic location.[175] Among the files of this type, little, if any, direct evidence is offered of the commander's personal involvement in specific war crimes. Evidence

164. Memorandum from Thomas Gregory Motta, CEELI/CIJ Legal Specialist, to CEELI/CIJ Washington (November 30, 1997) [hereinafter Motta Memorandum].

165. Typically, the witnesses would identify two or three soldiers who shot a civilian during a siege, or a concentration camp soldier who executed a prisoner. *See id.*

166. An example would be where witnesses responded to a questionnaire asking who participated in ethnic cleansing. A witness' statement would note that "suspect X, my neighbor, participated in mass killings." However, there would be no other statements or evidence explaining the meaning of "participated." Another example is where a witness' statement noted that "I recognized suspect X as among those who were present at the massacre." But, there was no mention of exactly in what capacity X was there. Bresler Report, *supra* note 98.

167. *Id.*

168. *See* Giaculone Memo, *supra* note 162.

169. *See* May 22nd Norman Memo, *supra* note 57.

170. *See* Bresler Report, *supra* note 98.

171. *See* Motta Memorandum, *supra* note 164.

172. *Id.*

173. *See* Memorandum from Thomas S. Marjenson to CEELI/CIJ (July 8, 1998) [hereinafter Marjenson Memo].

174. *See* Motta Memorandum, *supra* note 164.

175. *Id.* In the most recent review of files, four out of the 59 files were "regional" files that covered a large number of persons. *See* May 22nd Norman Memo, *supra* note 57.

tends to be circumstantial, consistent with the theory of *respondeat superior*.[176] For instance, a file may present a very clear case for the systematic destruction of religious and cultural institutions, in violation of Article 3 of the Statute,[177] without actually providing direct evidence that the commander of the brigade ordered, or even personally witnessed, the destruction of such institutions.[178]

XI.
FUTURE STEPS

Recognizing the importance of the procedural guidelines established by the Rules of the Road Procedures, the Clinton Administration announced that it would provide additional funding in support of the Rules of the Road Project.[179] New funding has thus far supported a third Rules of the Road team, including six legal specialists and six language assistants. Once again, CEELI/CIJ provided the legal specialists,[180] and agreed, based on discussions with the U.S. Department of Justice, to deploy a fourth team of specialists in the fall of 1998.

The OTP has clearly stated that it has neither the personnel nor the time to effectively manage the Rules of the Road review process.[181] Indeed, because the OTP has been unable to organize effectively all the files, there continue to be gaps in the files, missing files, and even a duplication of effort in reviewing the same materials twice.[182] Recognizing the contribution of the first two Rules of the Road teams, the OTP has determined that an appropriate long-term solution for completing the review process would be to hire an "Information Manager" to assist in managing the organization and flow of case files.[183] Indeed, the OTP has stated that without additional funding to reduce, or at least supplement, the short-term "bridging" arrangements provided by CEELI/CIJ with a permanent "Rules of the Road Unit," the OTP would consider terminating its involvement with the Rules of the Road.[184] To be sure, an immediate review of the status of the Rules of the Road files to determine their exact number, the location of the files within the Tribunal, and how they are being logged by the Tribunal, if at

176. *See* May 22nd Norman Memo, *supra* note 57. The theory of *respondeat superior* is reflected in Article 7(3) of the Statute, which reads, in part: "[Acts] committed by a subordinate does not relieve his superior of criminal responsibility if he knew or had reason to know that the subordinate was about to commit such acts or had done so and the superior failed to take the necessary and reasonable measures to prevent such acts or to punish the perpetrators thereof." *Statute, supra* note 20.

177. *See Statute*, *supra* note 20, art. 3.

178. *See* Motta Memorandum, *supra* note 164.

179. U.S. DEPARTMENT OF STATE PRESS RELEASE 98/165 (Mar. 13, 1998) [on file with the author].

180. The attorneys who arrived in The Hague in May 1998 for a two-month stay included T. Gregory Motta, Thomas Marjenson, Diane Giaculone, and Mark Summers. Three additional legal specialists were to be provided by the Air National Guard; however, logistical issues prevented the Guard from participating. It is expected that they will assist with future legal specialist teams.

181. *See* May 22nd Norman Memo, *supra* note 57.

182. *Id.*

183. The option was presented by an OTP representative during a meeting on March 12, 1998, with CEELI/CIJ representative Alain Norman [hereinafter May–Norman Memo] [on file with the author].

184. *See* Blewitt Memo, *supra* note 58.

all, should be the highest priority for the OTP. Yet, whether a full-time person is required for this task is debatable. The OTP views the secundment of CEELI/CIJ legal specialists as a "bridging" arrangement "to enable work on files to continue while sufficient resources are sought for a workable long-term solution."[185] Still, it is likely that the CEELI/CIJ legal specialists could themselves accomplish the task.

The OTP must also be more diligent in finalizing the review of the files and returning them without delay to the parties who submitted them. According to Bosnian officials, the Bosnian Government sent files to the OTP for *priority* review.[186] The CEELI/CIJ legal specialists completed the preliminary review of the files within a short timeframe. However, the OTP delayed the final review of the files for a considerable amount of time. This resulted in increased animosity toward the Tribunal by the Bosnian Government.[187]

Another challenge facing the Tribunal is the need for greater public understanding about the Rules of the Road proceedings, particularly in the regions of the Former Yugoslavia. There is a general lack of understanding about the purpose, objective, and procedural requirements associated with the Rules of the Road.[188] Talks are currently underway among representatives of the U.S. State Department, the Tribunal, the OSCE, and CEELI/CIJ to create a public information and training program in Bosnia-Herzegovina. The proposed project would consist of a series of roundtable discussions, held with local judges and law enforcement officials throughout Bosnia-Herzegovina, about how to strengthen Rules of the Road implementation.

The roundtables will be based on a "Rules of the Road Manual," which is to be created by CEELI/CIJ in cooperation with the OTP.[189] The Manual will present the relevant rules and guidelines for submitting case files to the Tribunal. It is hoped that such a manual will enhance the accuracy and efficiency of file preparation and review, and will further expedite decisions regarding Rules of the Road files. The OTP, however, has been reluctant to implement this project until it receives funding for a full-time coordinator.[190]

Efforts to bring attention to and strengthen the Rules of the Road process may also be relevant to the proposed International Criminal Court (ICC). Member states of the United Nations have recently adopted a statute that would, upon adoption by the Parties to the Treaty, establish a permanent international court that would try individuals who commit the most egregious human rights violations.[191] Negotiations on a draft statute for the ICC have been ongoing for two

185. *Id.*

186. Discussion between the author and the Bosnian Ambassador to the United States in June 1998.

187. *Id.*

188. This perception was particularly evident during a series of meetings held in 1997 in Bosnia-Herzegovina between the author and members of the Bosnian legal community.

189. *See* Manual, *supra* note 104.

190. Blewitt Memo, *supra* note 58.

191. Member states met in Rome, Italy, between June 15 and July 17, 1998, to negotiate a treaty to establish an International Criminal Court (ICC).

years. Since December, 1995, when the UN General Assembly created the Preparatory Committee on the Establishment of an International Criminal Court (PrepCom), member states have worked to produce a final Statute for the ICC.[192]

The draft statute for the ICC is premised on the principle that it will *complement* – not replace – national courts.[193] This concept of "complementarity" means that a case will be inadmissible before the ICC if and when it is being investigated or prosecuted by a state that has jurisdiction. The ICC may secure primary jurisdiction only if the ICC (through one of its judges) determines that the state in question is "unwilling or unable genuinely" to carry out the investigation or prosecution.[194] Even if a state decides not to prosecute, so long as it conducted a proper investigation, the ICC will not be able to intervene.[195] Ostensibly this means that the ICC will be able to intervene only when the national judicial system has collapsed. This is an exceedingly high level of "proof" for the ICC to meet, and there is a real concern that the ICC will not hear many cases.

There is nothing in the current draft ICC Statute to deter a national court from aggressively pursuing a war crimes case, even if its national legal system is incapable of providing a fair trial. It is possible that a national court would be *only too willing* to initiate proceedings in which the individual accused becomes a scapegoat for what might have been a more widely-based crime. And it is not inconceivable that a scenario similar to that which developed among the warring parties in Bosnia-Herzegovina, and which led to the Rules of the Road agreement in the first place, could emerge once again. A Rules of the Road provision in the ICC Statute would prevent a state from unilaterally initiating a case against an individual from its nemesis party without prior approval from the ICC. This very basic and practical provision could assist in encouraging reconciliation and preventing renewed conflict.

XII.
CONCLUSION

> *"If we fail to achieve justice, or at the very least, strive for it, we will have broken faith with the victims of the past and with our humanity, and worse yet, we will have failed to deter future victimization."*
>
> — *Cherif Bassiouni*

Ensuring accountability for violations of international humanitarian law is an essential element for national reconciliation. Victims of war crimes and human rights violations who do not believe that the alleged perpetrators will be brought to justice will find no peace. They will languish in a post-conflict envi-

192. *See generally* Rome Statute of the International Criminal Court, Report of the Preparatory Committee, A/Conf. 183/9/17 July 1998.

193. *See id.* at Preamble.

194. *Id.* art. 17.

195. *Id.*

ronment that lacks the very cornerstone of the rule of law – the notion of accountability.

For this reason, the Rules of the Road Project is fundamental to ensuring lasting peace in Bosnia-Herzegovina and the former Yugoslavia. It facilitates reconciliation through an accelerated process for bringing to justice those responsible for the atrocities in the region. It also ensures that the process is fair, which, in the end, may be the most important outcome of the Rules of the Road Project. The fact that Bosnia-Herzegovina currently lacks a sound legal system makes it improbable that a suspected war criminal would receive a fair trial in a Bosnian court. Thus, a mechanism designed to ensure that indictments are based on international standards will not only facilitate reconciliation, but will establish a basic tenet of the rule of law – fairness in criminal proceedings.

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Like Is a Four-Letter Wort - GATT Article III's Like Product Conundrum

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"Like" is a Four-Letter Word—GATT Article III's "Like Product" Conundrum

By
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INTRODUCTION

The General Agreement on Tariffs and Trade of 1947 (General Agreement)[1] seeks to limit the ability of each individual government to insulate its constituent industries from outside competition.[2] One of the central principles of the General Agreement is that of national treatment, a principle of nondiscrimination embodied in Article III.[3] In theory, Article III prohibits internal taxes and other regulations that enhance the competitive position of domestic producers relative to that of foreign producers.

Central to the application of Article III, particularly the second paragraph which addresses the use of internal taxes and other charges to differentiate between imports and domestically produced goods, is the concept of "like product," which arises out of the language of the statute.[4] Of the limited number of dispute resolution panel rulings issued by GATT,[5] three have considered in de-

* Associate, Milbank, Tweed, Hadley, and McLoy; J.D. Boalt Hall, University of California at Berkeley, 1998; B.A. University of Texas at Austin, 1995.

1. General Agreement on Tariffs and Trade, October 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 188 [hereinafter General Agreement]. In keeping with normal usage, this article will refer to the document as the General Agreement and to the quasi-institution that evolved to administer that document as the GATT.

2. The long-term goal of the General Agreement is trade liberalization so that all barriers to trade other than tariffs are eliminated, and the use of tariffs is restricted as they are "bound" and eventually negotiated down. This goal is, of course, a general objective and is subject to numerous exceptions. Philip M. Nichols, *GATT Doctrine*, 36 VA. J. INT'L L. 379, 386-87 (1996).

3. *See* John H. Jackson, *National Treatment Obligation and Non-Tariff Barriers*, 10 MICH. J. INT'L L. 207, 208 (1989) [hereinafter Jackson, *National Treatment*].

4. Specifically, the provision states: "[t]he products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to *like* domestic products." General Agreement, *supra* note 1, article III:2 (emphasis added).

5. Only 196 cases were handled by the GATT over nearly half a century. Francis Williams, *News: World Trade: Antagonists Queue for WTO Judgement: Frances* [sic] *Williams on a Vote of Confidence in the Trade Body's Capacity to Settle Disputes*, FIN. TIMES, Aug. 8, 1996, at 6. Of those, 115 complaints were filed during the 1980s, yielding 47 decisions by panels, which is more than the three previous decades combined. Nichols, *supra* note 2, at 398. *See also* ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM 13-14 (1993). This small number of rendered decisions means that the body of GATT law

tail the question of "like product" as it arises in Article III.[6] The result has been the emergence of two different approaches for applying the provision—one stresses a flexible reading of Article III to achieve the purpose of the provision; the other stresses a literal reading of the article to give each word of the provision its full effect. As a result, the role of the term "like product" in the first approach differs completely from that of the second.

Then came the World Trade Organization (WTO),[7] and along with it a recent panel ruling, *Japan—Alcoholic Beverages*, which was subsequently submitted to appellate scrutiny under the regime of the new WTO *Dispute Settlement Understanding*.[8] Unfortunately, the panel report was pedestrian in its reasoning and thoroughly muddled the "like product" issue by its strict adherence to formalism. The appellate ruling, in attempting to mitigate the damage done to the national treatment obligation without a wholesale rejection of the panel's approach, intensified the confusion over the application of the term. Consequently, there currently exists a national treatment obligation that is certainly unclear, likely too harsh, and which ultimately will do violence to the General Agreement's integrity and make the WTO unnecessarily intrusive on national government policy making.

The meaning of the term "like," as in "similar," is ambiguous. It produces all manners of metaphysical and epistemological questions. The *Alcoholic Beverages* panel and appellate body ignore these difficulties. Nevertheless, the appellate body rendered a meaningless, but apt, metaphor in its final report:

> there can be no precise and absolute definition of what is "like." The concept of "likeness" is a relative one and evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply.[9]

The metaphor of an accordion, despite its awkward phrasing and ultimate unhelpfulness in defining any useful "like product" standard in applying Article III, is amusingly accurate. This is so because the term "like product" has changed shape quite regularly in prior panel interpretations, not as a result of its inherent flexibility, but rather due to its inherent ambiguity.[10] While accurate when applied to the notion that the term "like product" cannot be defined to fit all provisions in the General Agreement, the appellate body's statement also can

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is limited. *Cf.* 74 cases have been filed with the WTO in the two years since its inception. *See* Williams, *supra* note 5 at 6.

6. *See* discussion *infra* text accompanying notes 16-49.

7. Marrakesh Agreement Establishing the World Trade Organization, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND (1994) [hereinafter WTO Agreement].

8. *See* WTO Dispute Appellate Body Report on Japan—Alcoholic Beverages, I.T.L.R. vol. 1, iss. 2 at 231 (July 11, 1996) [hereinafter 1996 Alcoholic Beverages Appellate Body].

9. *Id.* at 242.

10. *See* discussion of different ways in which the term "like product" is applied in Article III:2 and Article III:4, *infra* text accompanying notes 14-25.

be read ironically—as an expression of the frustration of and retreat from developing an intelligible standard for the application of the term in Article III.

This Comment analyzes the use of the term "like product" in Article III and the broader implications of different applications of the term. A major consideration is whether the term "like product" denotes a requirement for a finding of such in the application of the provision, or whether the term denotes a violation of the provision and thus reflects nothing more than a conclusion. Part I reviews the major cases dealing with the Article III "like product" definition in order to outline the reasoning behind each of the two interpretations of "like product." Part II scrutinizes the merits of each interpretation in light of the purpose of Article III. The Comment concludes that the Article III:2 should employ a modified version of the aim-and-effect test and should de-emphasize the term "like product" in order to prevent continued confusion in the future.

I.
THE DEVELOPMENT OF THE "LIKE PRODUCT" TESTS

Article III is the central provision in the General Agreement regulating the application of domestic policies to imported products. It requires contracting parties (now members under WTO) to accord national treatment to imported products. Article III, known as the national treatment obligation, focuses on discrimination against imports for the benefit of domestic production in the importing country. The purpose of this article is to ensure that that an imported product is treated in the same way in terms of taxation and regulatory treatment as a "like" domestically produced good after that imported product has cleared customs.[11] In essence, Article III protects imports from governmental measures which protect domestic goods through the imposition of unfair competitive conditions that favor domestic producers. The Article has many parts, but only three paragraphs are relevant to the immediate discussion.

Paragraph four of Article III (Article III:4) prohibits discrimination against imports through the imposition of regulatory treatment on imported products that differs from the treatment of domestically produced products. Article III:4 reads in part:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment *no less favorable* than that accorded to *like products of national origin* in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use (emphasis added).

This provision applies to all internal measures except those of a fiscal nature. Internal fiscal measures, such as internal taxes, are governed by the first sentence of the second paragraph of Article III (Article III:2) which states that:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind *in excess* of those applied, directly or indirectly, to *like domestic products* (emphasis added).

11. Article III:2 deals with tax treatment. Article III:4 deals with regulatory treatment.

The second sentence of Article III:2 broadens this rule by declaring that:

> no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

The first paragraph of Article III (Article III:1) lays out the general policy of the article. Paragraph 1 of Article III states, *inter alia*, that:

> The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products . . . should not be applied to imported products *so as to afford protection to domestic production* (emphasis added).

Note that the second sentence of Article III:2 directly references Article III:1, whereas the first sentence does not. This difference is a source of confusion, as will be discussed later in this Comment.

Furthermore, the scope of second sentence of Article III:2 is limited by an Interpretive Note *ad* Article III, paragraph 2, to apply only to "directly competitive or substitutable" products. The *ad* Article states:

> A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a *directly competitive or substitutable product* which was not similarly taxed (emphasis added).

The term "like product," which appears in Article III:4 and particularly in the first sentence of Article III:2, has given GATT and WTO panels many interpretive difficulties. This difficulty arises, in part, from the fact that the term appears repeatedly throughout the General Agreement.[12] The first ambiguity that arises is whether or not the term has a uniform application throughout the General Agreement. *The Working Party Report on Border Tax Adjustments* (*Border Tax*) resolved this question, stating that the Contracting Parties have never developed a general definition of "like product" for application to all the provisions of the General Agreement.[13] The *Border Tax* report further elaborates that:

> With regard to the interpretation of the term 'like or similar products', which occurs some sixteen times throughout the General Agreement, it was recalled that considerable discussion had taken place . . . but that no further improvement of the term had been achieved. The Working Party concluded that problems arising from the interpretation of the terms should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a 'similar' product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is 'similar': the product's end-uses in a

12. Report of the Working Party on Border Tax Adjustments, GATT B.I.S.D. II/18S/97 at ¶ 18 (1947) [hereinafter Border Tax].

13. The Panel notes that GATT drafting history confirmed that "the expression ("like product"), had different meanings in different contexts of the Draft Charter," indicating that the meaning of "like product" changed according to the context of the article in which it was being used. *See, e.g.*, 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 242; GATT Dispute Panel Report on United States—Taxes on Petroleum and Certain Imported Substances, L/6175-34S/136, B.I.S.D. 34th Supp., 1987 WL 421960 (GATT) at ¶ 5.1.1 (June 17, 1987) [hereinafter Taxes on Petroleum Panel].

> given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality.[14]

This language has become something of a mantra for subsequent panel and appellate body reports that have tried to apply the term "like product" in Article III cases. A restatement of the *Border Tax* criteria—the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality—precedes virtually every attempt to interpret and apply the term to a given case. Regularly, the *Border Tax* criteria are invoked without any subsequent discussion of their relevance or the manner of their application. Such neglect to explain the application of these criteria—which may appear to be straightforward but actually are not—is suspicious.

Since more GATT panels have focused on the application of "like product" with paragraph two rather than paragraph four, this Comment will focus the bulk of its analysis on Article III:2 and use Article III:4's application of the term to highlight and contrast certain points.

A. The Article III:2 "Like Product" Test

1. A Literal (and Obvious?) Reading: The Two-Step "Product" Test of Panel Report on Japan—Alcoholic Beverages

The 1987 Panel Report on *Japan—Custom Duties, Taxes and Labeling Practices on Imported Wines and Alcoholic Beverages* (*1987 Alcoholic Beverages*), concerned Japan's differential tax treatment of shochu, a traditional Japanese hard liquor, versus other alcoholic beverages, such as whisky and vodka.[15] A major issue for the parties in the case was what kind of a comparison between imported and domestically produced products was necessary to determine their "likeness" for the Article III:2 analysis.

Rejecting Japan's argument that an actual product comparison was unnecessary, the panel affirmed the necessity of a "like product" determination in applying the first sentence of Article III:2, and it adopted a two-step test for determining whether internal taxes conformed with Article III:2. The panel found:

> that the ordinary meaning of Article III:2 in its context and in light of its object and purpose supported the past GATT practice of examining the conformity of internal taxes with Article III:2 by determining, firstly, whether the taxed import and domestic products are 'like' or 'directly competitive or substitutable' and, secondly, whether the taxation is discriminatory (first sentence) or protective (second sentence of Article III:2).[16]

The first step was the evaluation of whether the taxed imported product and untaxed domestic product were "like" or "directly competitive or substitutable." If a finding of likeness or of direct competition or substitutability between the

14. Border Tax, *supra* note 12, at ¶ 18.

15. GATT Dispute Panel Report on Japan—Customs, Duties, Taxes and Labeling Practices on Imported Wines and Alcoholic Beverages, L/6216-34S/83, 1987 WL 421964 (GATT) (Nov. 10, 1987) [hereinafter 1987 Alcoholic Beverages Panel].

16. *Id.* at ¶ 5.5.

imported product and the domestic product was made, then the second part of the inquiry was to compare the fiscal burdens on the respective products, which would determine whether a violation of Article III had occurred.[17] I will refer to this type of test as a two-step product test, because the step preceding the evaluation of the regulation involves a comparison of the imported and domestic products themselves.

The panel laid out some guidelines for applying the initial step of the two-step test to determine the "likeness" between the imported and domestic products. The panel noted that the "wording 'like' products (in French text: 'produits similaires') has been used also in other GATT articles on non-discrimination (e.g. Article I:1) in the sense not only of 'identical' or 'equal' products but covering also products with similar qualities."[18] Thus, the panel stated a rather broad scope of what could constitute "like products." In addition, it reaffirmed that the Contracting Parties had never developed a general definition of "like product" for Article III:2 nor for GATT generally and that it had been prior GATT panel practice to determine what constituted "like products" on a case-by-case basis according to the criteria spelled out in the *Border Tax* report.[19]

Regarding the criteria spelled out in the *Border Tax* report, the panel noted that "likeness" between two products must be accounted for by both "objective" criteria (such as composition and manufacturing process) and the criteria of the "subjective" consumers' viewpoint (such as consumption patterns and manner of use by consumers).[20] However, the panel qualified these points by saying with regard to objective criteria that minor difference in taste, color, and other properties would not prevent products from qualifying as "like products."[21] With regard to subjective criteria, the panel noted that consumer habits were variable and could be affected by taxation and pricing, so that traditional Japanese consumer habits would not be enough to defeat a finding of "like"-ness.[22] Thus, the broad scope of the term "like product" combined with the indefiniteness and vague standards in how the "like product" determination is to be made allows a great deal of room for a panel to make subjective and discretionary judgments.

Notable in the second part of the test is the different treatment of the regulation depending on the finding made in the first part of the test. Should "like" products be found, then the subsequent determination is whether or not the tax is discriminatory. In essence, it is a trade effects evaluation. Only if the products are not found to be "like" and instead fall into the broader category of "directly

17. *Id.* at ¶ 5.5(d).

18. The Panel cites GATT Dispute Panel Report on Tariff Treatment by Spain of Imports of Unroasted Coffee, B.I.S.D. 28S/102, at 112 (1981) [hereinafter Unroasted Coffee], which is peculiar because it is an Article I (Most Favored Nation) panel decision. *Id.* at ¶ 5.5(a).

19. The Panel notes that GATT drafting history confirmed that "the expression ("like product") had different meanings in different contexts of the Draft Charter," indicating that the meaning of "like product" changed according to the context of the article in which it was being used. *Id.* at ¶ 5.6.

20. *Id.* at ¶ 5.7.

21. *Id.* at ¶ 5.6 (agreeing with an earlier panel report adopted by the Contracting Parties).

22. *Id.* at ¶ 5.7.

competitive or substitutable" products would the subsequent inquiry be limited to a determination of whether the tax was protective. As a result, the finding of "likeness" triggers a very trade protective standard, invalidating any discriminatory effect.

To give some limit to the scope of a panel's application of the provision, the panel also stated that the Article III:2 prohibition of discriminatory or protective taxation must be read within the context of the General Agreement's goal of liberalizing custom duties.[23] Thus, Article III:2 is meant to ensure that the reasonable expectation of competitive benefits accruing under tariff concessions would not be nullified or impaired by internal tax discrimination against like imported products.[24]

In conclusion, the panel speculated that even if likeness was not found, there was a "directly competitive or substitutable" relationship between the imported and domestic product, since one product provided consumers with an alternative to the other.[25] Apparently, the panel decided not to engage in the difficult task of making an authoritative determination of whether or not shochu and the imported alcoholic beverages were "like products." Instead, the panel relied on the second sentence of Article III:2 in order to find the products to be directly competitive or substitutable and therefore in violation of the national treatment obligation.

2. *In Search of the National Treatment Obligation: Striving for Aim-and-Effect in* United States—Measures Affecting Alcoholic and Malt Beverages *and* United States—Taxes on Automobiles

The two subsequent panel reports dealing with the issue of applying the term "like product" in an Article III:2 context began to reconsider the question along very different lines. The first to broach the new approach was the 1992 Panel Report entitled *United States—Measures Affecting Alcoholic and Malt Beverages*.[26] This report examined the excise tax exemption accorded by the state of Mississippi to wine made from scuppernong grapes, a particular variety

23. *Id.* at ¶ 5.5(b).

24. *Id.* This finding would be superseded by subsequent panel decisions and eventually by 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 240, in favor of a reading of Article III as protecting all trade, not just trade under tariff bindings. ("The sheltering scope of Article III is not limited to products that are the subject of tariff concessions under Article II. The Article III national treatment obligation is a general prohibition on the use of internal taxes and other regulatory measures so as to afford protection to domestic production.") *See also* Jackson, *National Treatment*, *supra* note 3, at 209 (stating that one policy is to prevent a tax or regulatory measure from defeating a tariff binding, but Article III:2 also applies to all products and not just bound products, so that the rule assists in reducing restraints on imports generally).

25. 1987 Alcoholic Beverages Panel, *supra* note 15, at ¶ 5.7.

26. GATT Dispute Panel Report on United States—Measures Affecting Alcoholic and Malt Beverages, DS23/R - 39S/206, 1992 WL 799397 (GATT) (June 19, 1992) [hereinafter Malt Beverages Panel].

of grape that only grew in Mississippi and in parts of the Mediterranean region (Mississippi Wine Tax).[27]

While the panel initially followed the language of the panel report in *1987 Alcoholic Beverages*, reciting the *Border Tax* considerations and criteria,[28] it focused on an issue not considered by the prior panel—the notion that the like product determination under Article III:2 should relate to the purpose of the article as a whole.[29] While the *Alcoholic Beverages* panel report had stated that the like product determination should be made with regard to the purpose of the General Agreement as a whole, it did not explicitly consider applying the determination in light of the specific purpose of the national treatment obligation. In a less than novel but nevertheless significant observation, the panel stated that the basic purpose of Article III is to prevent the use of internal taxes and regulations to protect domestic production. Article III was *not* designed to prevent Contracting Parties from using their fiscal and regulatory powers for purposes *other than* to afford protection to domestic production.[30] Specifically, Article III is not to prevent Contracting Parties from differentiating for policy purposes unrelated to the protection of domestic production.[31] Because differential treatment is permitted, the provision permits legitimate discrimination between imports and domestic goods. Thus, in applying the provision, the panel considered it necessary to account for this basic purpose—limited in scope to nullifying protectionist state measures—in applying the term "like product" and in the determination of whether two products subject to different tax or regulatory treatment are in fact "like."[32] The "like product" inquiry thus became an inquiry not simply of whether the *Border Tax* criteria and the considerations put forth by the *Alcoholic Beverages* panel were satisfied but, rather, whether it made sense to distinguish the products in the manner as contested for tax or regulatory pur-

27. *Id.* at ¶¶ 5.1, 5.23-5.26. At issue was a tax exemption based on a category of wine made from grapes that only grew in the United States and the Mediterranean region. The U.S. argued that this wine constituted a product unlike and different from other wines.

28. *Id.* at ¶¶ 5.21-5.26.

29. *Id.* at ¶ 5.24. Notably, the Panel does not mention the use of Article III to protect negotiated tariff concessions as was suggested in a prior case.

30. *Id.* at ¶ 5.24.

31. *Id.* In addition, the panel stated, "[I]t is imperative that the like product determination in the context of Article III be made in such a way that it not unnecessarily infringe upon the regulatory authority and domestic policy options of the contracting parties." *Id.* at ¶ 5.26.

32. "The basic purpose of Article III is to ensure, as emphasized in Article III:1, 'that the internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, purchase, transportation, distribution or use of the products . . . should not be applied to imported or domestic products so as to afford protection to domestic production." The purpose of Article III is thus not to prevent contracting parties from using their fiscal and regulatory powers for purposes other than to afford protection to domestic production. Specifically, the purpose of Article III is not to prevent contracting parties from differentiating between different product categories for policy purposes unrelated to the protection of domestic production. The Panel considered that the limited purpose of Article III has to be taken into account in interpreting the term 'like product' in this Article. Consequently, in determining whether two products subject to different treatment are like products, it is necessary to consider whether such product differentiation is being made 'so as to afford protection to domestic production.'" *Id.* at ¶ 5.25.

poses in a way that does not violate Article III's basic prohibition against protection of domestic industries.[33]

In applying this novel consideration, this panel confidently found that unsweetened still wines were indeed like products (in contrast with the panel in *1987 Alcoholic Beverages* which evaded the determination).[34] It also reiterated the relevance of the second sentence of Article III:2 as an important safety net provision, stating that even a special variety grape wine unlike other wines would at least be directly competitive or substitutable products. Therefore, a differential tax would be inconsistent with the national treatment obligation.[35]

Malt Beverages introduced a different approach to the application of the first sentence of Article III:2. Instead of focusing on the term "like product," it focused on examining the regulation itself to see if the regulatory distinctions between imported and domestic products were based on valid governmental motives. This inquiry focuses on the regulation at issue rather than the products. Furthermore, this test is comprised of one step, with its one step being an examination of the regulation itself (although that examination may itself require more than one step). The Comment will refer to this line of thinking as the one-step regulation test.

The demise of the two-step product test and its replacement by a one-step regulation test is a natural outgrowth of the considerations raised in the above panel report and in the subsequent case. The 1994 Panel Report entitled *United States—Taxes on Automobiles* (*Taxes on Automobiles*)[36] fell in the limbo of the demise of the GATT as a trade governing body and its replacement by the WTO and was never adopted by the Contracting Parties.[37] Nevertheless, the case is important to examine because it elucidated the one-step regulation test and addressed the question of what may be the basis of a legitimate differential tax or regulatory treatment of imported and domestic "like" products under Article III. The *Taxes on Automobiles* panel inquired into whether Article III:2 applied to the Luxury Tax, a measure in the United States which imposed a retail excise tax on certain luxury products, including passenger vehicles priced over $32,000.

The panel's reasoning focused on the question of what differences between products may form the basis of valid regulatory distinctions by governments that accord different treatment to imported products. Conversely, the panel asked which similarities between products would prohibit regulatory distinctions that

33. The Mississippi Wine Tax is an example of such. *Id.* at ¶ 5.26.

34. *Id.* at ¶ 5.26.

35. *Id.*

36. GATT Dispute Panel Report on United States—Taxes on Automobiles, DS31/R, 1994 WL910937 (GATT) (Oct. 11, 1994) [hereinafter Taxes on Automobiles Panel].

37. *See* James H. Snelson, Note, *Can GATT Article III Recover From Its Head-on Collision With United States—Taxes on Automobiles?*, 5 MINN. J. GLOBAL TRADE 467, 487 (1996). *See also* 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 238-239, on the status of adopted panel reports (stating that unadopted panel reports have no legal status in the GATT or WTO system since they have not been endorsed through decisions by the Contracting Parties to GATT or WTO Members, but their reasoning nevertheless could be a useful guide in future cases).

accord less favorable treatment to imported products.[38] It considered that Article III:2 had to be read in light of the central purpose of Article III, which was expressed in the first paragraph of Article III. Referring back to *Malt Beverage*, the panel reiterated that the "like product" test required consideration of whether the product differentiation was being made "so as to afford protection to domestic production" or not.[39] Thus, the panel reasoned that Article III served only to prohibit regulatory distinctions between products that protect domestic production; otherwise, Article III permits fiscal and regulatory distinctions to achieve other legitimate (e.g. non-protectionist) policy goals.[40]

The panel also integrated the oft-cited language of the *Border Tax* considerations and criteria into its argument that regulatory distinctions could be made if based on legitimate, non-protectionist policy grounds.[41] Essentially, the panel was conscripting both the language of the General Agreement as well as prior GATT panel reports to emphasize the centrality of protectionism analysis in applying Article III:2. Thus, the panel concluded that Article III could not be interpreted as prohibiting governmental policy options, based on product distinction, that were not taken so as to afford protection to domestic production.[42]

In a bold move, the panel rejected the two-step approach in applying Article III:2 in favor of a single test. The panel observed that the first step of the two-step test necessarily included in all but the most straightforward cases a determination of the *aim and effect* of the particular tax measure, so that a second step of determining whether or not the regulation afforded protection to domestic production would be redundant.[43] The panel concluded that issues of likeness under Article III should be analyzed primarily in terms of whether less favorable treatment was based on a regulatory distinction taken "so to afford protection to domestic production."[44] To accomplish this task, the panel proposed the new single-step aim-and-effect test, focusing on whether the tax had the "aim *and* effect" of protecting domestic production, to determine whether Article III:2 required taxes to be invalidated. Tax distinctions fail this new aim-and-effect test if (1) discrimination was a "desired outcome and not merely an incidental consequence of the pursuit of a legitimate policy goal," (i.e. aim) and (2) the regulatory distinctions between goods accord "greater competitive opportunities to domestic products than to imported products" (i.e. effect).[45] In other

38. Taxes on Automobiles Panel, *supra* note 36, at ¶ 5.6.

39. *Id.* (referencing Malt Beverages Panel, *supra* note 26).

40. *Id.* at ¶ 5.7.

41. *Id.* at ¶ 5.8 ("The Panel noted that earlier practice of the CONTRACTING PARTIES had been to determine the permissibility of regulatory distinctions under Article III on a case-by-case basis, examining likeness in terms of factors such as 'the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality.' The Panel noted that regulatory distinctions based on such factors were often, but not always, the means of implementing government policies other than the protection of domestic industry.").

42. *Id.* at ¶ 5.8.

43. *Id.* at ¶ 5.9. *See also id.* at ¶¶ 5.12-5.15, for an application of the aim-and-effect test to the Luxury Tax Threshold.

44. *Id.* at ¶ 5.9.

45. Snelson, *supra* note 37, at 484.

words, the sole determination of this test was whether or not a measure was a protectionist measure.

As for the second sentence of Article III:2, the panel stated that its effect was to extend the scope of the national treatment obligation from "like" products to "directly competitive or substitutable" products, in cases where the measure is applied "so as to afford protection to domestic production."[46] This could be problematic, as discussed in Part III, because it means that "like product" and "directly competitive or substitutable product" become interchangeable and redundant terms because both are merely proxies for the determination of the aim and effect of a national regulation. If this is so, it means a departure from any literal textual reading of Article III:2, eliminating any distinction between the first and second sentences of that provision.

Thus, *Taxes on Automobiles* eviscerates the original two-step "like product" test in two ways: first, by making the "like product" finding nothing more than a proxy for the determination of whether or not a regulation was protectionist, and, second, by subsuming the "directly competitive or substitutable product" test of the second sentence of Article III:2 into the reformulated "like product" test of the first sentence so that the two tests, and hence their respective legal duties, are indistinguishable.

After proceeding to an application of the aim-and-effect test, the panel found that the Luxury Tax did not create the effect of competition that divided the products inherently into two (imported and domestic) classes,[47] and that the distinction did not have the aim of affording protection to domestic protection.[48] Hence, the panel found neither like products nor directly competitive or substitutable products.

3. *From Completely Wrong to Merely Inconsistent: The Panel and Appellate Body Reports on Japan—Taxes on Alcoholic Beverages*

The *1987 Alcoholic Beverages* dispute was revived in 1995 as the European Community, the United States and Canada lodged complaints with the newly-created WTO that Japan's compliance with the earlier panel ruling was still inconsistent with Article III:2. The result was the 1996 *Panel Report on Japan—Taxes on Alcoholic Beverages* (*1996 Alcoholic Beverages Panel*) which squarely demolished the emerging aim-and-effect doctrine.[49] It did so largely by relying on the *Vienna Convention on the Law of Treaties* to interpret Article III.[50] The result is remarkable. The panel was able to dismiss all the considerations raised by the United States and Japan in favor of an aim-and-effect test with the simple argument that the test did not adhere to a literal reading of the

46. Taxes on Automobiles Panel, *supra* note 36, at ¶ 5.16.
47. *Id.* at ¶ 5.14.
48. *Id.* at ¶ 5.15.
49. WTO Panel Report on Japan—Taxes on Alcoholic Beverages, WT/DS8/R, WT/DS10/R, WT/DS11/R, 1996 WL 406720 (WTO) (July 11, 1996) [hereinafter 1996 Alcoholic Beverages Panel].
50. *Id.* at ¶ 6.11.

text of Article III:2.[51] The panel made its literalist bent obvious by further noting that the first sentence of Article III:2 made no reference to Article III:1, so that the assumption of the aim-and-effect test that the first sentence could make a reference to the limitation of "so as to afford protection" is wrong.[52] Furthermore, neither the wording of Article III:1 nor Article III:2 supports a distinction between origin-neutral and origin-specific measures as required in the aim-and-effect test.[53] By relentlessly pressing home its literal reading of the text of Article III, the panel ignored all the legal and policy arguments behind the aim-and-effect test. Specifically, the panel insisted that the text of the article indicated that there were two separate legal obligations in Article III:2, one embodied by the first sentence concerning "like" product and another embodied by the second sentence concerning "directly competitive or substitutable" products.[54] This assumption of two separate legal obligations in the article made it impossible to read Article III:2 in the manner proposed by the aim-and-effect test, which would tend to equivocate the scope of the first and second sentences. For good measure, it made clear that it rejected the reasoning of *Malt Beverages* and *Taxes on Automobiles* as inconsistent with a literal reading of the article.[55]

The panel revived the *1987 Alcoholic Beverages* two-step "like product" test and added an extra step. The steps are a determination of (1) whether products are like, (2) whether the contested measure is an "internal tax" or "other internal charge" (not an issue in the disputes discussed in this Comment), and (3) whether the tax imposed on foreign products is in excess of the tax imposed on like domestic products.[56] Thus, the application of the term "like product" was a required and independent step in the application of the first sentence of Article III:2. Applying the test, the panel concluded that shochu and vodka were like products and that shochu, whisky, brandy, rum, gin genever and liqueurs were "directly competitive or substitutable products," that there was discriminatory treatment in both cases, and hence Article III was violated on both counts.[57]

The recently-created appellate body reviewed the *1996 Alcoholic Beverages Panel* report in the *1996 Appellate Body Report on Japan—Taxes on Alcoholic Beverages* (*1996 Alcoholic Beverages, Appellate Body*)[58] and found that the panel had erred in law by failing, among other things, to take into account Article III:1 in interpreting both the first and second sentences of Article III:2. This, of course, sounds like the very consideration that was developed in *Malt Beverages* and *Taxes on Automobiles*. However, the appellate body cites to neither panel report in coming to this conclusion and makes no mention at all of *Taxes on Automobiles* in its report.[59] Nevertheless, its conclusion that the

51. *Id.* at ¶ 6.16.
52. *Id.*
53. *Id.*
54. *Id.* at ¶ 6.11.
55. *Id.* at ¶ 6.18.
56. *Id.* at ¶ 6.19.
57. *Id.* at ¶ 7.1.
58. 1996 Alcoholic Beverages Appellate Body, *supra* note 8.
59. *See id.* at note 40, which only cites the Malt Beverages Panel report, *supra* note 26, at ¶ 6.12.

panel's reading was in error is significant—it undermines a necessary conclusion derived from a strict literalist reading of Article III. If one were to read Article III:2 literally, one cannot consider Article III:1 when applying the first sentence. The appellate body insists that Article III:1 must be accounted for in both sentences of Article III:2. To do so would mean abandoning the literalist approach. This in itself does fatal damage to the reasoning in the panel decision below. Despite pointing out this error that undermines the reasoning of the panel decision, the appellate body upheld the panel decision, reaffirming its decision to interpret "like products" on the basis of a textual analysis of GATT Article III:1 and III:2 rather than on the aims and effect of the offending legislation. In doing so, it reaffirmed the two-step product test, but it significantly confused the issue by raising considerations contradictory to the literalist approach. As a result, it is not surprising that the appellate body did not integrate its findings into its subsequent analysis of the article.

The appellate body began its discussion of the interpretation of Article III in Part G of the report with a discussion of its broad and fundamental purpose, which is to avoid protectionism in the application of internal tax and regulatory measures and to ensure equality of competitive conditions for imported products in relation to domestic products.[60] The appellate body stated that Article III:1 contained general principles which informed the application of Article III:2, arguing that such an interpretation was the only permissible one in order to give effect to Article III:2.[61] In saying this, the appellate body implicitly rejected the notion advanced in the panel report that Article III:2 was to be read primarily within the context of the General Agreement's goal of liberalizing custom duties.[62] The appellate body also downplayed the significance of Article III as a means of protecting negotiating tariff concessions and commitments under Article II, reasoning that the scope of Article III covered more than just the products that are subject to tariff concessions under Article II to include any internal regulatory measure that affects a product in a way that affords protection to domestic production.[63]

The appellate body also suggested in part G of the report that Article III:1 informs the first sentence and the second sentence of Article III:2 in different ways,[64] and it made much of the fact that the first sentence of Article III:2 does not make reference to Article III:1.[65] Rather than indicating that Article III:1

60. *Id.* at 240 (*citing* Taxes on Petroleum Panel, *supra* note 13, at ¶ 5.1.9; 1987 Alcoholic Beverages Panel, *supra* note 15, at para.5.5(b)). It is notable that the Body's reference to the panel report below is not supported. The 1987 Alcoholic Beverages panel, in fact, stated, "[t]he context of Article III:2 shows that Article III:2 supplements, within the system of the General Agreement, the provisions on the liberalization of custom duties and of other charges by prohibiting *discriminatory* or protective taxation against certain products from other GATT contracting parties (emphasis added)."

61. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 241.

62. *See* 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶ 6.13.

63. *Id.*

64. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 241. The Appellate Body reasons according to the principle of effectiveness in treaty interpretation.

65. *Id.*

was irrelevant to the application of the first sentence of Article III:2, the appellate body argued that the absence of such reference merely reflected the non-necessity of such a reference because the first sentence of Article III:2 is itself an application of the general principle contained in Article III:1.[66] Thus, Article III:2, first sentence, requires an examination of whether the tax could be applied "so as to afford protection." As a result, the appellate body found that the panel had erred to take into account Article III:1 in interpreting Article III:2's first and second sentences. This finding did not affect the outcome of the case.[67] Nevertheless, the appellate body, despite its failure to refer to them, can be considered to be narrowly affirming *Malt Beverage* and *Taxes on Automobiles*' reading of Article III:2 in light of Article III:1.

By no means however, did the appellate body affirm the aim-and-effect test. In contrast, the appellate body noted that the second sentence of Article III:2 specifically invokes Article III:1 because the prohibition against protection of domestic production is not inherent in the language of Article III:1.[68] If imported and domestic products are found to be not "like products" and thereby satisfy the first sentence of Article III:2, they still may fall within the prohibition of the second sentence, which addresses the broader category of "directly competitive or substitutable products."

The appellate body's discussion of what constitutes "like products" in part H(1)(a) is surprising in light of *Malt Beverages* and *Taxes on Automobiles*. Unsurprisingly, it reiterated the *Border Tax* considerations and criteria. However, what follows is a less than helpful and vague discussion of what constitutes a "like product," with a particularly unhelpful and peculiar reference to an accordion.[69] Considering that it insisted on a literal "like" product comparison by adhering to the two-step product test, it is surprising that the appellate body gave such little guidance as to what constitutes "like" products. The appellate body emphasized the narrowness of the range of "like products" in Article III:2's first sentence, when compared to the range of "like products" in other GATT and WTO provisions, and further stated that the definition of "like product" should be construed narrowly.[70] The appellate body based this holding on the view that the second sentence of Article III:2 is the broader category of products which acts as a fall-back provision for products that fall outside of the reach of the first sentence of Article III:2. But the appellate body gave no additional guidance in

66. *Id.*

67. *Id.* at 242.

68. *Id.* at 243-44 ("Unlike that of Article III:2, first sentence, the language of Article III:2, second sentence, specifically invokes Article III:1. The significance of this distinction lies in the fact that whereas Article III:1 acts implicitly in addressing the two issues that must be considered in applying the first sentence, it acts explicitly as an entirely separate issue that must be addressed along with two other issues that are raised in applying the second sentence.").

69. The Appellate Body states, "[t]he concept of 'likeness' is a relative one that evokes the image of an accordion. The accordion of 'likeness' stretches and squeezes in different places as different provisions of the *WTO Agreement* are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term 'like' is encountered as well as by the context and the circumstances that prevail in any given case to which the provision may apply." *Id.* at 242.

70. *Id.* at 241.

outlining the limits of what are "like products." Instead, it stated that there is "an unavoidable element of individual, discretionary judgement" in the like product determination.[71] By announcing such discretion to future panels without elaboration of any further guidelines in the "like product" determination, the appellate body granted future panels more than just an element of discretion—it gave the panel full and autonomous discretion over the issue. As a result, the appellate body appeared to have decided that the "like product" determination is largely a question of fact in the exclusive domain of the panel and thus irreviewable by the appellate body.

As for applying the second sentence of Article III:2, the appellate body granted broad discretion to the panel in making this determination of fact on a case-by-case basis.[72] Although physical characteristics, tariff classifications and the elasticity of substitution in a market are factors, the appellate body affirmed the panel's view that the decisive criterion for finding a "directly competitive or substitutable product" is whether the products have common end-uses, as shown by elasticity of substitution.[73]

Essentially, the appellate body reaffirmed the two-step product test but added in issues raised by the reasoning behind the aim-and-effect test. As will be discussed later in this Comment, these elements are incompatible and therefore make for an unlikely synthesis.

B. "Like Product" Test Under Article III:4

The other Article III provision with a "like product" determination is found in paragraph four.[74] The language of Article III:4 requires that imported products receive "treatment no less favorable than that accorded to like products of national origin." This paragraph, like the first sentence of Article III:2 makes no explicit reference to Article III:1. It prohibits laws, regulations and requirements that affect internal sales, offerings for sales, purchases, transportation, distribution or use that unfairly burden "like" imports. Otherwise, Article III:4 does not prohibit differential treatment between "like" products if it is "no less favorable," and furthermore it does not prohibit different treatment when the products are not "like" products.[75] The "like product" issue in the context of

71. *Id.* at 242.

72. *Id.* at 244 ("How much broader that category of "directly competitive or substitutable products" may be in any given case is a matter for the panel to determine based on all the relevant facts in that case.")

73. *Id.*

74. General Agreement, *supra* note 1, art. III, ¶ 4:

> [t]he products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

75. *See, e.g.*, Malt Beverages Panel, *supra* note 26, at ¶ 3.121 (stating the United States' argument).

Article III:4 has arisen less often than it has with Article III:2 and hence this Comment will address it in less detail.

In *1996 Alcoholic Beverages*, the panel merely made reference to Article III:4 in its discussion of Article III:2. In a rare direct reference, it said that an interpretation of "like product" in Article III:4 as meaning "more or less the same product" was too strict an interpretation.[76] Otherwise, the approach of the panel here was to discuss the Article III:4 "like product" determination in the same breath as that of Article III:2, applying the same test.[77] Therefore, it can be inferred that this panel conceived that the Article III:4 and Article III:2 applications of "like product" involved the same two-step test.

Subsequently, in *Malt Beverages*, the panel addressed the question of whether or not low and high alcohol content beer were "like" products within the meaning of Article III:4 in order to determine whether or not the United States' categorization of beer according to alcohol content for purposes of regulating sale, distribution and labeling violated the national treatment obligation.[78] Referring to its earlier application of a "like product" examination under Article III:2, the panel proposed a different two step analysis: first, looking at the product's physical characteristics and, second, ensuring that the internal regulation is not applied so as to afford protection to domestic production.[79] It is notable that like the first sentence of Article III:2, Article III:4 makes no direct reference to Article III:1. Nevertheless, the panel assumed that Article III:4 embodied the requirements of Article III:1.

The way which the panel treated a finding of "like product" cannot be correct. The panel noted that once a product is found to be "like," then any regulatory differentiation between the "like" products would be inconsistent with the requirements of Article III, even if the regulation were *not* applied so as to afford protection to domestic industry.[80] Thus, it concluded, the "like product" determination must be made carefully in a way that does not necessarily infringe upon the regulatory authority and domestic policy options of the contracting parties.[81] This reasoning is circular: the panel recommended that an empirical finding of fact be colored by policy considerations. But as mentioned above, *Malt Beverages* is something of a transition case, a step in the evolution from the two-step product test to the one-step regulation test. As a result, the panel has not yet resolved its confusion over the tautology derived from the text of the article and prior panel practice. It was unaware that its fears were unfounded because it should be the case that one cannot find "like products" if the regulation is not applied so as to afford protection to domestic industry. After all, the term "like product" under the one-step test is nothing more than a conclusion of

76. 1987 Alcoholic Beverages Panel, *supra* note 15, at ¶ 5.5(b) (discussing Panel Report on Spain's restrictions on the domestic sale of soybean oil).

77. *See, e.g., id.* at ¶ 5.5(d) (applying the same two-step "like product" determination test to both internal taxation and internal regulations).

78. *Id.* at ¶ 5.71.

79. *Id.*

80. *Id.* at ¶ 5.72.

81. *Id.*

the fact that the measure under investigation impermissibly violates the national treatment obligation by affording protection to domestic production, a conclusion to which the reasoning in *Malt Beverages* invariably leads.

Furthermore, the weight that the panel gave each part of the two-step test in its application is revealing. The panel stated in one sentence, without further elaboration, the requirement of an examination of the physical characteristics of the products.[82] Compare this cursory treatment to their examination of whether the differentiation was such as to afford protection to domestic industry. The protectionist-purpose examination involved a detailed inquiry into whether the product was both imported and produced domestically, the lack of specific discrimination against imports *per se*, the market and consumer tastes, and the policy goals and legislative background of the laws at issue.[83] Given that so little attention was given to the first part of the determination of physical similarity, it appears to be somewhat irrelevant and unnecessary to the actual application of the provision. Furthermore, such a physical comparison advances no policy objective and serves no apparent purpose. Thus, it appears that the standard applied by the panel in practice really is not in any meaningful sense a two-part inquiry at all.

In *Taxes on Automobiles*, the panel applied the same rule to Article III:4 as it did to Article III:2. The panel read Article III:4 and III:2 together in the context of the purpose of the article, as embodied in Article III:1. Thus, Article III only prohibits a regulatory distinction between products when applied so as to afford protection to domestic products as determined by the aim-and-effect test, and it does not prohibit fiscal and regulatory distinctions when applied to achieve legitimate policy goals.[84]

The *1996 Alcoholic Beverages Panel*, as with the first sentence of Article III:2, reversed the trend of the prior two panel decisions by insisting on a literal reading of the Article III. The panel reasoned that because Article III:2 refers to Article III:1 whereas Article III:4 does not, the term "like product" must be interpreted differently in each of the provisions to account for that difference.[85] Primarily, the term "like product" should be construed narrowly in Article III:2 because it must be read in the context of the second sentence's term "directly competitive or substitutable" products. This is a broader term referring to Article III:1 encompassing those products that fall outside of the category of "like" products. In contrast, Article III:4 uses "like product" in isolation.[86]

82. *Id.* at ¶ 5.73 ("The Panel recognized on the basis of their physical characteristics, low alcohol beer and high alcohol beer are similar.")
83. *Id.* at ¶¶ 5.73-5.74.
84. Taxes on Automobiles Panel, *supra* note 36, at ¶ 5.7.
85. 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶ 6.20.
86. *Id.* at ¶ 6.21.

II.
ANALYSIS OF THE TWO "LIKE PRODUCT" TESTS AND THEIR COMPARATIVE MERITS

The most pressing issue in resolving how to apply Article III:2 is how to determine whether imported and domestic products are "like" under the first sentence of the article. A core issue in resolving this question is whether the first sentence inquiry requires an actual examination of the product's characteristics or whether the focus should be on the regulation itself. The confusion in the application of the first sentence of Article III:2 arises in large part from the confusion about the term "like product" as used in the panel and appellate body decisions. In some decisions, the term represents a factual finding involving an actual comparison of the products at issue. In later decisions, namely *Taxes on Automobiles*, the use of the term acts as a proxy for a panel finding that the purpose of the GATT provision has been frustrated by the tax or regulatory measure at issue. Thus, the first section of this part of the Comment will examine whether a comparison between imported and domestic products using the *Border Tax* criteria is of any benefit. Next, in order to determine the necessity of such a comparison, the Comment will discuss the scope and purpose of the Article III national treatment obligation. Assuming that the aim-and-effect test is the correct standard for applying Article III:2, the Comment will then discuss issues related to determining regulatory motivation and effect. Finally, the effects of the different interpretations on the interaction between the first and second sentences of Article III:2 will be discussed.

The "precedent" effect of GATT panel reports should be noted as an initial matter in order to make clear the fact that *Taxes on Automobiles* remains relevant to the analysis. Although panels tend to refer to earlier-adopted reports and even use them in their reasoning as if they were binding precedent, there is no such doctrine under international law.[87] Such reports may only have persuasive effect. However, once a prior-adopted panel report has become part of GATT practice, and can in that sense be relied upon for interpreting the General Agreement, it will have a stronger effect than when first adopted (even though the Contracting Parties are free to revoke it).[88] The main issue of contention, however, concerns *Taxes on Automobiles*, an unadopted panel report. The panel in *1996 Alcoholic Beverages* stated that unadopted panel reports have no legal status in the GATT or WTO system since they have not been endorsed through decisions of the Contracting Parties to GATT or WTO Members and thus did not constitute subsequent practice.[89] Although such reports are not considered particularly influential in GATT as decisions, they may have influence if they are well reasoned. Therefore, even such a report could conceivably become part

87. JOHN H. JACKSON, RESTRUCTURING THE GATT SYSTEM 67 (1990). *See also* 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 238.

88. JACKSON, RESTRUCTURING, *supra* note 87, at 68.

89. 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶¶ 6.10, 6.18.

of the overall practice of GATT.[90] Thus, it is completely feasible for the WTO to incorporate the reasoning of the unadopted report of *Taxes on Automobiles* into future WTO practice.

A. What is "Like"?: The Weakness of the Border Tax Criteria

The two-step "products" test of the *Alcoholic Beverages* report requires a comparison of the imported and domestic products at issue. Although the wording of Article III may seem to indicate the need to do so, it is not altogether certain that such a comparison would be of any use. Formalism for the sake of formalism has always been a weak legal argument. Thus, to determine whether or not this comparison in fact serves a purpose beyond formalism, a closer examination is required. Since the comparison is done most often under the auspices of the considerations and criteria laid out by the *Border Tax* report, it is best to start there.

Despite the repeated invocation of the *Border Tax* considerations and criteria, their recital does not lend much assistance in the actual application of the first sentence of Article III:2. As noted above, the *Border Tax* criteria play no functional role in the aim-and-effect test; however, they do constitute an integral part of the two-step product test. Assuming the application of the first sentence is in two parts, then the first step "like product" determination is equivalent to a determination of the similarities between the imported and domestic products' characteristics.

The question arises as to what characteristics one is to compare in order to determine the existence of "like" products. As far as a comparison of the products' physical characteristics (e.g. under the *Border Tax* criteria, "the product's properties, nature and quality"), prior panels have not gone into much detail about how this comparison is to be made, nor about the standards of similarity and dissimilarity which are meant to guide the evaluation.[91] One proposal for clarifying such standards was to look to the tariff schedules of international classification systems in order to back up a finding of "likeness" with an example from customary international practice.[92] Attractive as this alternative sounds,

90. *Id.* at 6.10; JACKSON, RESTRUCTURING, *supra* note 87, at 68. Note that the adoption of the WTO has resulted in a change in the procedure for adopting panel reports whereby panel reports are automatically adopted, unless appealed or blocked by a consensus. WTO Agreement, *supra* note 7. *See also* JEFFEREY J. SCHOTT, THE URUGUAY ROUND: AN ASSESSMENT 126-28 (1994).

91. To account for the lack of discussion of this issue, it can be argued that inherent characteristics, despite being termed "objective" later on in my discussion, are really a function of each person's subjective experience of the product. Such a determination may be largely subject to the individual whim of the adjudicator. Or another possible explanation for the absence of further discussion on the subject may be that such a determination does not actually matter much in the application of Article III:2, second sentence.

92. *See, e.g.*, European Communities' argument that one of the criteria relevant to the determination of "likeness" is the products' classification in Harmonized System nomenclature. 1996 Alcoholic Beverages Panel, *supra* note 49, at para. 4.20. *See* 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 242 (a uniform tariff classification of products can be relevant in determining what are "like products"). But there is a major difference between tariff classification nomenclature and tariff bindings or concessions made by Members of the WTO under Article II of the General Agreement, *supra* note 1. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 242-43 (discussing

customary practice may be for reasons entirely unrelated to the purposes of the national treatment obligation and therefore such an approach does not adequately justify invalidating national policy. But the appellate body has not adopted such an approach. As the law currently stands, the appellate body has endorsed *ad hoc* discretionary panel determinations of physical similarities. This is obviously unsatisfying and causes unpredictability. It would not be proper for the WTO to expect nations to abide by its regime for long if it is incapable of setting forth clear guidelines for nations to follow in passing legislation to avoid an Article III violation.[93]

A complementary approach is to compare the two products' market characteristics (e.g. under the *Border Tax* criteria, "the product's end-uses in a given market; consumers' tastes and habits, which change from country to country"). To do this, prior panels have relied on statistical evidence. This approach seems more appealing because it is less subjective. However, this determination begins to look much like the determination required in the second sentence of Article III:2 for finding "directly competitive or substitutable" products. Indeed, because there is overlap between "directly competitive or substitutable" and "like" products in that "like" products invariably do compete with each other in a market, the factor which distinguishes the two is not market characteristics but rather physical and other non-market characteristics. Furthermore, this approach would be contrary to the strict division of duty between the first and second sentences, as advocated by the *1996 Alcoholic Beverages Panel.* As a result, if "like" product is to mean anything different from "directly competitive or substitutable," it will be on the basis of similarity of characteristics other than market ones.

The difficulties mentioned above stem from the larger problem plaguing the endeavor of trying to compare the things themselves as we commonly perceive them, typically through their physical characteristics, to determine their "likeness." Comparing things in this manner requires that one assume that there is some appropriate, accurate and certain epistemological manner of ascertaining the identity of the imported and domestic products in order to make a valid comparison. The practice under the two-step product test has been something of an *ad hoc* discretionary and factual determination by the panel which tends not to be explained in the report except by recital of the criteria by which the products are judged. Even when it is explained in cursory fashion, the explanation is not based on any criteria relevant to the question why such a distinction between the imported and domestic products upholds the national treatment obligation.

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why it is not a good idea to rely completely on a nation's tariff binding classifications because they could cut across several Harmonized System's tariff headings (which has been recognized in General Agreement practice as providing a useful basis for confirming "likeness" in products) and may represent the results of trade concessions negotiated among Members of the WTO rather than any similarity of products. But this, of course, raises the nagging question of how to determine similarity of products, a question which the Appellate Body fails to address).

93. *See, e.g.*, the argument of the United States in 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶ 4.46 (stating that a "pure effects" test, such as the one proposed by the European Community and approved by the Panel, would give neither guidance nor certainty to legislators).

This ambiguity, I believe, arises from the fact that the panels have not seriously considered the question of what would be the proper epistemological perspective to view the products.

In order to determine the proper epistemological perspective, it is useful to start with the question of when does a "like product" question arise in Article III cases. The fact of the matter is that the question of whether a domestic and an imported product are "like products" only sometimes arises in Article III:2 (or Article III:4) disputes. An Article III violation may arise in several ways, but the "like product" issue arises only when a *category* for the tax or regulation of imported products is contested by the importing party as being drawn too narrowly so that it has the effect of putting imports at a disadvantage.[94] A party would only make the assertion that imported and domestic products are "like" if one or the other were excluded from a category, with the goal of having the adjudicating body classify both products as belonging to the same category. At the very least, the "like product" determination must be as stated here:

> [T]he starting point of the [like product] analysis cannot be the concrete objects to which an internal tax or regulation is applied but only the abstract categories of products distinguished by the contracting party. For instance, in the context of an analysis under Article III it is meaningless to say that the imported cup in my left hand is like the cup of domestic origin in my right hand because their properties, nature, quality, and end-uses are the same and that, consequently, the cup in my left hand must be accorded no less favorable treatment than the one in my right hand. It may be true that the two objects might be the same when considered as cups but the fact that they are cups may not at all be relevant under the domestic regulation at issue. One of the cups might under that legislation fall under the category of "nonrecyclable beverage container" (subject to environmental tax), "material producing poisonous gases when incinerated" (subject to a sales prohibition), or "household utensil" (subject to a reduced value-added tax). To compare the objects as cups when they are not distinguished by the contracting parties as such is arbitrary.[95]

Thus, the identity of a product is a function of the category within which a party intends to place it. Yet the prior reports have not approached "like product" determinations as a question of proper categorization; instead, they have tended to compare the products as objects in and of themselves, as perceived through our everyday senses and outside their regulatory classifications, by constant reference to the *Border Tax* criteria. The GATT and WTO adjudicatory bodies appear to have continued to use the *Border Tax* criteria primarily out of habit and convenience. The necessity of the criteria might appear to be a fair assumption since these criteria have been repeated by almost every GATT entity that has adjudicated a "like product" issue.[96] However, as mentioned above, prior adopted reports hold no power as precedent (despite being considered sub-

94. *See, e.g.*, the Mississippi wine tax in Malt Beverage Panel, *supra* note 25.

95. Frieder Roessler, *Diverging Domestic Policies and Multilateral Trade Integration*, in FAIR TRADE AND HARMONIZATION: PREREQUISITES FOR FREE TRADE? Jagdish Bhagwati and Robert E. Hudec, eds., 29 (1996).

96. These statements are usually made in reference to the Report of the Working Party on Border Tax Adjustments, *supra* note 12. This report was the first time these criteria were enumerated.

sequent practice), and it is also acknowledged that the General Agreement provides no definition of "like product." Thus, we are not bound to *Border Tax* as providing the guiding criteria for determining "likeness" of products except by the force of its reasoning, which frees us to search for a more appropriate set of criteria.

The use of categories to determine the existence of "like" products, however, ultimately leads to adoption of the aim-and-effect test. The reason is that the scope of particular categories must be defined. Defining the scope of such categories, in turn, relies on the purpose of the very act of categorizing. In the context of Article III, the relevant categories are those which are created by national legislation or regulation affecting competition between imported and domestic products. The most obvious categories that come to mind when one thinks of such regulation are imported products and domestically produced products. According to the two-step products test, such a classification is on its face in violation of Article III if the products at issue are "like." But such a conclusion does not prove that the policy supporting national treatment obligation has been compromised. To argue that a finding of likeness and a finding of discriminatory effect between like imported and domestic products is *per se* a violation of the obligation is to ignore the real question at issue.[97] The real question is what purpose do the categories used by national regulation of products inside a nation's borders serve.[98] This requires that one look at the aim-and-effect of the regulation. Therefore, I propose something even more radical than merely jettisoning the *Border Tax* criteria. I propose jettisoning the entire "like product" test as an independent step and as a factual determination.

Such an approach is necessary in order to achieve the goals of Article III. If the "like product" determination is a separate independent test, then it acts as a necessary condition for the finding of a violation of the first sentence of Article III:2. As a necessary condition, it is important that this step not frustrate the purpose and goals of the provision. The *1987 Alcoholic Beverages* panel advanced a two-step test which had as its first step a determination of "likeness," which was independent of the second step of determining whether there was protection afforded to domestic products. As mentioned before, this first step was quite straightforwardly an examination of the *Border Tax* criteria.[99] Ultimately, the problem with a separate determination of "likeness" in the application of Article III:2's first sentence is that the process of the determination of "likeness" would occur independently of the purpose of Article III, making it a prior and necessary condition of the application of Article III:2's first sentence.

97. *See* the argument of the European Community, 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶ 4.22 (stating that once it is established that two products are "like" and that the imported product is subject to a higher tax, then the finding of a violation of Article III:2, first sentence, is automatic. It is irrelevant whether or not the tax differential has a protectionist aim.).

98. *See, e.g.*, the argument of the United States, *id.*, at ¶ 4.24 (stating that the notion of "likeness" cannot be separated from the purpose of Article III:2 with respect to which products are "like," and the objectives of the regulatory scheme that draws a distinction between two otherwise similar products.).

99. 1987 Alcoholic Beverages Panel, *supra* note 15, at ¶ 5.6.

Such a system may possibly frustrate the purpose of Article III's national treatment prohibition. This danger is manifested primarily in terms of under-inclusiveness and over-inclusiveness, discussed in the following section.

As suggested earlier, the appellate body in *Alcoholic Beverages* did not really try to resolve this dilemma because it did not see it. Rather, it rejected any challenge to the panel's use of the two-step product test, and merely tipped its hat to any concern for the purpose of Article III (found in Article III:1). However, it did not integrate the "like product" determination into a policy analysis of the intent behind or effect of the tax or regulatory classification. The appellate body, in fact, approved of granting a great deal of discretion to the panel for applying the enumerated criteria as part of its determination of "likeness," stating that "[t]his will always involve an unavoidable element of individual, discretionary judgement" and that "panels can only apply their best judgement in determining whether in fact products are 'like'."[100] This surrender to the inevitability of panel subjectivity may be the natural result of the appellate body's reference to the insidious and mischievous *Border Tax* criteria. If so, my initial contention that the *Border Tax* criteria was indicative of the problematic nature of the product test is now blunted by the alternative of using categorization of products as the focus of the "like product" determination by looking. However, even if we reformulate the two-step test of *Alcoholic Beverages* by replacing the *Border Tax* criteria in the first step "like product" determination with an evaluation of whether the products fall into their proper regulatory categories, the potential of the two-step test to frustrate the purpose of Article III remains. How this might occur is discussed in the following section. This potential to frustrate the policy of Article III is the primary rationale behind my argument in favor of the aim-and-effect test.

B. Clarifying the Purpose of Article III—Discriminatory Effect Versus Protective Intent

We should clarify the appropriate standard, such as the *Border Tax* criteria, by which "like" products and "directly competitive or substitutable" products are differentiated because the products receive different treatment under the two-step products test. The former gives rise to the application of a discrimination standard and the latter a protectionist motivation standard. Yet, if we assume that the first sentence of Article III:2 embodies the national treatment obligation, we must determine whether or not the "likeness" of products is an adequate justification for a substantially harsher standard in assessing national regulation. I argue that it does not.

To understand what is required of the term "like" product, we should start from the beginning, with the purpose of Article III itself and an understanding of the national treatment obligation. While it has been recently reaffirmed by the appellate body that the purpose of Article III (as embodied in the first paragraph), plays a role in the interpretation of each subsequent provision in the

100. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 242.

article, the implications of that assertion have not been fully clarified. As for the "like product" determination of the first sentence of Article III:2, the appellate body assumed that because the first sentence does not make explicit reference to the first paragraph, the very application of the sentence incorporates the considerations contained in the first paragraph.[101] This assertion was drawn in contrast with the second sentence of Article III:2 which does makes explicit reference to Article III:1. However, the question of what the purpose of Article III is, as embodied in the first paragraph, does not produce a necessarily straightforward answer. Of course, this question is significant since it will play a role in the application of any provision under the article.

The first question is what is the purpose of Article III. Article III:1 states that taxes, charges or regulations should not be applied so as to afford protection to domestic production. This statement raises the question of whether Article III:1 prohibits only taxes, charges or regulations that have protectionist motives or whether it prohibits the much broader category of any tax, charge or regulation that has a discriminatory effect on imported goods. In *Malt Beverages*, the panel said that it is permissible for contracting parties under Article III:2 to differentiate between imported and domestic products so long as it is for policy purposes unrelated to the protection of domestic production.[102] The panel in *Taxes on Automobiles* followed a similar line of reasoning with its aim-and-effect test.[103] Thus, these two panels clearly suggest that in order for a measure

101. *See, e.g.*, 1996 Alcoholic Beverages Appellate Body, *supra* note 8.

102. Malt Beverages Panel, *supra* note 26, at ¶ 5.24. Objective criteria were stated as follows: "[u]nder Article III:2 a regulatory distinction could legitimately be made between any two products, as long as the distinction was based on *objective criteria aimed at a policy* other than the protection of domestic production." Taxes on Automobiles Panel, *supra* note 36, at ¶ 5.20. This raises the question of what are "objective" criteria. *See* Snelson, *supra* note 37, at note 120: "Ironically, the liquor cases laid the foundation for GATT tolerance of facially neutral taxes, even as they found Mississippi wine and Japanese liquor taxes inconsistent with Article III:2. These taxes were offensive because the tax distinctions were unsupported by any objective basis. In the parlance of the United States—Taxes on Automobiles, no aim other than protectionism explained the tax distinctions." But then Snelson contends that the Panel in Taxes on Automobiles was compelled to develop a new mechanism for evaluating facially neutral regulations under Article III because the taxes in this case were not so obviously offensive as those found in the liquor cases. *Id.* at 488.

103. Taxes on Automobiles Panel, *supra* note 36, at ¶ 5.8. Note the aim-and-effect test of Taxes on Automobiles, *id.* at ¶¶ 5.12 - 5.13. The test requires that one first consider whether the *aim* of establishing the threshold within the luxury tax was to afford protection to domestic industry. Then, one must consider whether the threshold distinction in the luxury tax had the *effect*, in terms of the conditions of competition, of affording protection to domestic production. The panel held that the threshold was not implemented so as to afford protection to domestic production, that automobiles above and below that threshold value could not, for purposes of the luxury tax, be considered like products under Article III:2, first sentence, and that different treatment could therefore be accorded under the luxury tax to automobiles above and below the threshold. *Id.* at para. 5.15. It appears the analysis of discriminatory effect is limited to conclusive evidence of a change in the conditions of competition favoring the importing country's producers. *See, e.g.*, Taxes on Automobiles Panel, *supra* note 36 at para. 5.13. Facial discrimination is not sufficient if there is no aim to protect domestic production. Also note that the test is aim *and* effect. The panel decided that effect cannot be an independent basis for a finding of a violation of Article III:2, but rather, must be coupled with the importing government's protectionist aim or intent. The aim-and-effect seems to require a showing of both protectionist aim and discriminatory effect so that discrimination by itself (without protectionist intent), may not be sufficient. *Id.* at ¶¶ 5.9, 5.12-5.15. However, facial discrimination may be sufficient to satisfy the discriminatory effect requirement since this test does not

to be found in violation of Article III:2, the measure must have been motivated by a legislative intent to protect domestic industry.[104]

The appellate body report for *Alcoholic Beverages* is significantly less clear.[105] First, it broadly asserts that Article III:2 must be read in light of the purpose of Article III as contained in the first paragraph.[106] The appellate body explicitly stated that the "broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures.[107] But the appellate body was unclear as to what its application of the term "protectionism" means. First, it stated that the prohibiting protectionism requires Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products, which amounts to equality of treatment.[108] Equality of treatment implies a no-discrimination standard, especially if no other determination is required in order to apply the standard. Furthermore, in spelling out the application of the first sentence of Article III:2, the appellate body implies that the purpose of the national treatment obligation is to prevent any discrimination. It does so by first saying that Article III:2's first sentence acts as an application of the general principle contained in Article III:1. Then it states that the application of Article III:2, first sentence, requires an inquiry into whether or not there was a charge applied to a imported product "in excess" of that applied to a like domestic good.[109] Specifically, it states that if a WTO Member has placed a tax on imported products that are in excess of those on like domestic products, then:

> the Member that has imposed a tax is not in compliance with Article III. Even the smallest amount of "excess" is too much. "The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a 'trade effects test' nor is it qualified by a *de minimis* standard."[110]

The focus on whether the charge was "in excess" indicates that the appellate body understood the requirement of Article III:1 to prohibit any form of discrimination.[111] Once "likeness" between imported and domestic products is found,

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elaborate on the level of discrimination required, so we can assume the prior report's position (that facial discrimination suffices), remains valid.

104. Assuming that the purpose of Article III is to prevent measures informed by protectionist intent, the question arises as to what extent should regulatory purpose be examined. *See* Snelson, *supra* note 37, at 491 (rejecting a superficial examination of regulatory purpose and advocating the need for a comprehensive review of a measure's real goal).

105. *Cf.* 1987 Alcoholic Beverages Panel, *supra* note 15. The drafting history of the GATT confirms that Article III:2 was designed with "the intention that internal taxes on goods should not be used as a means of protection." *Id.* at ¶ 5.5(c) (citing UN Conference on Trade and Employment, Reports of Committees, at 61 (1948)).

106. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 240.

107. *Id.*

108. *Id.* ("[T]he intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products once they had been cleared through customs. Otherwise, indirect protection could be given.") quoting GATT Dispute Panel Report on Italian Discrimination Against Imported Agricultural Machinery, B.I.S.D. 7S/60, ¶ 11 [hereinafter Agricultural Machinery].

109. 1996 Alcoholic Beverages Appellate Body, *supra* note 8.

110. *Id.* at 243.

111. The 1987 Alcoholic Beverages Panel argued that the purpose of Article III:2 was to prohibit discriminatory or protective taxation against certain products from other GATT contracting

then charges "in excess" must be found in order to find a violation of Article III:2. Keeping in mind that the determination of "like" product does not involve considerations of the purpose of the article (despite what the appellate body says), the practical effect of the appellate body's test is to strike down all statutes with any discriminatory effect. Thus, the two contesting versions of the purpose of Article III:2 are (1) the prevention of measures with protectionist intent, and (2) the prevention of measures with discriminatory effect.

So who is right? The answer lies in understanding the national treatment obligation. At its most basic, the obligation imposes the principle of nondiscrimination as between domestically produced goods and the "like" imported goods. Looking at past panel reports, we can begin to discern the purpose of Article III. The 1958 Panel Report on *Italian Discrimination against Imported Agricultural Machinery* provided that "it was considered . . . that the intention of the drafters of the [General] Agreement was clearly to treat the imported products in the same way as the like domestic products once they had been cleared through customs; otherwise, *indirect protection* could be given (emphasis added)."[112] Thus, the focus of Article III prohibition has been on indirect protection, which requires an affirmative legislative act. Treating products "in the same way," however, is ambiguous. Frieder Roessler argues that Article III does not require formally equal treatment but only no-less-favorable treatment, which in turn clearly permits contracting parties to treat domestic and imported products differently. His argument is premised on making Article III:4, which uses the language of "treatment no less favorable," the core national treatment provision that embodies the principles of national treatment.[113]

The question that follows is how should protectionism—manifested as treatment that is not "no-less-favorable"—be measured? Two standards have been considered in GATT practice: the treatment is less favorable if it has an *economic impact* that is less favorable, or, alternately, the treatment is less favorable if it accords *competitive opportunities* that are less favorable.[114] The trade effects (i.e., economic impact), criterion has been consistently rejected by the GATT Contracting Parties since the 1949 Report of the Working Party on

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parties, primarily for the purpose of ensuring that the reasonable expectation of competitive benefits accruing under tariff concessions would not be nullified. 1987 Alcoholic Beverages Panel, *supra* note 15, at ¶ 5.5(b). Later, the appellate body explicitly downplayed the issue of protecting tariff concessions, stating that the obligation of Article III also extends to products not bound under Article II. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 240. It also stated that the purpose and object of Article III:2 is to promote non-discriminatory competition among imported and like domestic products. *Id.* at 241. It supported this position by examining the application of Article III:2, first sentence, based on two questions, the first being an indeterminate "like product" analysis and the second being a determination of whether the differential imposed on imported products was "in excess of" that imposed on domestic goods. The determination of "in excess of" indicates that any discriminatory effect that burdens imports constitutes a violation.

112. GATT Dispute Panel Report—Italian Discrimination Against Imported Agricultural Machinery L/833, 7S/60, 63-64, ¶ 11 (October 23, 1958).

113. Roessler, *supra* note 95, at 26.

114. *Id.*

Brazilian Internal Taxes.[115] The rationale for this rejection was given in the 1987 Panel Report entitled *United States—Taxes on Petroleum and Certain Imported Substances*, which asserted that Article III:2 obliged contracting parties to establish competitive conditions for imported products in relation to domestic products and protected the contracting parties' expectations under these competitive conditions; it did not protect expectations on export volumes.[116] Essentially, Article III's national treatment obligation requires effective equality of opportunities for imported products in relation to domestic products, not equal-

115. 2 B.I.S.D. 181, ¶ 16 (1952). *See also* Roessler, *supra* note 95, at 27: "The delegate of Brazil submitted the argument that if an internal tax, even though discriminatory, does not operate in a protective manner, the provisions of Article III would not be applicable. He drew attention to the first paragraph of Article III, which prescribes that such taxes should not be applied 'so as to afford protection to domestic production' . . . . The delegate for Brazil . . . suggested that where there were no imports of a given commodity or where imports were small in volume, the provisions of Article III did not apply . . . . [The majority of the working party] argued that the absence of imports from contracting parties during any period of time that might be selected for examination *would not necessarily be an indication that they had no interest in exports of the product affected by the tax*, since their potentialities as exporters, given national treatment, should be taken into account. These members of the working party therefore took the view that the provisions of the first sentence of Article III, paragraph 2, were equally applicable whether imports from other contracting parties were substantial, small or non-existent." (emphasis added).

116. B.I.S.D. 34th Supp. 136, ¶ 5.1.9 (1988), stating:

> An acceptance of the argument that measures which have only an insignificant effect on the volume of exports do not nullify or impair benefits accruing under Article III:2, first sentence, implies that the basic rationale of this provision—the benefit it generates for the contracting parties—is to protect expectations on export volumes. That, however, is not the case. Article III:2, first sentence, obliges contracting parties to establish certain competitive conditions for imported products in relation to domestic products. Unlike some other provisions in the General Agreement, it does not refer to trade effects. The majority of the members of the Working Party on the 'Brazilian Internal Taxes' therefore correctly concluded that the provisions of Article III:2, first sentence, 'were equally applicable, whether imports from other contracting parties were substantial, small or non-existent' (B.I.S.D. Vol. II/185). The Working Party also concluded that 'a contracting party was bound by the provisions of Article III whether or not the contracting party in question had undertaken tariff commitments in respect of the goods concerned' (B.I.S.D. Vol. II/182), in other words, the benefits under Article III accrue independent of whether there is a negotiated expectation of market access or not. Moreover, it is conceivable that a tax consistent with the national treatment principle (for instance, a high but non-discriminatory excise tax) has a more severe impact on the exports of other contracting parties than a tax that violates that principle (for instance a very low but discriminatory tax). The case before the panel illustrates this point: the United States could bring the tax on petroleum in conformity with Article III:2, first sentence, by raising the tax on domestic products, by lowering the tax on imported products or by fixing a new common tax rate for both imported and domestic products. Each of these solutions would have different trade results, and it is therefore logically not possible to determine the difference in trade impact . . . resulting from the non-observance of that provision. For these reasons, Article III:2, first sentence, cannot be interpreted to protect expectations on export volumes; it protects expectations on the competitive relationship between imported and domestic products. A change in the competitive relationship contrary to that provision must consequently be regarded *ipso facto* as a nullification or impairment of benefits accruing under the General Agreement. A demonstration that a measure inconsistent with Article III:2, first sentence, has no or insignificant effects would therefore in the view of the Panel not be a sufficient demonstration that the benefits accruing under that provision had not been nullified or impaired even if such a rebuttal were in principle permitted.

ity of trade.[117] Although this language of effective equality of treatment originally arises out of Article III:4's language of according imports "treatment no less favorable" than that accorded a like domestic product, it is also similar to the obligation in Article III:2.[118] Favor requires favoritism, a conscious act. Hence, the "treatment no less favorable" standard is compatible with a reading of Article III:1 which prohibits regulations motivated by protectionism. Furthermore, since Article III tolerates trade effects that may result in incidental discrimination against imports, its prohibition must be narrower than an outright ban on any discriminatory effect; thus, Article III:1 can be read to only prohibit measures showing protectionist intent.

Having determined that the purpose of Article III is to prevent protectionist-motivated regulations from burdening imports to the advantage of domestic production, a conclusion that the first sentence of Article III:2 should incorporate the terms of Article III:1 does not necessarily follow. While one could correctly assume that Article III:2 cannot be in conflict with Article III:1, it does not follow that the application of Article III:2, first sentence, must include a test based on Article III:1. Thus, the justification for including consideration of protectionist intent must arise from the actual application of the "like" product provision. As discussed earlier, the use of the *Border Tax* criteria without reference to anything more could do mischief to and frustrate the national treatment obligation. This possibility alone is a sufficient reason to incorporate Article III:1 into the reading of the first sentence of Article III:2. Determination of "likeness" according to *Border Tax* criteria defeats the intent and purpose of the first sentence of Article III:2 because it ties the arbitrary evaluation of imported and domestic products to a no-discriminatory effect standard. The no discriminatory effect standard is too harsh and, when combined with a test of "likeness" focused on the products' characteristics, is also too legally arbitrary to uphold the national treatment obligation. Furthermore, there is no inherent reason why two products that are similar under the *Border Tax* criteria should, on account of their identity, receive preferred GATT treatment (e.g. no discriminatory effect allowed), when their cousin "directly competitive or substitutable products" (e.g. shielded from protectionist measures only) does not.

The application of the *Border Tax* criteria leads to absurd and unreasonable results.[119] For example, the use of the criteria could lead to under-inclusiveness. Protectionist measures may be overlooked if too much emphasis is placed on a finding of similarities in the products' characteristics. This, in actual practice, would be unlikely to pose a real problem since there is always the fallback

117. GATT Dispute Panel Report on United States—Section 337 of the Tariff Act of 1930, B.I.S.D. 36th Supp. 345, ¶ 5.11 (1990).

118. *See* Taxes on Petroleum Panel, *supra* note 13, at 158, ¶ 5.10, stating "Article III:2, first sentence, obliges contracting parties to establish certain competitive conditions for imported products in relation to domestic products. Unlike some other provisions in the General Agreement, it does not refer to trade effects."

119. Article 32 of the Vienna Convention on treaty interpretation permits supplementary means of interpretation if interpretation by ordinary meaning of the terms of the treaty under Article 31 leads to "a result which is manifestly absurd or unreasonable." *See* 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 237.

provision of "directly competitive or substitutable" of the second sentence, which should absorb most cases falling outside of the "like" classification. Nevertheless, this fact merely indicates that a finding of "likeness" is really more or less legally insignificant and that the focus should be on competitive relationships.

The real danger, however, is the over-inclusiveness of the category of "like" products, which has the potential for invalidating perfectly legitimate legislation that does not burden trade. What is at stake is the fact that a measure, which is non-protectionist in legislative motive and *de minimis* discriminatory effect, will be found to have violated the national treatment obligation simply because the import and domestic products are similar, e.g. "like," whereas a compatriot measure affecting directly competitive or substitutable products will be found to not be in violation of Article III:2. There is no rationale for the distinction between "like" and "directly competitive or substitutable" other than the text of the article. As such, it is arbitrary. Furthermore, the two-step products test would permit a panel to automatically condemn a non-protective regulation.[120] As a result, the two-part products test would disqualify what are potentially valid and legitimate measures. This would force policy harmonization and encroach on the policy options available to legislators and regulators to an extent unanticipated when GATT was drafted.[121] Therefore, the two-part test would be overly invasive of national sovereignty and hence, practically, politically untenable.

An objection to the above analysis might be that the purpose and effect of a regulatory distinction should not be taken into account in the determination of the likeness of products under Article III. Rather, such a determination should be made in the context of Article XX, which establishes broad exceptions from the obligations under the General Agreement for measures required in the pursuit of policy objectives other than that of affording protection. The European Community in *1996 Alcoholic Beverages Panel* argued that examination of the aim of a regulation is relevant *only* under the general exceptions to GATT in Article XX.[122] This approach, however, is too limited. Article XX lists only ten policy goals as justifying measures deviating from the other provisions of the General Agreement, but there are far more legitimate policy goals that can only be attained by distinguishing between different product categories. If one were to examine the purpose of product distinctions only in the context of Article XX, this would severely constrict policy options for WTO Members and therefore hardly be acceptable to them.[123]

120. The European Community recognized that the Malt Beverages Panel was concerned with over-inclusiveness of the two-part products test in that it could be excessively rigid and lead to the automatic condemnation of innocuous regulatory distinctions, but claimed that these concerns were exaggerated because the general exceptions to GATT under Article XX and the notion of dual flexibility which the Community advanced would account for the problem. 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶ 4.38.

121. *See* argument of the United States, *id.* at ¶ 4.26.

122. *Id.* at ¶ 4.22. *See also id.* at ¶¶ 4.13, 4.14, 4.22, 4.37, 4.38, 4.41, 4.44.

123. Roessler, *supra* note 95, at 30.

Nevertheless, the panel in *1996 Alcoholic Beverages* adhered to the notion that Article XX was adequate to protect legitimately discriminatory regulations from invalidation. It did so because it reasoned that the aim-and-effect test would make Article XX redundant or useless since the aim-and-effect test did not contain a definitive list of the grounds to justify departure from the obligations of Article III.[124] This is a reflection of the European Community's concern that the safeguards which buttress the application of Article XX would be absent and that panels would be left without guidance as to what may constitute a "legitimate policy objective."[125] These concerns are unwarranted as they can be easily addressed. Safeguards are in proper procedures.[126] The appellate body could very easily discern procedures which parties to a dispute would consider fair. Under the new system of automatic approval of reports under the WTO, a majority of Member nations would have to dissent from its adoption. This gives the appellate body much more latitude in creating a proper standard of review with procedural safeguards to create a sense of fairness in the proceedings and a sense of legitimacy to its judgments. Instead of taking the initiative, the appellate body has tied its hands by declining to do so.

A major issue concerning the fairness of a determination of regulatory aim is burden of proof. Under the aim-and-effect test, the initial burden of proof would fall on the complainant, who would be required to produce a *prima facie* case that the a measure had both the aim and effect of affording protection to domestic production. Once the complainant had demonstrated that this was the case, then it would be up to the defending party to present evidence to rebut the claim.[127] The panel in *1996 Alcoholic Beverages* repeats this very statement as if it were a self-evident revelation of the injustice of such an approach and an argument against its feasibility.[128] But, of course, it is nothing more than a tautology. The initial burden of proof is merely to prove a *prima facie* case. This amounts to little more than the burden of presentation or the burden of coming forward. Proving a *prima facie* case is not to prove the case itself. Thus, the weight would be on the defending party to show that protectionist aims did not motivate the issuance of the regulation at issue. Besides, when one considers that the United States, as the complainant in *Alcoholic Beverages* cases, did not feel so burdened by such a procedure as to propose it, is indicative of its feasibility and fairness.

If it should be that the appellate body's discussion of the so-called necessity of considering Article III:1 when reading both sentences of Article III:2 has no

124. 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶ 6.17.

125. *Id.* at ¶ 4.41.

126. Procedure creates the belief that the application of the substantive law is done so fairly and that there will be legitimacy for the application of the substantive rule. This would allow for a shift away from the pragmatic negotiated approach to trade law to a more formal legalistic approach to which the WTO aspires. Thus, the false antithesis between legalism and pragmatism can be broken down by recourse to procedures for achieving defined goals. KENNETH DAM, THE GATT: LAW AND THE INTERNATIONAL ECONOMIC ORGANIZATION, 4-5 (1970).

127. *See, e.g.*, argument of the United States in 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶ 4.32.

128. *Id.* at ¶ 6.17.

effect in the actual application of the first sentence of Article III:2, why does the appellate body overturn the lower panel's report on this point? In the some nine years after the original *Alcoholic Beverages* panel decision, two other panels have addressed the "like product" issue of Article III in detail.[129] It is possible that the appellate body is responding to the approach to Article III found in *Malt Beverages* and *Taxes on Automobiles*. However, the appellate body appears to have misunderstood what is at stake in the holdings of these two panels. These two panels found that a reading of the first sentence of Article III:2, which banned all discriminatory treatment, impossibly harsh and they argued that the sentence must permit national governments to discriminate against imports if there was a valid purpose to the regulation. The panel scoped out a broad area for valid purpose, essentially anything that was *not* "to afford protection to domestic protection." Thus, this sounds like a ban on national measures that are protectionist in nature. *Taxes on Automobiles*, going much further in rejecting the two-part test than *Malt Beverages* did, spelled out an alternative test. This test is the aim-and-effect test, where a tax measure will be found to be in contravention of the first sentence of Article III:2 if it (1) does not have trade neutral effects, and (2) has a protectionist aim (note that the order of the actual test is the reverse of the order of the terms in the name of the test).[130] As a result, the declaration of a finding of "like product" is no more than a conclusory statement that the first sentence Article III:2 has been violated.

This conclusion may be viewed in another way. The "likeness" of two products is not a function of everyday perception. Instead, the perception of "likeness" must consciously account for the required perspective. In the case of Article III, the required perspective is prescribed by Article III:1 which declares that domestic taxes and regulations should not be applied "so as to afford protection to domestic production." The term "so as to" suggests that both the intent and the effect of the regulation or tax are relevant. In determining whether two products are alike, the central issue thus is whether the product categories under which they fall have been distinguished with the intent and the effect of affording protection.[131] Thus, the focus of any Article III examination should be on the regulation or tax itself and not on the products affected, and hence the proper test is the aim-and-effect test.

C. Issues in Distinguishing Legitimate Discrimination from Invalid Protectionism

A significant point in the application of the aim-and-effect test is the issue of proof itself. The panel in *1996 Alcoholic Beverages* focused on problems in discerning the aim of a regulation, which it claims sometimes can be indiscernible. It also raised the issue of the complainant's ability to access legislative

129. *See* Malt Beverages Panel, *supra* note 26, and Taxes on Automobiles Panel, *supra* note 36.

130. This test may be better termed as the "effect-and-aim" test, since it requires a finding of trade non-neutral effect before moving on to an inquiry into protectionist aim (since the reverse would make the determination of trade neutrality moot).

131. *See* Roessler, *supra* note 95, at 29.

materials and the ambiguity in determining which legislative materials in each particular country would be primarily determinant of the aims of the legislation.[132] Certainly, the determination of the proper means of proving the aim of a regulation needs to be clarified, but it need not be an obstacle to the adoption of the aim-and-effect test.

While it is beyond the scope of this Comment to extensively discuss how panels should in practice discern legitimate discrimination from impermissible protection of domestic production, I would like to raise a few points for consideration. Roessler makes the distinction between policies that discriminate between domestic and foreign products and policies that merely discriminate between different categories of products without taking into account their origin. He refers to the former as "trade policies," which the General Agreement is meant to constrain, and the latter as "domestic policies," which is beyond the scope of the General Agreement and belongs exclusively to the WTO Members' governments.[133] Our focus, then, is on how to discern trade policies, which the WTO can invalidate, from domestic policies, which are outside the WTO's jurisdiction. In other words, we need to find a standard for legally establishing protectionist aim in a regulation.

The United States proposed something of a test in its submission before the Panel in *1996 Alcoholic Beverages*. It can be broken down as such:

> (1) look at the stated policy objectives for the tax or legislative measure in question, the statements by the legislators, preparatory work and the wording of the legislation as a whole;
>
> (2) look at the treatment of the products on either side of the regulatory distinction drawn, and whether it was known at the time the legislation was enacted that it would draw a line between one group of products that would be foreign and another group that would be domestic; and
>
> (3) and examine the incentives created by the legislation, and whether these incentives would lead to a result consistent with the stated policy behind the legislation or a change in competitive opportunities that favor domestic products.[134]

The question boils down to whether the legislation or regulation appeared arbitrary or contrived in the context of the stated policies pursued.[135] These considerations are a good start, but other issues still loom.

Some commentators have analogized the role of the panel in finding protectionist aim to the U.S. Supreme Court's role in dormant commerce clause cases.[136] The U.S. Supreme Court has a well-developed doctrine for assessing whether a State regulation is impermissibly protective of local production in a manner that violates free interstate commerce. This analogy, while a useful

132. 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶ 6.16.
133. Roessler, *supra* note 95, at 21.
134. *See* 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶¶ 4.17, 4.30.
135. *Id.* at ¶ 4.30.
136. Snelson, *supra* note 37, at 491.

starting place, is only of limited help because the Constitution organizes a federation under a sovereign power with supreme authority over the States on issues of trans-border trade. This is not the case with the WTO and its Members. The WTO is still a voluntary organization, and while the Uruguay Round has made WTO significantly more legalistic in its approach to Members states' policies than was the case under GATT, the Member states retain their sovereign power and hence will tolerate only so much interference in their domestic policy-making.

The particularities of international trade law require one to appreciate the fact that international trade is largely a matter of domestic politics, because trade flows originate in domestic price structures, which depend upon the organization of production and government policies in individual countries. Production and policy, in turn, depend on political choices both past and present.[137] Societies may differ radically in the way they organize trade, such as Western market-oriented economies compared to Eastern command-oriented economies. Hence, trade between such societies will inevitably be limited since each society prefers to trade on the basis of their own societal structure.[138] However, such preferences cannot be viewed as inherently protectionist.

Determining protectionist intent is complicated by the requirement of complex institutional analysis. Each nation has a different set of government actors involved in trade policymaking. The lead agency on trade policy varies significantly across countries. Except in the United States, legislatures play only a modest role in trade policy-making decisions. Furthermore, issues of the degree of centralization of trade policymaking also affect the analysis. Also at issue is whether the process is predictable and transparent or *ad hoc* and arbitrary. There are also issues of organizational links between political leadership and bureaucratic interests, trade and finance agencies, and trade and domestic budget agencies.[139] The need for research and study into this area of establishing the proper standards for evaluating regulatory aim is indeed extensive.

D. The Relationship Between the First and Second Sentences of Article III:2—Is There a Difference Between Being "Like" and "Directly Competitive or Substitutable"?

Supporters of the two-step products test have assailed the aim-and-effect test for not strictly adhering to the text of Article III. Specifically, the *1996 Alcoholic Beverages Panel* has argued that the first and second sentences of Article III must be distinguished on the grounds that (1) the first sentence makes no reference to Article III:1 whereas the second sentence does, and (2) the first sentence concerns "like" products whereas the second sentence concerns "directly competitive or substitutable" products. The panel assumes that these two are interrelated such that the existence of one distinction proves the necessity of

137. HENRY R. NAU, ED., DOMESTIC TRADE POLICIES AND THE URUGUAY ROUND xiii (1989).
138. *Id.*
139. *Id.* at 6-7.

the other. Such a facile assumption itself does not prove the necessity of maintaining the distinction.

The only case in which "like" products are appropriately distinguished from "directly competitive or substitutable" products is when two products are (1) accorded different treatment on account of their respective classification, and (2) the difference in their classification goes to some purpose in support of the national treatment obligation. However, this is not the case. The two *Alcoholic Beverages* panels interpreted Article III:2 to require that "like" products be treated under a discrimination standard whereas "directly competitive or substitutable" products be treated under a protectionist motive standard. The panel in *1996 Alcoholic Beverages* assumed that the first sentence excluded reference to protective motivation, and hence consideration of Article III:1 was irrelevant.[140] Yet the appellate body held that the first sentence of Article III:2 was an application of the requirements of the purpose of the national treatment obligation as embodied in Article III:1.[141] These are very different ways of reading the first sentence of Article III:2, but because the appellate body has ruled on the issue, we can dismiss the reasoning of the panel below. As discussed above, the distinction between "like" and "directly competitive or substitutable" products is a consequence of the awkward way in which the article was drafted. If both the first and second sentences must account for protectionist effect, then the legal necessity of a distinction between "like" and "directly competitive or substitutable" products collapses. Recall that we have seen that Article III:1 does not permit the invalidation of national regulation based on mere discriminatory effect absent a finding of protectionist motive. As Article III:2 in its entirety falls within the scope of Article III:1, the need for a distinction between "like" and "directly competitive or substitutable" dissolves as they both serve the same end of identifying protectionist national measures.

The appellate body in *Alcoholic Beverages* discussed the rules for treaty interpretation. Citing Article 31 of the Vienna Convention, it adopted the rule that the General Agreement should be interpreted in accordance with the ordinary meaning of the terms in their context and in light of the treaty's object and purpose.[142] Because Article III:2 of the General Agreement includes separate provisions for "like" products and "directly competitive or substitutable" products, it appears that making the terms functionally synonymous under the above analysis may contradict the requirements of the Convention. However, the above analysis also indicates that a reading according to the explicit terms of Article III:2 would contravene the object and the purpose of the national treatment obligation. It would also lead to the unreasonable and absurd result of being over-inclusive, thereby invalidating legitimate domestic policies.[143]

140. 1996 Alcoholic Beverages Panel, *supra* note 49, at ¶ 6.16.

141. 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at part H(1), 241.

142. *Id.* at part D, 237.

143. Vienna Convention, Article 32, permits recourse to supplementary means of interpretation when interpretation according to Article 31 "leads to a result which is manifestly absurd or unreasonable." *See* 1996 Alcoholic Beverages Appellate Body, *supra* note 8, at 237.

In addition, the literal wording of the provisions of the General Agreement may not facilitate the intended ends of the Agreement. Some commentators have noted that the rules of GATT tend to fail to take account of the teachings of economic theory because most of the significant theoretical international trade work did not appear in technical economic literature until the 1950s and did not appear in popular discussion of international economic problems until even later.[144] Thus, it is very possible that the explicit terms of the General Agreement may not be the best way to achieve the goal of liberalizing international trade. Hence, the fact that this analysis equivocates "like" products and "directly competitive or substitutable" products should not be a serious argument against its adoption.

III.
CONCLUSION: A "LIKE" PRODUCT TEST THAT MAKES SENSE

The WTO's appellate body has unfortunately reversed the promising trend of greater flexibility in interpreting Article III and has affirmed the literalist approach to the reading of the provision. The literalist approach fails on several counts. It fails by requiring a comparison of the imported and domestically produced products which, at best, is irrelevant to and, more likely, frustrates the national treatment obligation. Instead, the proper test needs to account for the purpose of Article III's national treatment obligation.

By looking at the characteristics of the products, this first step of the two-step product test advocated by the literalist approach does not, and in fact cannot, consider the purpose of Article III. That inquiry is either reserved for the second step of the test, if that step applies at all. As the purpose of Article III does not guide the application of the first step, the panels have thought that it is the *Border Tax* criteria which does. However, we have seen that the *Border Tax* criteria are both unclear and potentially harmful to the national treatment obligation. In other words, the *Border Tax* criteria could possibly contravene the purpose of Article III. A better approach is to consider the purpose of Article III in the application of *all* of its provisions. To do so, it is necessary to eliminate the first step of comparing the imported and domestically produced products as objects. Instead, the regulations which define the products must be compared. Such an evaluation would involve an examination of the aim and the effect of the regulation, with the prohibited aim being the primary determination. The aim that is prohibited must be of improper motive under the national treatment obligation. Because the obligation does not prohibit discrimination between products for legitimate reasons, the scope of improper aim is limited to protectionist aims.

While such a test is more difficult to administer than the test proposed by the *Alcoholic Beverages* reports, it is ultimately fairer. If the WTO wishes to maintain its legitimacy and the good graces of its Membership, it should strive for the fairest proceedings possible.

144. DAM, *supra* note 126, at 5-6.

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Living with the IMF: A New Approach to Corporate Governance and Regulation of Financial Institutions in Korea

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INTRODUCTION

Improving corporate governance is not easy, particularly for newly industrialized economies. Policymakers in such economies have little experience in controlling such problems as shirking and greed when they appear in the sophisticated organizational form of the modern corporation. As a result, they must turn to the more advanced economies to find a role model for institutional reforms and improvements. Comparative corporate governance is an important area of study in this regard.

A recent study on comparative corporate governance noted that "[n]ational governance systems turned out to be more adaptable in function, and therefore more persistent in form, than the prophets of convergence expected."[1] This study also suggested that formal convergence should come as a last resort due to the substantial political and social costs involved.[2] This view delivers important messages to scholars and policy-makers of some newly industrialized countries who are struggling with corporate governance issues in order to improve the

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1. Gilson, Globalizing Corporate Governance: Convergence of Form or Function 3-4 (discussion paper for the *Symposium on Globalization and Law for the Twentieth Century*, sponsored by Seoul National University College of Law, October 10-11th, 1997) [hereinafter Gilson, Globalizing Corporate Governance].

2. *Id.* at 7.

competitiveness of their countries' enterprises in global markets.[3] In their efforts to find an optimal structural relationship between capital markets, financial institutions, and corporate governance, they must be aware of the political and social costs involved in radical institutional reforms that go beyond the path-dependent limit of their institutions. The functional approach to corporate governance issues should come first in those economies as elsewhere.

Korea, one of the most dynamic economies of the global market, should benefit from this reasoning. Korea has recently recognized the importance of the systematic improvement of its industrial organization and corporate governance practices. The globalization of Korean firms' operational and financing activities and the internationalization of its capital markets have initiated, and even greatly contributed to, recent efforts toward various reforms and reform proposals. The process of reform was hastened by the foreign exchange crisis of 1997 and the consequential involvement of the international lending agencies such as the International Monetary Fund (IMF) and the World Bank in the restructuring of Korean industries.

In this article, I will discuss the current system and developments in corporate governance in Korea and address important lessons Korea has derived from recent studies on comparative corporate governance. The issue of corporate governance of banks is given particular attention in view of the recent failures of some large Korean conglomerates and the consequential negative impact on major Korean banks.

Part I describes the traditional "Korean institution" and its problems, singling out the so-called *Chaebol*-question and representative issues of corporate governance in Korea. Recent developments in Korean markets in terms of industrial restructuring under the IMF-mandated plan are also described. Part II explains and analyzes various corporate governance mechanisms newly introduced in Korea, focusing in particular on the Korean efforts to cultivate markets for corporate control. Part III tackles the important issue of corporate governance of banks and banks' participatory investments in Korea. Part IV explores the relationship between market internationalization and globalization of financing and corporate governance with reference to the case of Korean firms. This section also describes and analyzes the influence of international regulation of financial institutions on the governance of local banks and the new role of institutional investors in the Korean market.

This article is intended to be something more than a case study. One point made throughout this article is that the internationalization of capital markets, both inbound and outbound, will greatly improve corporate governance in Korea and elsewhere. Prudential regulations, as well as active transactions in interna-

3. For efforts in emerging market economies, *see* Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911 (1996) (developing a "self-enforcing" model of corporate law for emerging markets based on a case study of the Russian Federation). *But cf.* Roberta Romano, *A Cautionary Note on Drawing Lessons from Comparative Corporate Law*, 102 YALE L. J. 2021, 2036 (1993) (noting that "no tight connection [can] be demonstrated between corporate governance institutions and international competitiveness").

tional financial markets, have strongly promoted the functional convergence of corporate governance institutions.[4] The involvement of international lending agencies in the industrial restructuring process of the Korean economy has subjected Korean firms and banks to the harsh, but fair, discipline of international financial markets. The converging process of Korean corporate governance institutions into international standards is mandated by the discipline of international financial markets. By identifying the main trends and perspectives of this convergence, Korean policy-makers may have a better idea of the way they want to lead the Korean economy in the future.

I.
PROBLEMS WITH THE "TRADITIONAL" INSTITUTION

A. The Korean Institution

The traditional corporate governance institution in Korea is characterized by large groupings of related corporations under highly concentrated family or individual control and a unique pattern of unrelated diversification.[5] In terms of finance, Korean firms are highly leveraged but do not have the harsh discipline normally associated with debt.[6] Authoritarian military governments began building Korea's economic system since the 1960s and have traditionally favored big businesses through the provision of immense bank loans ("directed lending"). The Korean populace tolerated the *Chaebol*'s rise in the belief that they greatly contributed to the competitiveness of the Korean economy in global markets.[7]

The *Chaebol,* however, cannot necessarily be understood as a pattern of corporate governance. Rather, the term *Chaebol* describes a concentration of economic power and a pattern of doing business through unrelated diversifica-

4. Similarly, in one of my previous studies, I suggested that market internationalization and new financial institutions' regulations of the European Union may change the traditional governance pattern and ownership structure of German corporations, roughly towards the one prevailing in the United States. *See* Hwa-Jin Kim, *Markets, Financial Institutions, and Corporate Governance: Perspectives from Germany*, 26 LAW & POL'Y INT'L BUS. 371, 394-99 (1995). *Cf.* Curtis J. Milhaupt, *Property Rights in Firms*, 84 VA. L. REV. 1145, 1185-89 (1998) (suggesting that the recent developments in Korea in terms of the currency and debt crisis support the convergence-from-competition hypothesis).

5. The Korean economy and corporate governance institutions are path dependent and are extremely sensitive to initial conditions set in the 1960s. For the concept of path dependency, see Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641 (1996). The path dependency of the Korean system takes the common semi-strong form. *Cf. id.* at 648-50. Recent scholarship emphasizes the importance of path dependence in determining the ownership structure of large public companies and corporate law in general. *See id.* at 643-58; Black and Kraakman, *supra* note 3, at 1974-77; MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE *passim* (1994).

6. For an excellent account of the disciplinary effects of high leverage on corporate management, *see generally* GEORGE ANDERS, MERCHANTS OF DEBT, chs. 8-9 (1992).

7. *See generally* Kon Sik Kim, Chaebol and Corporate Governance in Korea, ch.1 (University of Washington Dissertation 1995) [hereinafter KS Kim, Chaebol and Corporate Governance]; MYUNG HUN KANG, THE KOREAN BUSINESS CONGLOMERATE: CHAEBOL THEN AND NOW (1996). *See also* Meredith Woo-Cumings, *How Industrial Policy Caused South Korea's Collapse*, WALL ST. J. EUROPE, Dec. 9, 1997, at 8.

tion. The traditional Korean system can be classified as a bank-centered capital market system in which the banks lack ownership of the commercial enterprises. Most of these enterprises, even those ranked in the Fortune International 500, such as Samsung or Hyundai, are family-controlled. According to the then Korean Securities Supervisory Board, the listed Korean firms' major shareholders had an average shareholding of 33.31 percent as of the end of October 1997.[8] It has recently been reported that out of 769 listed Korean corporations, some 380 are directly controlled by their major shareholders as full-time directors.[9] These enterprises are also highly leveraged. Banks and other financial institutions have tremendous amounts of credit outstanding with these large enterprises with significant security interest in these firms' assets. Neverthless, banks have been rather indifferent to corporate governance issues, partly because they have been under the government's influence, and partly because they have lacked motives and skills to effectively monitor these enterprises.[10]

As a result, the debt-to-equity ratios of some large Korean firms has become extremely high. The average debt to equity ratio of the 30 largest Korean conglomerates accounted for 519 percent of their shareholders' equity by the end of 1997.[11] Hanbo Steel's peak of 1,893 percent in June 1996, Sammi Steel's peak of 1,762 percent in December 1996, and Woosung Construction's peak of 3,323 percent in June 1997 are the most conspicuous examples. Such unusually high debt-to-equity ratios have been made possible through the widespread practice of "cross guarantees" between member firms within corporate groups.[12] The volume of cross guarantees within the 30 largest Korean conglomerates reached 469 percent of their shareholders' equity by April 1, 1993. The ratio decreased to 91.34 percent by April 1, 1997,[13] but this decrease was due largely to the bankruptcy of two large Korean conglomerates, Halla and Jinro, in 1997.

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8. *See* KOREA HERALD, Nov. 13, 1997, at 11.

9. *See* JOONG-ANG ILBO, Sept. 23, 1997, at 35.

10. Although Japanese firms have long been role models for Korean *Chaebols*, the Korean system differs significantly from the Japanese in terms of commercial banks' ownership interest in and effective monitoring of borrower companies. Some view the Korean system as similar to that of the Japanese. *See, e.g.*, Alan Murray, *Asia's Financial Pain Makes U.S. System Look Like a Winner*, WALL ST. J. EUROPE, Dec. 9, 1997, at 1, 7 (arguing that the American system, with its emphasis on the short-term and shareholder activism, is doing far better than the Japanese one with long-term relationships of cross-shareholdings and preferential bank financing). *But see* Milhaupt, *supra* note 4, at 1158-84 (showing non-convergence of corporate governance systems in the United States, Japan and Korea). For the Japanese institution, see Curtis J. Milhaupt, *A Relational Theory of Japanese Corporate Governance: Contract, Culture, and the Rule of Law*, 37 HARV. INT'L L. J. 3 (1996); Ronald J. Gilson and Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L. J. 871 (1993); Kang, *supra* note 7, at 63-91; Masahiko Aoki, *Toward an Economic Model of the Japanese Firm*, 28 J. ECON. LIT. 1 (1990); J. Mark Ramseyer, *Takeovers in Japan: Opportunism, Ideology and Corporate Control*, 35 UCLA L. REV. 1 (1987). *See also* Mark G. Robilotti, *Codetermination, Stakeholder Rights, and Hostile Takeovers: A Reevaluation of the Evidence from Abroad*, 38 HARV. INT'L L. J. 536 (1997) (critically analyzing the stakeholder corporate governance debate in comparative perspectives).

11. *See* CHOSUN ILBO, April 16, 1998, at 3.

12. *See* Steve Glain and Namju Cho, *Chaebols Gasp Under Suffocating Debt*, ASIAN WALL ST. J., Dec. 23, 1997, at 1, 7 (reporting severe credit crunch of large Korean firms).

13. *See infra* p. 93 (Table 1).

These two conglomerates went into bankruptcy with cross guarantees of 891 percent and 473 percent of shareholders' equity, respectively.

As some large *Chaebols* (Hanbo, Sammi, Jinro, Dainong, Kia, New Core, Haitai, and Halla) went into bankruptcy in 1997, Korean banks lost credit in the market due to their bad loans to the failed firms. Korean commercial banks and merchant banks were saddled with 28.52 trillion won and 3.89 trillion won, respectively, in non-performing loans by October 1997.[14] The result was general skepticism about the soundness of the Korean market and system. The international financial community soon realized that the Korean economy had serious structural problems and that the government had not taken leadership in regulatory reforms.[15] As a result, foreign investors quickly withdrew from the Korean market and the Korean currency fell in international financial markets.[16] The stock market index also declined to a ten-year low. During the turmoil of 1997, the number of insolvent firms placed under the supervision of the Korea Stock Exchange reached seventy-two, representing ten percent of all listed firms. As the Korean government's emergency package for market-boosting financial stabilization measures, including the kick-off plan of Big Bang failed to satisfy markets, Korea ultimately applied for the bailout funds with the IMF on November 21, 1997, one year after joining the OECD. Korea was then forced to restructure its financial industry and industrial organization under the guidance of the IMF.[17]

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14. *See Gov't to Allow Wider Won Price Swing*, KOREA HERALD, Nov. 20, 1997, at 1. As of the end of December 1998, total non-performing loans (loans classified as either substandard, doubtful or estimated loss), of 22 Korean commercial banks stood at 22.22 trillion won. *See* Korea Financial Supervisory Commission, *Bank Nonperforming Loans at End-December, 1998* (visited March 5, 1999) <http://www.fsc.go.kr/kfsc/board/11/pr_0303.html>.

15. *See Korean Leadership*, WALL ST. J. EUROPE, Nov. 25, 1997, at 10 (noting that the *Chaebols* are "a drag on the economy" and the Korean developmental model is "hopelessly outdated and outclassed by market forces").

16. *See* HAL S. SCOTT & PHILIP A. WELLONS, INTERNATIONAL FINANCE: TRANSACTIONS, POLICY, AND REGULATION 32-36 (5th ed. 1998).

17. *See* Mark L. Clifford, *Korea's Crisis*, BUS. WK. (Asian Edition), Nov. 24, 1997, at 18-21; Michael Hirsh, Jeffrey Bartholet and Lee Pyongchong, *Seoul Calls for Help*, NEWSWEEK, Dec. 1, 1997, at 34-37; *Seoul, IMF Agree on $55-bil. Bailout Deal*, KOREA HERALD, Dec. 4, 1997, at 1; Bob Davis, *Bitter Medicine: Korea Plays Adverse Patient to IMF's Rescue Team*, ASIAN WALL ST. J., March 3, 1998, at 1, 9. Even after the IMF bailout, Korea careened toward the catastrophe of a default. The near-bankrupt Korean economy was finally rescued by G-7 countries' decision of December 24, 1997, for advancement of the bailout package. *See* Paul Blustein & Clay Chandler, *Behind Korean Bailout*, KOREA HERALD [Washington Post Service], Dec. 30, 1997, at 6 (reporting that there had been talk [in Washington] of letting Korea fail and "pay the price for years of economic mismanagement"); David Wessel, *South Korean Bailout Evokes Some Tough Questions*, ASIAN WALL ST. J., Dec. 29, 1997, at 6 (citing some hard-liners who say world governments and the IMF are making a big mistake by insulating private investors and lenders from the discipline of the market); Michael Duffy, *The Rubin Rescue*, TIME, Jan. 12, 1998, at 12-15. Korea's total foreign debts were tallied at $156.9 billion at the end of November 1997. *See Korea's Foreign Debts Total $156.9 Bil. by IMF Standards*, KOREA HERALD, Dec. 31, 1997, at 1. Most of the country's short-term corporate foreign debts were restructured in January 1998. *See* Stephen E. Frank & Namju Cho, *Korea, Creditors Finalize Debt-Restructuring Deal*, ASIAN WALL ST. J., January 30-31, 1998, at 3.

B. Inordinate Efforts to Change Complimentary Institutions?

Even before the advent of this recent turmoil, Korean policy-makers and scholars believed that their system was relatively inefficient in comparison to those of the United States, Germany, or Japan. Korean scholars, particularly, increasingly believed that the existing Korean model could no longer effectively compete in the global market. Consequently, the Korean government's initiative towards dilution of the ownership concentration,[18] particularly in large firms, has been strongly supported by public opinion. The Berle-Means corporation, with separated ownership and control, has long been a superior ideal in the minds of the Korean public. It is widely believed that professional managers, not being the "owners,"[19] would be able to rationalize outbound corporate relationships with the government, financial institutions, securities markets and internal reform operations without a heavy conflict of interest. Furthermore, Korean law does not allow dual class voting.[20] By now, it appears that there is a consensus that the U.S. system, with its dispersed ownership structure and efficient securities market, should be imported to rationalize the Korean system. The IMF-mandated reforms will support such developments.

However, it is questionable if this is the most efficient way to achieve rationalization, especially in view of recent trends in the United States to bridge ownership and control of public companies in order to diminish agency costs. This course of action could also be tainted by the common emotional drive for "*Chaebol*-bashing."[21] Perhaps too much emphasis has been placed on institutional changes regarding ownership structure and structural relationships between capital markets and business corporations. The basic Korean approach has been to adapt the institution to fit a fixed political or social goal, no matter what the political or social costs. In such an environment, there is not much

18. In order to reduce the burden of servicing high-interest bearing debts, Korean firms will continuously have to increase capital. This will lead to dilution of ownership concentration and ultimately promote the separation of ownership and control. Since the cost of capital of Korean shareholders will continue to be very high because of high interest rates, new capital injections are likely to come from foreign investors.

19. This widely used term is a misnomer. No one can claim to be the owner of a public corporation unless he or she holds a 100 percent sharehold of the firm, which is not possible. Otherwise, he or she can just control the firm, identifying personal interest with that of the company in most cases. However, the agency problem still exists in view of the non-controlling shareholders' interest especially when the controlling shareholder holds less than 50 percent. In Korea, substantial agency costs already exist in such cases where the controlling shareholder-manager mismanages the firm and/or causes wealth transfer from non-controlling shareholders to himself/herself. In the latter case, the cost will be borne by non-controlling shareholders only, the controlling shareholder excluded. The term "owner" is not only a misnomer, but also contributes to distortion of reality.

20. The Korean Commercial Code accepts the one share, one vote principle. *See* Art. 369(1).

21. It should be noted that there is a widespread confusion in Korea of general corporate governance issues with the so-called "*Chaebol*-question." To be sure, the latter should be understood in terms of the unique path dependency of the Korean institution. However, the issue is better approached through the sound reasoning against concentration of economic power. It would be unfair to declare that the *Chaebols* are the source of all failures in the Korean model. Transparency and accountability of corporate management are standards applicable to any corporation in Korea. On the other hand, it would be also unfair to apply the fundamentals of the "*Chaebol*-policy" to medium or small firms. Some of the newly introduced rules in the Korean Securities and Exchange Act exemplify the confusion of the above two conceptually distinct issues.

room left for reform through functional improvements of the existing regime, whether it be political or industrial.

C. *Who Replaces Poorly Performing Managers?*

Will Korea be able to find a functional solution to this central question of corporate governance[22] within its path dependent limits? Although it has tried to change the ownership structure of firms through a rather formal approach, it also has tried to respond to managerial accountability problems through a functional approach. The recent general revision of the *Commercial Code* and *Securities and Exchange Act* described below evidences this. However, the point of these revisions was the protection of minority investors, not a systematic remaking of the corporate governance institution. The latter was only recently identified as an important goal since the latest involvement of the international lending agencies in reforms of the Korean economy.

Indeed, there has been no entity which has been able to replace the poorly performing managers in Korea. The managers themselves are major controlling shareholders. In most cases, Korean corporate boards are nominal organizations under direct control of these controlling shareholders. The troubling question here is: who controls the controlling shareholder-managers of Korean firms?[23] Although Korean law recognizes the concept of managers' fiduciary duty of loyalty, it falls short of the standards set in American corporate law. Derivative litigation has existed only in statute[24] until recently,[25] and its deterrence and disciplining influence will probably be nonexistent because of the absence of class action and contingency fee devices.[26] Recent developments indicate that it

22. For a good overview of mechanisms to replace inefficient management, *see* Park McGinty, *Replacing Hostile Takeovers*, 144 U. PA L. REV. 983, 990-99 (1996).

23. Here we come back to the question raised by Alchian and Demsetz: "[W]ho will monitor the monitor?" Armen Alchian and Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 782 (1972). *See also* Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 835 n. 61 (1981).

24. *See* Arts. 403-406 of the KOREAN COMMERCIAL CODE. Under Art. 403(1) of the COMMERCIAL CODE, shareholders holding 1 percent (previously 5 percent under the pre-1998 version law) of the company's issued and outstanding shares may file a derivative suit. The amount of reimbursed attorneys fees for a successful shareholder is subject to certain limits ruled by the Supreme Court. *See* Art. 99-2 of the KOREAN CODE OF CIVIL PROCEDURE.

25. The recent turmoil in the financial market has resulted in few derivative lawsuits in Korea. Further, the new practice in Japan is expected to influence the recent insurgence of derivative litigation in Korea. In Japan, shareholders derivative litigation is gaining importance in corporate governance of Japanese firms. *See* Shiro Kawashima & Susumu Sakurai, *Shareholder Derivative Litigation in Japan: Law, Practice, and Suggested Reforms*, 33 STAN. J. INT'L L. 9 (1997); Milhaupt, *supra* note 4, at 55-57.

26. For skeptical views on the benefits of derivative litigation, *see* Roberta Romano, *The Shareholder Suit: Litigation without Foundation?*, 7 J. L. ECON. & ORG. 55, 84 (1991) (finding little empirical evidence of specific deterrence and concluding that "shareholder litigation is a weak, if not ineffective, instrument of corporate governance"); Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261 (1986) (casting doubt on the assumption that liability rules enforced by derivative suits play a fundamental role in aligning the interests of managers and investors). For the mixed data on the effect of changes in laws concerning derivative suits, see Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA

may be the banks' role to demand accountability from management. However, Korean banks, deep in trouble themselves, have a strong voice only in those cases where their debtor firms face fatal financial failure. Would they also be active in "peace time"?

It is widely believed in Korea that the solution should be found in an active market for corporate control and with institutional investors' enhanced activism. The internationalization of the Korean capital markets, either by voluntary efforts or by the IMF-mandated plans,[27] will contribute to the shaping of the new regime. For now, Korea has decided to model its capital markets after the American system. As far as the capital market is concerned in the Korean economy, adapting to the U.S. system would not require radical institutional changes. For example, Korean efforts to seek strong venture capital markets with the opening of the Korea Securities Dealers Automated Quotation System (KOSDAQ) may be a good test for a successful adaptation.

D. Remaking of the Korean Institution Under the IMF-Mandated Plan

Immediately after its decision to seek a bailout fund from the IMF, the Korean government started to accelerate the corporate and financial restructuring process. As the IMF was expected to ask for such a restructuring anyway, and the Korean government had long been realizing its inevitability, it came as no great surprise. The *Chaebols* also started paring down businesses.[28] Throughout 1998, many Korean firms and financial institutions went through restructuring, private workouts, strategic alliance talks with foreign firms, and domestic and international mergers and acquisitions transactions.[29] In particu-

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L. REV. 1 (1989); Elliott J. Weiss & Lawrence J. White, *Of Econometrics and Indeterminacy: A Study of Investors' Reactions to "Changes" in Corporate Law*, 75 CAL. L. REV. 551 (1987).

27. For the full text of the Korean government's Letter of Intent with the Memorandum on the Economic Program (hereinafter Korea-IMF Memorandum) submitted to the IMF, see CHOSUN ILBO, Dec. 6, 1997, at 12. For the full text of the second and third packages submitted to the IMF by the Korean government, see JOONG-ANG ILBO, Dec. 26, 1997, at 5 and MAEIL KYONGJE, Feb. 18, 1998, at 3, respectively. The implementation of the restructuring plans are coordinated by the Structural Reform Planning Unit created by the Korea Financial Supervisory Commission. For various discussions and opinions on the Korea-IMF deal, see *Korea's IMF Negotiations*, WALL ST. J. EUROPE, Dec. 3, 1997, at 8; Seong C. Gweon, *Why is IMF Bad for the Market?*, KOREA HERALD, Dec. 10, 1997, at 8; Michael Schuman and Namju Cho, *Is Korean Bailout the Right Medicine?*, WALL ST. J. EUROPE, Dec. 8, 1997, at 5; Robert J. Fouser, *Antiforeignism*, KOREA HERALD, Dec. 17, 1997, at 6; Editorial, *Hurdles Ahead for South Korea*, N.Y. TIMES, Jan. 2, 1998, at 16; Ajay Kapur, *Bad Medicine from the IMF*, ASIAN WALL ST. J., Jan. 15, 1998, at 6. *See also* George P. Shultz, William E. Simon and Walter B. Wriston, *Who Needs the IMF?*, ASIAN WALL ST. J., Feb. 4, 1998, at 8; David Sacks and Peter Thiel, *The IMF's Big Wealth Transfer*, ASIAN WALL ST. J., March 12, 1998, at 6; Lawrence Summers, *The IMF: Good for Donors Too*, ASIAN WALL ST. J., March 30, 1998, at 10; *What's an IMF For?*, ASIAN WALL ST. J., April 7, 1998, at 10; *The IMF Crisis*, ASIAN WALL ST. J., April 16, 1998, at 8; David Rockefeller, *Why We Need the IMF*, WALL ST. J. EUROPE, May 11, 1998, at 10.

28. *See* Michael Schuman, *Ssangyong's Restructuring Gives It a Fighting Chance*, ASIAN WALL ST. J., Dec. 29, 1997, at 1, 5.

29. Ninety-three merger cases among listed Korean firms have been reported in 1998. *See* MAEIL KYONGJE, Dec. 30, 1998, at 19. The following web sites provide useful data and information on recent developments in Korea in terms of industrial and corporate restructuring: *The Korea Financial Supervisory Commission* <http://www.fsc.go.kr>; *The Korea Fair Trade Commission* <http://www.ftc.go.kr>; *The Korean Ministry of Finance and Economy* <http://www.mofe.go.kr>;

lar, Korea's five largest *Chaebols* have tried to agree on so-called "Big Deals," the exchange or consolidation of big businesses under the government's guidance.[30]

Because it was believed that the Korean financial crisis was started in part by the loss of foreign investors' confidence in the governance of large Korean corporations and banks,[31] the Korean government has started to focus on this aspect and review the regulatory infrastructure again for possible reform as agreed with the IMF. As it is also widely believed that the inefficient governance of large companies and banks are one of the sources of the troubles Korea now faces,[32] various reforms in terms of industrial policy and corporate governance have been planned and are expected to be implemented.

The package developed by the IMF in consultation with the Korean government includes several measures for improving of governance institutions of Korean firms.[33] According to the Korea-IMF Memorandum ("the Memorandum"), the Korean government recognized "the need to improve corporate governance and the corporate structure."[34] Toward that end, the Korean government and the IMF agreed that: "transparency of corporate balance sheets (including profit and loss accounts) will be improved by enforcing accounting standards in line with generally accepted accounting practices, including independent external audits, full disclosure, and provision of consolidated statements for business conglomerates."[35] The Memorandum also provides that

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and the *Korean Ministry of Commerce, Industry and Energy* <http://www.mocie.go.kr>. *Cf.* The Korea Stock Exchange <http://www.kse.or.kr>; Korea Asset Management Corporation <http://www.kamco.or.kr>; Korea Federation of Banks <http://www.kfb.or.kr>; The Korea Securities Dealers Association <http://www.ksda.or.kr>; Korea Investment Trust Companies Association <http://www.kitca.or.kr>; The Federation of Korean Industries <http://www.fki.or.kr>.

30. *See Korea Financial Supervisory Commission, Agreement for the Restructuring of the Top 5 Chaebol, December 7, 1998* (visited March 5, 1999) <http://www.fsc.go.kr/kfsc/board/11/981208-1.html>.

31. *See* HAN-GUK KYONGJE SHINMUN, Nov. 24, 1997, at 3 (analysing possible impacts of IMF bailout); *id.*, Nov. 6, 1997, at 20 (reporting foreign investors' frustration in Korean firms' ignorance of minority shareholder interest and non-transparent management and accounting practices).

32. *See, e.g.*, Tony Emerson & B. J. Lee, *Foreign Medicine*, NEWSWEEK, Dec. 15, 1997, at 41 ("To be fair, Chaebol owners were simply taking advantage of the system . . . . And to raise money by selling stock would have diluted the owners' control over family enterprises. So they borrowed and borrowed, knowing that the larger they got, the less likely the government would ever allow them to fail . . . . By forcing Chaebol to sell majority stockholdings, the IMF deal could not only topple this pyramid [of debt], but eventually the Chaebol owners themselves."); Fred Hu, *Should China Grow Chaebol?*, ASIAN WALL ST. J., Dec. 18, 1997 (Korean lessons to China).

33. The international lending agencies like the IMF and World Bank regularly extend loans with "conditionality". The concept of "conditionality" does not exist in private lending. But it is not very different from security arrangements on loans of the private sector. To be sure, it is understood that the breach of the agreement with an international lending institution does not constitute the violation of international law *per se*. However, any default in implementation of such an agreement will limit further borrowing and lower the country's credit rating, which shall exert far greater detrimental impacts on the economy than any cause of legal action might do. *See generally* HAROLD JAMES, INTERNATIONAL MONETARY COOPERATION SINCE BRETTON WOODS 322-35 (1996); WILLIAM A. MCCLEARY, THE DESIGN AND IMPLEMENTATION OF CONDITIONALITY, in RESTRUCTURING ECONOMIES IN DISTRESS: POLICY REFORM AND THE WORLD BANK 197-215 (Vinod Thomas et al. eds. 1995).

34. *See* Korea-IMF Memorandum, *supra* note 27, at No. 34.

35. *Id.*

"[t]he commercial orientation of bank lending will be fully respected and the government will not intervene in bank management and lending decisions (except for prudential regulations)."[36] Directed lending shall immediately be eliminated.[37] Further, the Korean government shall formulate, with the assistance of international lending agencies, a plan "to encourage the restructuring of corporate finances, including measures to reduce the high debt-to-equity ratio of corporations, develop capital markets to reduce the share of bank financing by corporations, and change the system of cross guarantees within conglomerates."[38] The implementation of this program began in early 1998 and has resulted in substantial regulatory changes.

II.
FUNCTIONAL APPROACHES TO CORPORATE GOVERNANCE ISSUES

A. Recent Statutory Changes

The Korean government's recent efforts towards implementing a new regulatory environment to promote an efficient function of corporate governance mechanisms and an active market for corporate control shows that the functional approach to corporate governance issues is slowly being put into place in Korea. In particular, the *Korean Securities and Exchange Act* (KSEA) and the *Commercial Code* have been amended to reflect the changed circumstances in the capital markets and to reflect Korean firms' new pattern of doing business and methods of financing. The government has also introduced numerous provisions that promote corporate restructuring and mergers and acquisition in Korea. At the same time, the new provisions are designed to protect unsophisticated investors under the changed regulatory environment. Interestingly, the new *Securities and Exchange Act* addresses many of the corporate governance issues that have traditionally been regarded as within the domain of the *Commercial Code*.

1. The New Securities and Exchange Act[39]

The KSEA, effective from April 1, 1997, has substantially improved the status of minority shareholders in listed Korean companies. To promote transparency and managerial accountability, it provides minority shareholders with the right to check and/or challenge management by less restrictive procedural requirements than those provided for in the *Commercial Code*. The requirements have been lessened further through the partial amendments to the KSEA in February and May 1998, as an implementation of the Korean government's

36. *Id.*
37. *Id.*
38. *See id.* at No. 37. To strengthen market discipline, the Korean bankruptcy laws shall be reformed so that their orderly function without government interference will be made possible. *Id.* at No. 35 prohibits "government subsidized support or tax privileges" to bail out individual corporations. The Korean bankruptcy laws have been amended in February 1998 to introduce more strict substantial requirements and facilitate the court proceedings.
39. For an excellent description of the Korean securities market and the (old) SECURITIES AND EXCHANGE ACT, *see* Joon Park, *Internationalization of the Korean Securities Market*, 7 INT'L TAX & BUS. LAW 1 (1989).

agreement with the IMF. Now, shareholders holding less than one percent of a listed company's issued and outstanding shares may exercise certain shareholder's rights, including the filing of a derivative suit, provided that they satisfy some technical requirements.[40] Shareholders holding 0.01% of a listed company's issued and outstanding shares may file a derivative suit, provided that they acquired their shares at least six months prior and maintained the holding continuously until the filing date.[41]

The new system has been widely welcomed by the Korean legal and academic communities. It is regarded as an advanced mechanism for a more balanced relationship between controlling and minority shareholders. Indeed, the institutional reform hastened by the recent economic crisis has initiated new shareholder activism in Korea that is led by a group of highly motivated scholars and lawyers. The advocates of minority shareholders' rights have been successful so far in raising corporate governance issues at some large Korean companies such as Samsung Electronics and SK Telecom.[42] These highly publicized victories for shareholder democracy, combined with foreign investors' active involvement,[43] is expected to greatly contribute to the improvement of corporate governance in Korea. However, it remains to be seen whether the new system can function effectively without being abused by bad-faith shareholders who want to utilize it in a control contest situation. The new provisions regarding mergers and acquisitions will be discussed separately below.

2. *The New Commercial Code*

A generally revised new *Korean Commercial Code* (KCC), went into effect on October 1, 1996. The new amendments to the KCC deal mainly with the section governing stock corporations and have a substantial impact on corporate governance. The official comments to the amendments declare that they reflect changed social and economic circumstances in Korea and are intended to promote competitiveness of Korean enterprises in an era of internationalization of business in Korea.

First of all, a quorum requirement for general shareholders' meetings is abolished. Now, no direct quorum requirement exists unless a company's Articles of Incorporation otherwise provide.[44] To be sure, new voting require-

40. *See* Art. 191-13 of the KSEA.

41. *See* Art. 191-13 (1) of the KSEA. Minority shareholders of the Securities Investment Companies can exercise their shareholders' rights under the rules provided by the KSEA without any regard to the listing of the stocks at the Korea Stock Exchange or KOSDAQ. Further, the 0.01% requirement is waived for the shareholders of the Securities Investment Companies, i.e., any shareholder holding at least one share can bring the derivative suit. *See* Art. 84 (3) of the SECURITIES INVESTMENT COMPANY ACT.

42. *See, e.g.*, CHOSUN ILBO, March 28, 1998, at 8 (reporting that the annual shareholders meeting of Samsung Electronics took more than 13 hours due to active discussion on corporate governance issues); CHOSUN ILBO, March 27, 1998, at 9 (reporting that SK Telecom accepted minority shareholders' request for managerial transparency).

43. *See* Part IV, B below.

44. *See* Art. 368 of the KCC.

ments[45] have the effect of imposing a *de facto* quorum requirement.[46] However, they are substantially more liberal than those imposed under the pre-1996 law. This new rule is regarded as pro-management due to the newly created flexibility for holding general shareholders' meetings.

The new KCC also allows restrictions on transfer of shares. Under the new KCC, the Articles of Incorporation of stock corporations can restrict a transfer of shares by making it subject to the approval of the board.[47] An appraisal remedy will be available to the affected shareholders. This change has significant implications for change of control of the firms with few shareholders, including joint-venture enterprises.[48] The powers of the board under the Articles of Incorporation to restrict a share transfer provide the incumbent management with a strong tool to protect its control.

Parallel with the pro-management changes to the KCC, a statutory auditor's tenure is extended from two to three years[49] to safeguard its independence and supervisory functions. Also, the statutory auditor's legal power has greatly been enhanced through, *inter alia*, the new entitlement to call an extraordinary shareholders' meeting.[50] As before, for the purpose of electing statutory auditors, a shareholder holding more than three percent of the outstanding shares having voting rights may not exercise voting rights with respect to shares held in excess of three percent.[51]

The KCC also mandates appraisal rights for dissenters in mergers or sales of businesses.[52] The appraisal remedy for dissenting shareholders in mergers or sales of businesses was not unknown in Korea; the KSEA also provides procedural rules for expressal rights, along with a valuation method.[53] There have been several instances where proposed merger transactions were aborted due to the drain on a company's liquidity. Of course, whether those deals would have been value increasing ones cannot ultimately be known.[54] Dissenting share-

45. *See id.*

46. The failure to meet those requirements does not invalidate the meetings held, but prevents the relevant resolutions from being adopted; normal resolutions require the vote of at least twenty-five percent of all of the issued and outstanding shares in the company voting therefor. Special resolutions for central business decisions such as mergers require the vote of at least one-third of all of the issued and outstanding shares in the company voting therefor. The Articles of Incorporation are allowed to impose more restrictive requirements than the ones stipulated in Art. 368 of the KCC, but not less restrictive ones.

47. *See* Art. 335 of the KCC.

48. It is common practice in Korea for a joint-venture agreement to have express provision prohibiting any transfer of shares without prior consent of the other partner. Although, under such contractual arrangements, no cause of action is available against the company itself, the Seoul District Court, in its decision of Nov. 20, 1997, 97pa7454, has recently ruled that shareholders who acquired shares in violation of such a prohibition are not entitled to call a shareholders' meeting.

49. *See* Art. 410 of the KCC.

50. *See* Art. 412-3 of the KCC.

51. *See* Art. 409 (2) of the KCC. Art. 409 (3) of the KCC allows more restrictive requirements in a charter provision. The three percent-limit rule applies to discharge of statutory auditors of listed companies without cause. *See* Art. 191-11 (1) of the KSEA.

52. *See* Art. 374-2 with Art. 530 (2) of the KCC.

53. *See* Art. 191 of the KSEA.

54. *Cf.* Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L. J. 223, 234-36 (1962) (criticizing appraisal as a possible drain on a company's liquidity

holders in the deals reportedly were disappointed by proposed merger ratios. As they were institutional investors with significant shareholdings, they successfully blocked the transaction by announcing their intent to exercise their appraisal rights in advance.[55] Nevertheless, while approval rights can be a powerful tool of shareholders, there is little empirical evidence showing that the appraisal remedy systematically checks Korean managers' breaches of fiduciary duty.[56]

The KCC was amended again in October 1998 to comply with the IMF-mandated program. The amendments deal exclusively with the section governing stock corporations and have a direct impact on corporate governance and restructuring. The official comments to the amendments state that they are intended to support corporate restructuring and enhance managerial accountability and transparency through efficient monitoring.

The KCC has introduced the concept of directors' fiduciary duty of loyalty into the statute.[57] It has long been recognized that the director of a stock corporation is under such a duty even though the KCC did not explicitly provide for it. The current version of the KCC now imposes this statutory obligation on directors of stock corporations. Further, the current KCC also holds *de facto* directors liable for damages under certain circumstances.[58] It has been a widespread practice in Korea that the ultimate control over large firms lies in the hands of "owners" who do not hold any official corporate directorship. The KCC enhances managerial accountability by also holding them liable for mismanagement and misconduct. The status of minority shareholders is promoted through the introduction of a shareholder proposal right.[59] The KCC also introduces cumulative voting.[60] This is a quasi-default rule in the KCC

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that may deter value-increasing deals); FRANK H. EASTERBROOK AND DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 145-49 (1991) (viewing appraisal as a protective mechanism for shareholders from value-decreasing transactions).

55. *See* KS Kim, Chaebol and Corporate Governance, *supra* note 7, at 166-7. It has been reported that dissenting shareholders of 25 listed Korean companies have exercised their appraisal rights in merger or sale of business transactions for a total of 4.91 million shares in 1997. JOONG-ANG ILBO, Dec. 30, 1997, at 30.

56. *Cf.* Victor Brudney and Marvin Chirelstein, *Fair Shares in Mergers and Take-Overs*, 88 HARV. L. REV. 297, 304-07 (1974) (arguing that the appraisal remedy has limited power as a check on managers' breaches of fiduciary duty because of the rational apathy and free-rider problems).

57. *See* Art. 382-3 of the KCC.

58. *See* Art. 401-2 of the KCC.

59. *See* Art. 363-2 of the KCC.

60. *See* Art. 382-2 of the KCC. As Art. 369 (1) of the KCC (accepting the one share, one vote principle) is understood to be a mandatory rule, cumulative voting was not allowed. However, I argued elsewhere that Art. 369 (1) of the KCC can be interpreted as non-mandatory, referring to criteria developed in Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549 (1989). *See* HWA-JIN KIM, M&A-WA KYONGYONGKWON [M&A AND CORPORATE CONTROL] ch. 6 (3rd ed. 1999) (hereinafter Kim, [M&A AND CORPORATE CONTROL]). Accordingly, cumulative voting could be adopted by charter provision. For questions of voting in emerging economies, *see generally* Black & Kraakman, *supra* note 4, at 1945-52. Black & Kraakman report that straight voting is the default rule in most emerging market jurisdictions they have studied. *See id.* at 1948, note 73. For an account of the U.S. laws, see Jeffrey N. Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 COLUM. L. REV. 124 (1994). Many Korean corporate law scholars recognized the value of cumulative voting in protecting minority shareholders'

as it can be ruled out by charter provisions and made subject to shareholders' claims.[61]

B. A New Focus on Outside Directors

As mentioned above, Korean corporate boards are nominal organizations under the direct control of controlling shareholders in most cases. The boards of Korean firms are regularly comprised of officer-directors without the participation of outside, independent directors. Thus, the role of the board in corporate governance is minimal in Korean corporations. This is also related in part to the fact that in Korea, corporations' directors do not regularly face lawsuits for breaches of fiduciary duties.

The function of corporate boards in improving corporate governance has recently become an important point of public concern in Korea.[62] It is understood that public opinion supports the concept of active independent board members checking the controlling shareholder-managers and officer-directors. The firms themselves also have slowly realized the value of having efficient boards. Beginning in 1996, the so-called "outside director system" was adopted by several large firms including the Hyundai Group.[63] However, the new trend focusing on the board and outside directors is closely related to the *Chaebol*-policy. The Korean government sees an effective policy tool in the outside director system for its role in separating ownership and control of large public companies. The IMF also has required the Korean government to enhance the managerial accountability of Korean firms through outside directors. Accordingly, the Korean government has made it mandatory for listed companies to have a board with a ratio of three officer-directors to one outside director. The listing rule of the Korea Stock Exchange was amended in February 1998 to enforce this policy.[64]

The *Korean Banking Act* has introduced a system under which non-officer directors shall hold the majority position on corporate boards. It has been followed by the *Law for Structural Improvement and Privatization of State Enterprises*, promulgated in August 1997 and put into force on October 1, 1997.[65] This law places a ceiling of seven percent on individual ownership of shares in

interest. *See, e.g.*, DONG-YOON CHUNG, HOESHABUP [THE LAW OF CORPORATIONS] 363 (4th ed. 1996).

61. The new KCC has also introduced the short-form merger and the small-scale merger. In the former, the subsidiary by more than 90 percent shareholding, can be merged into the parent without the approval of the shareholders' meeting. *See* Art. 527-2 (1) of the KCC. In the latter, no approval of the shareholders' meeting of the surviving firm is required if the number of shares to be issued upon a merger amounts to less than five percent of the outstanding shares of the surviving firm. *See* Art. 527-3 (1) of the KCC. The corporate division also has been introduced in the new KCC. *See* Art. 530-2 through Art. 530-12 of the KCC.

62. *See* opinion of Kwang-Sun Chung, HAN-GUK KYONGJE SHINMIN, Sept. 30, 1997, at 10 (arguing for "corporate governance revolution" in Korea).

63. *See* HAN-GUK KYONGJE SHINMUN, Jan. 19, 1998, at 10 (reporting Hyundai Group's positive experience).

64. *See* Art. 48-5 of the Listing Rule of the Korea Stock Exchange.

65. *See* Law for Structural Improvement and Privatization of State Enterprises, Art. 5 (2) [hereinafter the Law]. This Law applies to the four giant state-invested enterprises that are planned

newly privatized state-owned enterprises. According to the official comment to this law, it is intended to enhance efficiency and accountability of professional managers.[66]

C. *The Establishment of the Secondary Segment of the Korean Securities Market*

The KOSDAQ was launched on July 1, 1996. This secondary segment of the Korean securities market was established mainly to support the financing efforts of new ventures and small businesses. As of November 1997, some 350 firms, including seventy-seven venture companies, were enrolled at the KOSDAQ.[67] The favorable tax treatment for securities traded on the KOSDAQ is expected to induce large numbers of investors, including foreign investors,[68] to invest in venture firms specializing in the high-tech and biotechnology areas. However, the KOSDAQ imposes the strict requirements of ownership dispersion for the firms enrolled. For a venture firm to be enrolled in the KOSDAQ, more than twenty percent of its issued and outstanding shares must be held by more than 100 minority shareholders.[69]

Korea's efforts to replicate the U.S.'s success in developing a strong venture capital industry exemplify its recognition that its current model of corporate governance and financial market fails to support newer and smaller companies. However, like some European countries,[70] Korea may not be successful in developing the institutional infrastructure necessary to support a venture capital market, unless it also introduces some complimentary institutions that are present in the U.S.[71] Merely creating a stock market in a system lacking complimentary institutions will not be sufficient to provide the necessary conditions for an active venture capital industry.[72]

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to be privatized, i.e., Korea Tobacco & Ginseng Corporation, Korea Telecom, Korea Gas Corporation, and Korea Heavy Industries & Construction Company. *See* Art. 2 of the Law.

66. To this end, more restrictive charter provisions are allowed. *See* Art. 18 (1) of the Law. The Korean government couldn't live up to its official promise to select a foreign professional manager as CEO of one of the four firms. *See Foreign CEO Plan at State Firms Fails*, KOREA HERALD, Dec. 10, 1997, at 12.

67. *See Foreigners Allowed to Invest in KOSDAQ Venture Companies*, KOREA HERALD, Nov. 14, 1997, at 12.

68. *See id.*

69. *See* Art. 4 (1) No.3 of the KOSDAQ Rule.

70. For an overview of start-up financing in European countries, *see* Arndt Stengel and Joseph W. Marx, The Financing of Start-up Companies (General Report for AIJA Annual Congress 1997).

71. Such complimentary institutions are venture capital organizations, investment bankers, and a supply of entrepreneurs. Gilson, Globalizing Corporate Governance, *supra* note 1, at 12-13. *See also* Curtis J. Milhaupt, *The Market for Innovation in the United States and Japan: Venture Capital and the Comparative Corporate Governance Debate*, 91 Nw. U. L. REV. 865, 879-94 (1997) (singling out five traits of the institutional environment that contribute to the success of the U.S. venture capital market: "the existence of large, independent sources of venture capital funding; liquidity; highly developed legal and contractual incentive structures; labor mobility; and risk tolerance").

72. Gilson, Globalizing Corporate Governance, *supra* note 1, at 12.

D. *Cultivating Markets for Corporate Control in Korea*[73]

The recent hostile takeover cases in Korea exemplify some of the problems of Korean corporate governance arising from changes in Korean capital markets. They also received extensive publicity, due largely to the departure they represented from generally staid inter-corporate relations in Korea. Under the old law, there was a practical ban on hostile takeovers, which was circumvented in many cases by a loophole for certain shareholding vehicles. This ban, along with related restrictions, was lifted on April 1, 1997, and should result in a greater increase in merger and acquisition activity. In 1997 alone, eleven tender offers were launched in the market, some of them hostile. Furthermore, as will be discussed below, the lifting of the ban on hostile takeovers also applies to foreign investors. As a result, there should be an increase in foreign takeovers of Korean firms.

1. The Current Situation

The Korean business community has increasingly accepted mergers and acquisitions (M&A) as a viable strategic option for external growth and restructuring.[74] The Korean government also understands that M&A represents a useful policy tool in industrial restructuring. Although there have been no serious discussions yet in Korea about the beneficial effects of takeovers in terms of shareholder wealth,[75] the role of the market in disciplining poorly performing management[76] is slowly being recognized by the Korean academic and legal communities.

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73. For law and practice of corporate acquisitions in Korea, see generally Kim, [M&A AND CORPORATE CONTROL], *supra* note 60.

74. *See Firms Urge Special Law on Restructuring*, KOREA HERALD, Nov. 7, 1997, at 12 (reporting that in a poll of 315 large firms about problems in industrial restructuring, about 60 percent of respondents cited the current complex procedure for M&As as the biggest hurdle to their restructuring efforts).

75. For studies of the evidence that takeovers are beneficial to shareholders and society, see Easterbrook and Fischel, *supra* note 54, at 190-205; Richard Roll, *Empirical Evidence on Takeover Activity and Shareholder Wealth*, in KNIGHTS, RAIDERS AND TARGETS: THE IMPACT OF THE HOSTILE TAKEOVER, ch.14 (John C. Coffee et al. eds. 1988). *See also* McGinty, *supra* note 22, at 992, n. 17 (informative summaries of literature). As takeovers generally benefited society, takeover defenses and anti-takeover laws of the individual States of the U.S. are viewed as detrimental to the societal wealth maximization. *See, e.g.*, Gregg A. Jarrell et al., *The Market for Corporate Control: The Empirical Evidence Since 1980*, 2 J. ECON. PERSP. 49 (1988); Jonathan M. Karpoff & Paul H. Malatesta, *The Wealth Effects of Second-Generation State Takeover Legislation*, 25 J. FIN. ECON. 291 (1989).

76. For the earliest account, *see* Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965) (pointing out, for the first time, the importance of the takeover threat in inducing managers to be concerned about shareholders' interests). *See also* Frank H. Easterbrook and Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1165-74 (1981) (emphasizing the role of tender offers in disciplining managers); Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with the Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 873-901 (1993) (collection of anecdotal evidence indicating the potential for shareholder gains from replacing incumbent management); RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS, ch. 10 (2nd ed. 1995) (selected empirical studies). However, as American managers have successfully developed effective takeover defenses and convinced state legislatures to enact anti-takeover laws, takeovers' disciplinary threat to management has significantly weakened. Discussions about alterna-

The internationalization of Korean capital markets is likely to increase takeovers and foreign ownership of listed companies.[77] Foreign firms' acquisition of undervalued Korean firms with weak local currency is expected to increase, in particular during the industrial restructuring period guided by the IMF. This activity, along with the abolished ownership restriction, will facilitate the growth of the M&A market in Korea. An increased number of diverse M&A transactions has already been reported among listed companies since 1995. Tender offers, once viewed as a remote foreign tool, have increased recently, although usually in their most basic form. To be sure, most deals occurring in Korea so far have been friendly and consummated with the aim of restructuring the operational functions of large businesses. However, the active M&A market is expected to eventually develop a market for corporate control in Korea, which should have a wide range of impacts within Korea.

The arguably emerging market for corporate control in Korea has already impacted Korean financial markets. For instance, after the highly-publicized proxy battle for Hanwha Merchant Bank in early 1997, where the incumbent management successfully preserved control by secretly issuing convertible bonds to friendly firms,[78] many Korean companies privately placed convertible bonds or bonds with warrants in huge volumes to increase friendly shareholding. As the negative impact of this practice on the market reached the critical point in March 1997,[79] the Korean government introduced some restrictions on certain market-distorting activities. The increase of takeover activities in Korea will continuously encourage concerned firms to search for effective takeover defensive tactics, including restructuring of their capital structure.[80] The financial institutions in Korea may also be interested in entering into the lucrative busi-

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tive mechanism are ongoing in the U.S., and increasingly focused on the new shareholder activism by institutional investors, independent directors and foreign governance institutions.

77. *See* Art. 5 of the Korean Financial Supervisory Commission Rule on Securities Transaction by Foreigners.

78. The Seoul District Court, in its decision of Feb. 6, 1997, 97kahap118, dismissed a motion to enjoin exercising voting rights attached to the converted shares in question, holding that issuing convertible bonds in the case was legitimate and legal. The Court emphasized the importance of liquidity protection for the shares. The Seoul High Court, in its decision of May 13, 1997, 97ra36, upheld the decision of first instance, but held that the convertible bonds issued in question were invalid for illegality involved in the issuing process. For the text of both decisions, *see* Kim, [M&A AND CORPORATE CONTROL], *supra* note 60, at 150-160. Such cases became moot as the merchant bank closed in February 1998.

79. In January, February, and March 1997, 46 companies issued convertible bonds and 22 companies issued bonds with warrants, all through private placement. The volume totaled 1.22 trillion won. The decision of the Seoul District Court in the Hanwha Merchant Bank Case was handed down on Feb. 6, 1997, and the 10 percent ownership restriction was abolished from April 1, 1997. *See* Kim, [M&A AND CORPORATE CONTROL], *supra* note 60, at 148-149.

80. The placement of new common shares or equity-related debt instruments on friendly hands is the most widely used, and controversial, takeover defensive tactic in Korea. Under Korean law, poison pill, in its forms prevailing in the U.S., is not allowed. Defensive stock repurchases have become fairly popular, but the 33.3 percent limit and requirement of purchase through securities exchange have been restraining factors until the recent abolishment of such limitations. Staggered boards, limiting the number of board members, proxy campaign and lock-ups are also widely used defensive tactics in Korea. For takeover defensive tactics available under Korean laws, *see generally* Kim, [M&A AND CORPORATE CONTROL], *supra* note 60, chs. 5, 6-7.

ness of takeover finance. The Korean government will focus more intensively than before on financial institutions regulation, a fundamental reform which has long been overdue.

2. The New Regulatory Framework

Under the old KSEA, there was a basic ceiling of ten percent for individual ownership of listed companies.[81] The rule generally applied to any shareholders except the founder of the company. The reasoning was to convince the controlling shareholders (founders) to let their firms go public without the fear of losing corporate control. Indeed, this policy has greatly contributed in expediting the building of Korean capital markets. This restriction, however, made less sense as the size of the Korean stock market increased. The rapid growth achieved by Korean firms compelled them to go public and, as a consequence, the incentive rule has become unnecessary. It only distorted the ordinary functioning of the capital market by imposing an anomalous barrier in securities trading. The new KSEA has abolished the restrictive rule.

Under the new KSEA, tender offers are the central mechanism for shifts in corporate control. Although some tender offers launched so far in Korea have been criticized for their questionable purposes,[82] it is widely accepted that the tender offer is the most appropriate mechanism for protection of minority shareholders from control abuses. Now, a securities transaction involving the transfer of more than a five percent (5%) shareholding out of the Korea Stock Exchange or KOSDAQ is required basically through tender offers.[83]

The old KSEA had introduced the obligation to make a bid. Any person aiming to acquire securities, which, when added to any existing holdings, gave him voting rights in a company totaling more than twenty-five percent, was obliged to make a bid by tender offer to acquire more than fifty percent of the

81. *See* Art. 200 of the old KSEA.

82. Some tender offers made at a price lower than market price of the shares have been successful because the tendering shareholders have already committed to tender by certain contractual arrangement with the offerer. Those shareholders were either nominal shareholders who bought the shares on offer with a simple fee arrangement or real shareholders who bought the shares upon offerer's contractual commitment to buy the shares with a fixed premium. In latter cases, agreement on voting was common. Also, there were instances where the potential acquirer entered into secret share purchase agreements with a third party and bought shares of the target in reliance on the agreement before launching a tender offer. This tactic has been used mainly to avoid the requirement of the disclosure rule. Currently, there is one reported case in Korea from which a lawsuit for damages has developed in relation to the breach of such contractual arrangements. *See* Kim, [M&A AND CORPORATE CONTROL], *supra* note 60, at 85, note 6. On the other hand, the recent high-profile tender offer for shares in Lady Furniture turned out to be part of a fraudulent scheme. This incident has raised doubt about the efficiency of current regulation. *See* HAN-GUK KYONGJE SHINMUN, Nov. 26, 1997, at 4.

83. *See* Art. 21 (1) of the KSEA. There existed a requirement for tender offer price under the pre-1998 version rule: the bid shall be made at the highest price an individual paid for any of the target company's shares within twelve months or the market price of the target company's shares on the previous day of his or her filing of application with the authority, whichever is higher (Art. 13-3 of Enforcement Decree to the pre-1998 version KSEA). Such requirement was abolished by the February 1998 revision of the rule.

issued and outstanding voting shares of that company.[84] The tender offers for 24.99 percent of Ssangyong Paper and Hankuk Electric Glass, both in November 1997, were made under the rule. This rule modified from the *British City Code on Takeovers and Mergers*[85] and the proposed *European Community 13th Directive on Company Law*,[86] was widely criticized for facilitating the concentration of economic power and setting an unreasonably high burden on value-increasing corporate acquisitions. The February 1998 amendments to the KSEA abolished this requirement.

The new KSEA has also refined "the early warning system," or five percent disclosure rule.[87] Now, the obligation to report is expanded to such equity-related debt instruments as convertible bonds, bonds with warrants, and exchangeable bonds.[88] The KSEA has widened the circle of obliged persons by introducing the concept of "holders on common purposes",[89] adopting the practical approach of the U.S. *Williams Act*.[90]

3. *The Emergence of the Market for Corporate Control*

The friendly acquisition of Korean firms by foreign investors was allowed, with some qualifications, under the (then) *Law on Foreign Investment and Foreign Capital Inducement*,[91] effective from February 1, 1997. However, direct hostile acquisition of Korean firms by foreign investors without the approval of incumbent management was not possible until recently. Also, the ceiling on individual foreign ownership in listed companies practically prevented foreigners from acquiring control of listed Korean firms. Nevertheless, the opening of the domestic market for foreign control has become a reality since the abolition of these restrictions.

It has been discussed whether Korea should open the domestic market for corporate control to promote competitiveness, including that of financial institutions. The proponents' view[92] has recently received much support. The issue, however, was not totally new to Korea. Since late 1996, Korea has participated

84. *See* Art. 21 (2) of the pre-1998 version KSEA with Art. 11-2 of Enforcement Decree to the KSEA.

85. Panel on Takeovers and Mergers, The City Code on Takeovers and Mergers and the Rules Governing Substantial Acquisitions of Shares (1993). *See* Deborah A. DeMott, *Current Issues in Tender Offer Regulation: Lessons from the British*, 58 N.Y.U. L. REV. 945 (1983).

86. Commission Proposal for a Thirteenth Directive on Company Law Concerning Takeover and Other General Bids, 1990 O. J. (C 38) 41, 44. *See* Klaus J. Hopt, *European Takeover Regulation: Barriers to and Problems of Harmonizing Takeover Law in the European Community*, in EUROPEAN TAKEOVERS – LAW AND PRACTICE ch. 6 (Klaus J. Hopt & Eddy Wymeersch eds. 1992); Jeffrey P. Greenbaum, *Tender Offers in the European Community: The Playing Field Shrinks*, 22 VAND. J. TRANSNAT'L L. 923 (1989); Nathalie Basaldua, *Towards the Harmonization of EC-Member States' Regulations on Takeover Bids: The Proposal for a Thirteenth Council Directive on Company Law*, 9 NW. J. INT'L. & BUS. 487 (1989).

87. *See* Art. 200-2 (1) of the KSEA.

88. *See* Art. 10 of Enforcement Decree to the KSEA.

89. *See id.* Art. 10-3 (4).

90. For the concept of a "group" under Section 13(d) of the WILLIAMS ACT, *see* ROBERT CHARLES CLARK, CORPORATE LAW 555-57 (1986).

91. *See* Art. 8-2 FOREIGN INVESTMENT PROMOTION ACT, effective from Nov. 17, 1998.

92. *See, e.g.*, Seong C. Gweon, *Fighting for What?*, KOREA HERALD, Nov. 19, 1997, at 8.

in negotiations on the *Multilateral Agreement on Investments* (MAI) sponsored by the OECD. The MAI would allow hostile takeovers by foreign investors in Korea as all parties to the agreement would be required to give foreigners the same treatment as their domestic counterparts. Even though most Korean companies wanted a delay in foreign investors' hostile takeover activities in Korea, it was unclear if other members of the OECD would accept such a position. The major concern of Korean companies was the lack of a level playing field for both domestic and foreign firms. The opening of the domestic market for foreign control in Korea, however, has become a reality since the abolition of restrictions on foreign ownership discussed previously.

It is anticipated that foreigners' participatory investments in large Korean companies will increase due to the weak Korean currency and undervalued stock prices.[93] Korean firms themselves have started to seek foreign partners for global strategic alliances to meet the challenges from the whole new business and regulatory environment.[94] It is widely recognized that opening of the Korean market for corporate acquisitions and strategic alliances to foreign firms will not be complete and effective without enhanced transparency of "consolidated" corporate financial statements made by generally accepted international accounting practices.[95] General deregulation on business activities, improvement of labor market flexibility, free international transfer of capital, and improvement of administrative infrastructure in the public services sector are also necessary. For the improvement of labor market flexibility, which was a key condition of the IMF bailout package,[96] the *Basic Labor Law* has been amended to allow companies to lay off workers when they face an "emergency situation."[97] According to the *Basic Labor Law*, sale of businesses or mergers and acquisitions to avoid financial trouble shall justify layoffs.[98] The new *Law Concerning Foreign Ownership of Land*, effective on June 26, 1998, has abolished various restrictions on the foreign ownership of land to promote foreign invest-

93. *See Listed Firms' Combined Stocks Worth Less Than World's Top 70th Company*, KOREA HERALD, Dec. 27, 1997, at 11 (reporting that, as of Dec. 24, 1997, the market value of the total amount of stocks listed on the Korea Stock Exchange stood at $33.9 billion, which was less than that of the Dutch ING).

94. *See* Steve Glain & Michael Schuman, *Seoul Looks to Foreigners for a Lifeline*, ASIAN WALL ST. J., Dec. 24, 1997, at 1, 5; *Korea's Woes Don't Deter Some Multinational Firms*, ASIAN WALL ST. J., Feb. 16, 1998, at 3; Mark Clifford et al., *Age of the Deal*, BUS. WEEK (Asian Edition), March 2, 1998, at 16-20; Martin du Bois, *Buyer's Market: As Asia's Going Gets Rough, Europe Inc. Goes Asset Shopping*, WALL ST. J. EUROPE, May 11, 1998, at 1, 11.

95. *See Chaebols Test Waters for Transparency*, KOREA HERALD, Jan. 6, 1998, at 10 (reporting that the total sales figure of a large group could be slashed by as much as 30% in consolidated financial statements). *See also Korea Financial Supervisory Commission & Korea Securities and Futures Commission, Reform of Accounting Standards in Korea, Dec. 11, 1998* (visited March 6, 1999) <http://www.fsc.go.kr/kfsc/new_e_index1.htm> (claiming that "financial accounting standards are newly born in Korea inconsistent with international best practices").

96. *See* No. 38 of the Korea-IMF Memorandum, *supra* note 27.

97. *See* Michael Schuman, *Korean Layoffs Pact Shows Union's Change in Stance*, ASIAN WALL ST. J., Feb. 9, 1998, at 3.

98. *See* Art. 31 (1) of the Law. The Law calls for management to do its best to avoid layoffs (*see id.* Art. 31 [2]) and give 60 days notice before dismissing workers (*see id.* Art. 31 [3]). Employers are also required to try to rehire dismissed workers first if business improves (*see id.* Art. 31-2).

ments in Korea. Now, acquisition of land by foreigners is not subject to government approval except for certain cases concerning military policy, environmental protection, and landmark protection.[99]

III.
CORPORATE GOVERNANCE AND BANKS IN KOREA

A. *A Need for Change of the Ownership Structure of Banks?*

One of the most contentious issues in Korea currently is corporate governance of banks. It is widely believed that many failures in Korea have been caused by bank managers' breach of their fiduciary duties. This widespread "directed lending" under governmental influence produced a huge volume of non-performing loans to highly leveraged large businesses.[100] When directed lending was the common practice, no effective monitoring system was available. As those borrower firms failed, the lender banks also lost substantial sums of money, which in turn led to the chaotic situation of the Korean financial markets. This arguably could have been prevented by closer monitoring of bank managers.

One solution to this problem is to allow non-financial firms—including those belonging to the *Chaebols*—to control commercial banks. This could be achieved by lessening ownership restrictions on bank shares. A controlling shareholder with a private business background might be able to improve the efficiency and accountability of bank management.[101] The proponents of lesser restriction on bank ownership argue that a concentration of bank ownership may be helpful in overhauling the financial system in Korea.

Others have argued that if the restrictions on the ownership of bank shares were relaxed, Korean banks would easily become the treasury of some *Chaebols*.[102] This could lead to mismanagement of those shareholder-firms because they would feel unjustifiably secure in their financing efforts. Proponents of ownership restriction argue that efficiency and accountability can be achieved by enhancing bank supervisory systems and/or introducing well-functioning outside directors. Another approach is to promote bank mergers. The Korean government has provided a separate legal regime to promote mergers of banks under the theory that such mergers increase competitiveness through enhanced operational efficiency and financial soundness. The *Korean Banking Act* also has been changed to introduce the outside director system.

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99. Still, there are notification requirements. *See* Art. 4 (1) and Art. 5 of the Law.

100. *See* Roy Ramos & Chunsoo Lim, *Bailout or Not, Korea Needs Change*, ASIAN WALL ST. J., Dec. 1, 1997 at 20 (estimating that bad debts amount to $110 billion which would be more than the entire annual economic output of Singapore, Malaysia or the Philippines).

101. *See, e.g., Editorial*, HAN-GUK KYONGJE SHINMUN, June 26, 1997, at 11; *Opinion of Byung-Ho Kang*, MAEIL KYONGJE, Oct. 4, 1996, at 5; *Editorial*, HAN-GUK KYONGJE SHINMUN, Jan. 17, 1998, at 5.

102. *See, e.g., Opinion of Un-Chan Jung*, CHOSUN ILBO, July 2, 1997, at 5 and Chung-Lim Choi, CHOSUN ILBO, April 3, 1997, at 5.

Until recently, Korea maintained a basic ceiling of four percent for bank ownership.[103] The ceiling on bank ownership, however, has been weakened by the new *Korean Banking Act,*[104] promulgated on January 13, 1998, and partially amended again in February and May 1998 and January 1999. The *Korean Banking Act* implements the agreement of the Korean government with the IMF. Although the ceiling still formally remains, the acquisition of bank shares of more than four percent or fifteen percent may be done by the approval of the Korean government. Since the new regulation is structured in a way to favor foreign investors, it is now being discussed whether the basics should also be changed. It remains to be seen whether the IMF-mandated change of ownership structure of Korean banks will prove efficient. However, it is clear that the improvement of governance of Korean banks will also continuously be sought through functional approaches in line with such efforts for non-banking corporations.

What are the possible lessons from comparative corporate governance in terms of bank managers' accountability? Should Korea continue the efforts toward functional improvement of bank governance, even after the internationally mandated formal changes have been implemented? The answer is clearly yes. The efficiency and soundness of a banking system are too complicated to be answered by any single approach. So is the accountability of bank managers. Strict monitoring may prevent the bank managers from self-dealing and engaging in other misconduct. Nevertheless, strict monitoring may also cause conservative lending practices, which may be difficult to differentiate from self-entrenchment. Korean banks need both the changed ownership structure and the private, business-oriented, managerial minds "supported" by a well-functioning board.

B. Outside Directors Again

Under the new *Korean Banking Act*, the board of directors of Korean banks shall have more outside directors than officer-directors.[105] The outside directors are to be appointed among the candidates recommended by representatives of shareholders and the board at the elective ratio of seven to three.[106] The president of a bank shall be elected by an affirmative vote of two-thirds or more of the outside directors.[107]

This new approach to bank corporate governance has been strongly criticized for not being realistic. As in other economies, even those highly efficient economies such as Germany[108] and the U.S.,[109] the "outside" directors often

103. *See* Art. 17-3 of the former BANKING ACT. This restriction did not apply to the shareholding in joint venture banks and local banks with restricted regional business areas. To the local banks, the ownership ceiling of 15 percent applied. *See* Art. 17-3 (1) of the former BANKING ACT.

104. *See* Arts. 15, 16 and 17 of the Act.

105. Art. 22 (2) of the Act.

106. *See* Art. 22 (3) through (9) of the Act.

107. *Id.* Art. 24.

108. For the failure of the German two-tier system, see *Guenter H. Roth, Supervision of Corporate Management: The "Outside" Director and the German Experience,* 51 N. C. L. REV. 1369,

turn out to be not "independent" enough to contribute to managerial accountability. The complicated recommendation and appointment procedure has only made the bankers' jobs harder, with little to show for such troubles. It is, however, interesting to see that the first ever effort to rationalize corporate boards in Korea has been made by the *Banking Act*. The model suggested by the *Banking Act* has also been adopted by some newly privatized state-owned enterprises as described earlier.

C. Bank Mergers and Acquisitions

Although the M&A boom among large banks abroad[110] was well known in Korea, the concept of bank mergers has not been widely accepted until recently. This is related to the traditional view of financial institutions as quasi-public organizations rather than private business entities. It also clearly illustrates the path dependent limits of the Korean economy as it exists today. However, the argument that rising international standards and increasing competition among banks in global markets should be met by promoting mergers of banks has recently become very compelling and persuasive. Thus, in December 1996, the Korean government promulgated the *Law for Structural Improvement of Financial Industry* to facilitate mergers of Korean banks. It contains various provisions easing mergers of financial institutions, including favorable tax treatment for the merger transaction, and regulating the liquidation and reorganization process for troubled financial institutions. However, the voluntary mergers of banks as envisaged were still not feasible due largely to potential problems of layoffs that would inevitably follow any merger of banks in Korea.

The recent restructuring efforts guided by the IMF have changed the situation. As the ownership ceiling on bank shares and foreign ownership restriction

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1378-82 (1973). Two separate and distinct bodies, i.e., the management board (Vorstand) and the supervisory board (Aufsichtsrat), govern the German stock corporation (Aktiengesellschaft). Direct control of corporate affairs is vested in the former which, in turn, is supervised by the latter. It is argued that the management boards of German corporations succeed in usurping the controlling function of the supervisory boards. *See* Josef Esser, *Bank Power in West Germany Revised*, 13 WEST EUR. POLITICS 17, 27 (1990). However, the two-tier system has been spreading throughout Europe in recent years and is presently reflected in the European Union's major legislative proposals relating to company law. *See* Kim, *supra* note 4, at 379 n. 40.

109. For recent efforts addressing the governance role of the board with increased independence of outside directors, see, e.g., The Business Roundtable, *Corporate Governance and American Competitiveness*, 46 BUS. LAW. 241 (1990); Ronald J. Gilson and Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991) (advocating increasing the dependence of outside directors on shareholders). *But see*, Victor Brudney, *The Independent Director - Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 607-39 (1982) (skeptical view). For positive practical cases, see Grundfest, *supra* note 76, at 880-900. *See also* John W. Byrd and Kent A. Hickman, *Do Outside Directors Monitor Managers?: Evidence from Tender Offer Bids*, 32 J. FIN. ECON. 195, 201-05 (1992) (recognizing outside directors' role in improving managerial performance); John A. Byrne et al., *The Best BOA*, BUS. WEEK, Dec. 8, 1997, at 46-52.

110. *See, e.g.*, Thane Peterson et al., *The Big One*, BUS. WEEK, Dec. 22, 1997, at 26-29 (merger of UBS and SBC in Switzerland); Michael Siconolfi, *Citicorp Merger with Travelers Signals New Era*, ASIAN WALL ST. J., April 7, 1998, at 1, 2; *Really Big Deal*, ASIAN WALL ST. J., April 8, 1998, at 8; Steven Lipin & Anita Raghavan, *BankAmerica, NationsBank to Join in $60 Billion Deal*, ASIAN WALL ST. J., April 14, 1998, at 1, 26.

on acquisition of controlling shares of listed firms have been abolished, foreign banks are expected to acquire some Korean financial institutions, including commercial banks. The *Korea-IMF Memorandum* also provides that the financial sector restructuring could involve "mergers and acquisitions by domestic and foreign institutions"[111] and that foreign financial institutions will be allowed "to participate in mergers and acquisitions of domestic financial institutions in a friendly manner and on equal principles."[112] As the first step to honor the commitment, the Korean government agreed with the IMF to privatize to certain U.S. commercial banks the troubled Korea First Bank and Seoul Bank by November 1998.[113] The January 1998 revision of the *Korean Banking Act* accommodates, and even promotes, foreign investors' acquisition of Korean banks by allowing them to acquire bank shares without limit with the approval of the Korean government.[114] On the local level as well, bank mergers are underway as the Korean government seeks to comply with the IMF-mandated program for the restructuring of the financial industry. In June 1998, four troubled local banks have practically been merged into other local banks by relevant rules of the *Law for Structural Improvement of Financial Industry*. In August and September 1998, some local banks announced their plans for friendly merger with each other, namely, The Commercial Bank of Korea with Hanil Bank; Hana Bank with Boram Bank; and Kookmin Bank with Korea Long Term Credit Bank.

D. Banks' Participatory Investments

Contrary to the academic environment in the U.S. and Europe, banks' participatory investments in non-banking and non-financial sectors are not actively discussed in Korea.[115] At present, the *Korean Banking Act* limits bank's ownership of non-financial corporations to fifteen percent.[116] This reflects, in part, the historical reality that Korean banks have exercised far greater influence on their debtor corporations as the creditor. However, such influence does not necessar-

111. *See* No. 17 of the Korea-IMF Memorandum, *supra* note 27.

112. *Id.*, Nos. 19 and 31.

113. *See* HAN-GUK KYONGJE SHINMUN, Feb. 18, 1998, at 4.

114. *See* Art. 15 (3) of the Act.

115. The most widely studied model for banks' participatory investments is the German model because German law allows banks to hold voting shares of non-banking companies and the German firms under such a system are in fact very competitive in the global market. The literature on German corporate governance in that respect has in the mean time become very rich. *See, e.g.*, Ulrich Immenga, *Participatory Investments by Banks: A Structural Problem of the Universal Banking System in Germany*, 2 J. COMP. CORP. L. & SEC. REG. 29 (1979); Theodor Baums, *Corporate Governance in Germany: The Role of the Banks*, 40 AM. J. COMP. L. 503 (1992); Friedrich K. Kübler, *Institutional Owners and Corporate Managers: A German Dilemma*, 57 BROOK. L. REV. 97 (1991); Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE L. J. 1927 (1993); Kim, *supra* note 4; John Cable, *Capital Market Information and Industrial Performance: The Role of West German Banks*, 95 ECON. J. 118 (1985); Hermann Kallfass, *The American Corporation and the Institutional Investor: Are There Lessons from Abroad? The German Experience*, 1988 COLUM. BUS. L. REV. 775.

116. *See* Art. 37 (1) of the Act.

ily contribute to the improvement of governance of the debtor firms.[117] Therefore, it is expected that the discussion on banks' participatory investments, in the form of the statutory change on the limits of ownership, will take place as the practical influence of Korean banks on their debtor firms diminishes due to the financial market internationalization.

In such anticipated discussions and studies, Koreans should also take into account the skeptical views of commercial bank involvement in corporate governance. In their recent study, Professors Macey and Miller argue that "proponents of bank involvement not only fail to address the significant costs of the Japanese and German systems of bank-dominated corporate governance, but ignore important benefits of the American system of equity-dominated corporate governance as well."[118] In their opinion, bank involvement will not cure the agency problems created by the separation of ownership and control because it carries with it an entirely new set of conflicts between equity claimants and creditors.[119] It is clear that Korean banks, having realized the importance of controlling the moral hazard of their borrowers, will actively seek the opportunity to participate in the governance of borrowers. Their stake in the borrower firms may even arise through bad debt-to-equity swaps. *The Korean Banking Act* now allows banks to transfer credits to equity even in such cases where the banks end up with a shareholding of more than fifteen percent. Such an effort, however, may have an adverse impact on the development of the securities market in Korea, which is crucial to the improvement of Korea's financial institutions.

Korean banks should also be aware that the Korean bankruptcy law accepts the principle of equitable subordination in its rather extreme form. Under the typical reorganization plan presented to Korean courts, corporate debts owed to creditors in control are completely forgiven. The Korean Supreme Court interprets the doctrine of equal treatment provided in the *Corporate Reorganization Act*[120] in terms of fairness and equity so that such treatment of creditors in control may be seen as legitimate.[121]

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117. However, the Korean banks' influence on the governance of their borrowers is expected to increase through the "Accords for Improvement of Financial Structure" between the banks and large corporate groups. Under the accord, which was initiated by the new Korean government, large corporate groups shall appoint outside directors, cause their subsidiaries to merge, and allow banks to investigate various corporate documents and manufacturing sites. A breach of the accord will cause loan call-offs and call-ins. *See* MAEIL KYONGJE, Feb. 18, 1998, at 1, 7; Chun Sung-Woo, *Banks Seen as Key Players of Corporate Restructuring*, ASIAN WALL ST. J., Feb. 21, 1998, at 10.

118. Jonathan R. Macey & Geoffrey P. Miller, *Corporate Governance and Commercial Banking: A Comparative Examination of Germany, Japan, and the United States*, 48 STAN. L. REV. 73, 75 (1995).

119. *See id.* ("Advocates of bank influence also ignore critical differences between the monitoring incentives of equity holders and the monitoring incentives of debt holders. Much of the confusion in the current debate stems from a failure to appreciate the economics of commercial banking in general and of commercial bank lending in particular.")

120. *See* Art. 229 of the Act.

121. *See* the Court's decision of July 25, 1989, 88ma266. Further, the practice of the Korean judiciary is that once the court approves a reorganization plan, shares held by the controlling shareholder, who is responsible for the insolvency of the firm, shall in principle be redeemed in total.

IV.
MARKET INTERNATIONALIZATION AND CORPORATE GOVERNANCE

A. International Regulation of Financial Institutions

Bank failures, unlike those of non-financial corporations, are minimized by a different kind of safety valve. Their operational soundness and functional efficiency are also guaranteed by the regulation of financial institutions. Parallel with the improvement of corporate governance of Korean banks through structural changes, more attention should be given to the effect of banking regulations.[122] In particular, due to the rapid increase of Korean banks' activities in international financial markets, international standards for the regulation of financial institutions are expected to exert positive influences on the operation of Korean banks. These standards may enhance the bank managers' accountability.

The Korean government had already introduced the risk-adjusted capital standards recommended by the Bank for International Settlements (BIS)[123] as a prudential measure to ensure capital adequacy of Korean banks. These requirements came into force at the end of 1995 and all Korean banks are now required to maintain an equity capital position equivalent to at least eight percent as suggested by the BIS. The normative power of the BIS rules has become tremendous in the Korean financial community since the recent involvement of international lending agencies in the restructuring of the Korean financial sector. The BIS rules have been used as an important policy tool for the Korean government in its restructuring efforts for the troubled Korean financial industry, under its agreement with the IMF. The *Korea-IMF Memorandum* provides first that Korea needs "a strong and transparent financial system which operates free of political interference and according to the rules and practices of the advanced industrial countries."[124] It then makes revocation of merchant banking licenses

122. *See generally* Office of Bank Supervision of the Bank of Korea, Bank Supervisory System in Korea (May 1997). The LAW ON ESTABLISHMENT OF FINANCIAL SUPERVISORY AGENCY, promulgated on December 31, 1997 with effect from April 1, 1998, has set up an integrated financial supervisory agency in Korea. The new Financial Supervisory Board has resulted from the merging of financial supervisory units so far spread among the Ministry of Finance and Economy and three separate watchdogs, i.e., Office of Bank Supervision, Securities Supervisory Board, and Insurance Supervisory Board. The KSEC's jurisdiction was split and distributed to the Financial Supervisory Board and the Securities and Futures Commission.

123. Committee on Banking Regulations and Supervisory Practices, International Convergence of Capital Measurement and Capital Standards (July 1988) ("the Basle Accord"). *See* Scott & Wellons, *supra* note 16, at 256-323; Duncan E. Alford, *Basle Committee International Capital Adequacy Standards: Analysis and Implications for the Banking Industry*, 10 DICK. J. INT'L L. 189 (1992); Camille M. Caesar, *Capital-Based Regulation and U.S. Banking Reform*, 101 YALE L. J. 1525 (1992). *See also* David Fairlamb, *Beyond Capital Adequacy*, INST. INV. (International Edition), August 1997, at 22-35. *See also* <http://www.BIS.org>. The BIS standards are implemented in the European Union through its directives on its own funds and on solvency ratios. *Cf.* Council Directive 89/299 of 17 April 1989 on The Own Funds of Credit Institutions, 1989 O. J. (L 124) 16; Council Directive 89/647 of 18 December 1989 on a Solvency Ratio for Credit Institutions, 1989 O. J. (L 386) 14. For a brief account that these rules may change the traditional ownership structure of German corporations, *see* Kim, *supra* note 4, at 397-9.

124. *See* No. 2 of the Korea-IMF Memorandum, *supra* note 27.

contingent upon fulfillment of the BIS standards within a certain time frame.[125] It also envisages severe disciplinary measures to commercial banks, including liquidation, no distribution of dividends and/or freezing management payrolls, again contingent upon rehabilitation plans meeting the BIS standards.[126] Consequently, Korean commercial banks and other financial institutions have become so sensitive to the BIS standards that they almost blindly called in outstanding loans to borrowers, which has resulted in sudden bankruptcies of affected firms.[127]

It is quite interesting to see that an international standard for banking regulation may contribute to the improvement of soundness of Korean banks that in turn helps improve the governance of Korean banks. The Korean government's participation in the international supervisory system was totally voluntary in a legal sense, but undeniably motivated by the necessity for Korean banks to be recognized as credible partners in global financial markets. This clearly shows that the international financial market may exercise great influence on convergence of national institutions, including corporate governance.[128] To the extent that such regulations are successful, the use of international banking regulations to improve the banks' governance is an impressive example of functional convergence of corporate governance institutions.

B. Market Internationalization and Institutional Investors' Activism

In Korea, institutional investors will hold decisive voting blocks in many instances in Korea in the future. At the end of 1996, they held some 31.2 percent of the total shares of listed Korean companies.[129] Considering the 10.4

125. *See id.*, No. 22.

126. *See id.*, Nos. 23-25.

127. *See Massive Corporate Bankruptcy Looming*, KOREA HERALD, Dec. 29, 1997, at 12 (reporting banks collecting loans to meet BIS standards that would be a crucial criteria for the evaluation of their management and eventually, their M&As).

128. Professor Van Zandt views that "[i]n some respects, the banking sector is approaching a situation in which it makes sense to talk about the existence of a single international regulatory framework." David E. Van Zandt, *The Regulatory and Institutional Conditions for an International Securities Market*, 32 VA. J. INT'L L. 47, 76 (1991). It should be noted that, in contrast to the situation in banking regulation, there may be little incentive for nations to introduce an international regulatory framework to improve governance of general corporations. However, the most notable exception may be found in the European Union's efforts to harmonize company laws of the Member States. *See generally* Steven M. Schneebaum, *The Company Law Harmonization Program of the European Community*, 14 LAW & POL'Y INT'L BUS. 293 (1982); Eric Stein, HARMONIZATION OF EUROPEAN COMPANY LAWS (1971); Alfred F. Conard, *The European Alternative to Uniformity in Corporation Laws*, 89 MICH. L. REV. 2150 (1991). The European Union's efforts to harmonize Member States' company laws are also closely related to its financial market integration program. *See generally* Scott and Wellons, *supra* note 16, at 324-379; Manning Gilbert Warren, *Global Harmonization of Securities Laws: The Achievements of the European Communities*, 31 HARV. INT'L L. J. 185 (1990); Michael J. Levitin, *The Treatment of United States Financial Services Firms in Post-1992 Europe*, 31 HARV. INT'L L. J. 507 (1990); Michael Gruson & Werner Nikowitz, *The Second Banking Directive of the European Economic Community and Its Importance for Non-EEC Banks*, 12 FORDHAM INT'L L. J. 205 (1989).

129. *See* Yu-Kyung Kim, *The Growing Financial Market Importance of Institutional Investors: The Case of Korea*, in INSTITUTIONAL INVESTORS IN THE NEW FINANCIAL LANDSCAPE 159, 172-173 (OECD 1998). *See also* Je Won Lee, A Study on Institutional Investors and Their Roles in the Governance Structure of Korea's Publicly Held Companies 224 (Seoul National University Disserta-

percent held by "foreigners"—who usually are institutions—the practical number may well exceed forty percent. This could affect corporate governance, since there is a greater likelihood of a rational apathy problem where foreign investors hold a small percentage of stock in a company. Foreign investors, especially institutions, may actively involve themselves in corporate governance. However, their interest in corporate performance may be limited in that it is primarily tied to the stock price, not to the firm's long-term business prospects. Moreover, they may well prefer liquidity to control. Consequently, the inactivity and lack of interest by foreign institutional investors—who will hold substantial stakes in Korean firms—may be viewed as a problem.

Nevertheless, although the internationalization of Korean capital markets will not directly result in general improvements in corporate governance of Korean firms, many commentators argue that it is likely to introduce such American concepts as institutional investors activism,[130] shareholder value, shareholder democracy,[131] and managerial transparency. The Korean government should continue the effort to loosen its tight grip on capital markets as many other national authorities have done since the mid-1980s. The recent steps taken toward deregulation and complete opening-up of Korean capital markets have upgraded the Korean financial system and, as a consequence, created a more favorable environment for balanced development.

Also, some new laws have been promulgated to bring the Korean financial market up to international standards. For instance, in September 16, 1998, the mutual fund was introduced in Korea through the promulgation of the *Securities Investment Company Act*, which supplemented the existing *Securities Invest-*

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tion 1997) (in Korean). Contrary to the situation in the United States, public funds in Korea have been passive in equity investments. The total assets held by some 70 public and other funds in Korea have reached 100 trillion won recently. It has been reported they invest less than two percent of their assets in the securities market. *See Editorial*, HAN-GUK KYONGJE SHINMUN, Oct. 15, 1997, at 11 (urging efficient and responsible management of public funds).

130. The literature discussing the role of institutional investors in corporate governance in the U.S. is voluminous. *See, e.g.*, John C. Coffee, *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277 (1991); Thomas A. Smith, *Institutions and Entrepreneurs in American Corporate Finance*, 85 CAL. L. REV. 1 (1997); Bernard S. Black, *The Value of Institutional Investor Monitoring: The Empirical Evidence*, 39 UCLA L. REV. 895 (1992); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L. J. 445 (1991); Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992); Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520 (1990); John C. Coffee, *The Folklore of Investor Capitalism*, 95 MICH. L. REV. 1970 (1997) (book review article). For studies in a more comparative style, *see* INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE (Theodor Baums, Richard M. Buxbaum and Klaus J. Hopt eds., 1994); Bernard S. Black & John C. Coffee, *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV. 1997 (1994); G. P. Stapledon, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE (1996); Ronald J. Gilson and Reinier Kraakman, *Investment Companies as Guardian Shareholders: The Place of the MSIC in the Corporate Governance Debate*, 45 STAN. L. REV. 985 (1993); Thomas Christian Paefgen, *Institutional Investors Ante Portas: A Comparative Analysis of an Emergent Force in Corporate America and Germany*, 26 INT'L LAW. 327 (1992); James A. Fanto, *The Transformation of French Corporate Governance and United States Institutional Investors*, 21 BROOK. J. INT'L L. 1 (1995).

131. For recent developments in Europe, *see* Paula Dwyer et al., *Shareholder Revolt*, BUS. WEEK (International Edition), Sept. 18, 1995, at 16-21 (reporting new shareholder activism in European countries).

ment Trust Business Act.[132] Mutual funds may have significant impact on the corporate governance of Korean firms, in particular in the control contest context, if aggressive managers oversee them with long-term perspectives. Thus far, securities investment trust companies in Korea exercise voting rights that they hold by the shadow voting rule. This rule, however, has been changed to the extent that the securities investment trust companies may now exercise their voting rights without restriction unless such exercise is to acquire the control over the portfolio companies.[133] The new *Securities Investment Company Act* has the same provision.[134]

The developments in the Korean market so far have resulted in some foreign institutions becoming increasingly active and aggressive[135] in corporate governance issues towards the firms in which they are investing.[136] One can expect that the influence of foreign institutions will become more visible as the ceiling on foreign stock ownership is abolished and Korean capital markets become more global. Future occurrences of this kind of activism may well provoke a reaction among the Korean public and invite government action. In March 1998, Tiger Management successfully forced SK Telecom, Korea's largest mobile-phone operator, to give outsiders two seats on its board and consult in advance with such outside directors for certain large overseas investments and transactions.[137]

It will be very interesting to see how financial institutions in Korea— both domestic and foreign—view their role in corporate governance as the capital market develops. The discussion of these issues has only just begun in Korea, and will continue to draw keen attention in the future. Recent developments still seem to promote the separation of ownership and control. In Korea, the Berle-Means corporation is part of the future, not just the past.

C. Globalization of Financing and Corporate Governance

Due largely to high interest rates in the domestic financial market, an increasing number of Korean firms now raise funds abroad, often by issuing Depository Receipts (DRs) and equity-related debt instruments such as Convertible Bonds in the Euromarket. By the end of 1996, Korean firms raised $10.6 billion

132. Other new financial regulations include the LAW CONCERNING ASSET-BACKED SECURITIZATION, which was promulgated and went into effect on September 16, 1998, and the HOME MORTGAGE LOAN SECURITIZATION COMPANY LAW, promulgated on January 29, 1999, effective from April 30, 1999. *See* Hwa-Jin Kim, *The New Special Purpose Companies in Korea*, forthcoming in RECENT TRANSFORMATION OF KOREAN SOCIETY AND LAW (1999).

133. *See* Art. 25-2 of the Act.

134. Art. 31 of the Act.

135. *See, e.g.*, CHOSUN ILBO, Feb. 1, 1997, at 11 (reporting that the Korea Investment Trust indicated its intent to support hostile takeover of Midopa should Midopa issue convertible bonds for defensive purposes).

136. *See* CHOSUN ILBO, Feb. 29, 1997, at 11 (reporting Tiger Management's plan to raise voice in the management of Chosun Brewery); MAEIL KYONGJE, Jan. 17, 1998, at 1 (reporting that three foreign investment funds have exercised their minority shareholders' rights).

137. CHOSUN ILBO, March 21, 1998, at 9; Jon E. Hilsenrath, *Tiger Won Telecom Fight, But Locals May Win War*, ASIAN WALL ST. J., March 23, 1998, at 19, 28.

by issuing equity-related overseas securities.[138] Korean involvment in the U.S. market has also increased, due to the easy access afforded by *SEC Regulation S* and *Regulation 144A*.[139] As the restrictions on raising capital abroad have been abolished on implementation of the agreement with the IMF,[140] the Korean firms' practice of international financing with securities is expected to increase further. In 1997, Korean listed firms financed nearly $2 billion by issuing securities abroad. Of this amount, 64.7 percent were convertible bonds and 31.5 percent were DRs.[141]

These developments may have significant implications for corporate governance in Korea. In particular, many Korean firms have accessed the U.S. capital markets through the issuance of DRs. In order to get their shares admitted to the U.S. securities markets, corporate governance related requirements must be met.[142] In order to keep their shares listed and traded on NYSE or NASDAQ (as of May 1999, ADRs of four Korean companies were listed on NYSE - Pohang Iron & Steel, Korea Electric Power, Korean Telecom and SK Telecom), the strict periodic reporting requirements must also be fulfilled. In practice, they may face pressure from their foreign owners in the global markets to disclose more information to investors[143] and manage in their interests. According to a report, Merrill Lynch considered suing some Korean commercial banks that issued DRs for their possible acquisition of bad assets from troubled merchant banks.[144] Further, Korean managers can be sued by U.S. investors even in the

138. *See* Ho-Yun Chang, *International Listing of Korean Stocks and Stock-related Securities and Its Impact on the Korean Stock Market* (Korean), 8 KUJHE KYONGYONG YONGU 151, 152, 185-88 (1997).

139. Samsung Electronics was the first Korean issuer placing GDRs under Regulation S and Rule 144A in December 1990, followed by numerous other companies. Regulation S was adopted by the SEC on April 24, 1990 in order to provide safe harbors for offshore distributions and resales of unregistered securities of U.S and foreign issuers. It clarifies the non-applicability of the registration requirements of the SECURITIES ACT OF 1933 to offers and sales of securities that occur outside the United States. *See* JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 329-39 (1991). Rule 144A was adopted by the SEC on April 23, 1990 in order to provide a safe harbor exemption from the registration requirements of the SECURITIES ACT OF 1933 for resales of restricted securities to "qualified institutional buyers." *See id.*, at 479-85. Despite SEC's attempts to increase access and to eliminate barriers to foreign participants in U.S. markets, foreign issuers still regard the American market as highly restrictive. *See generally* Roberta S. Karmel & Mary S. Head, *Barriers to Foreign Issuer Entry Into U.S. Markets*, 24 LAW & POL'Y INT'L BUS. 1207 (1993); Andreas J. Roquette & Christoph W. Stanger, *Das Engagement ausländischer Gesellschaften im US-amerikanischen Kapitalmarkt*, 48 WERTPAPIER MITTEILUNGEN 137 (1994). For non-U.S. companies listed on the NYSE, see <http://www.nyse.com/international>.

140. *See* No. 33 of the Korea-IMF Memorandum, *supra* note 27 ("[A] timetable will be set by end-February 1998 to eliminate restrictions on foreign borrowing by corporations").

141. Due to the sluggish domestic stock market and plunging credit ratings, 42 firms canceled or deferred issuance worth $3,231.8 million. From January to October 1998, Korean firms financed only $663.6 million by issuing securities abroad. *See Korea Financial Supervisory Commission, Overseas Securities Offerings by Type* (visited March 5, 1999) <http://www.fsc.go.kr/kfsc/static/12/O107.htm>. In 1996, Korean listed firms financed $2,586.9 million by floating securities abroad. *See* KOREA HERALD, Dec. 31, 1997, at 13. *See also Local Firms Issue 23 Overseas Securities Worth $2 Bil. in '97*, KOREA HERALD, Jan. 17, 1998, at 11.

142. *Cf.* New York Stock Exchange Listed Company Manual, section 3.

143. *Cf.* Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 MICH. L. REV. 2498 (1997).

144. *See, e.g.*, CHOSUN ILBO, Nov. 29, 1997, at 11.

U.S. courts. It is well known that the U.S. courts traditionally exercise wide extraterritorial jurisdiction in securities law cases based upon effects and/or conduct tests.[145] The monetary interest of holders of DRs in the United States may easily establish U.S. courts' jurisdiction in such cases where a violation of U.S. securities laws by a Korean firm is alleged.[146] This corporate manager's nightmare is becoming reality, as is evidenced by the recent solicitation of an American insurance company to Korean managers advertising their D&O liability insurance package.[147]

V.
CONCLUSION

Will we be still discussing the convergence of corporate governance institutions ten years from now? Either functionally or formally, the national corporate governance institutions may converge by that time due to globalization of firms' operational and financing activities, as is evidenced by recent developments in Korea. Still, the answer to the question above may be yes. The dynamics of economic development and changes in the competitive environment of the global markets will continuously require private enterprises to innovate and adapt to new economic circumstances. Methods of doing business will constantly evolve dependent upon each economy's path dependency and/or political decisions; the search for the most efficient system will continue. Comparative corporate governance will matter, especially for emerging market economies.[148] The focus will also move from the comparative study of the problems of monitoring and disciplining corporate managers to that of assessing various systems "in terms of their ability to encourage and find economic innovation and to promote corporate adaptability."[149]

145. *See, e.g.*, Schoenbaum v. Firstbrook, 405 F. 2d 200 (2d Cir. 1968), cert. denied, 395 U.S. 906 (1969); Leasco Data Processing Equipment Corp. v. Maxwell, 468 F. 2d 1326 (2d Cir. 1972). *See also* COX ET AL., *supra* note 139, at 1333-70; Louis Loss, *Extra-territoriality in the Federal Securities Code*, 20 HARV. INT'L L. J. 305 (1979).

146. On the other hand, it is not unthinkable that Korean firms with their ADRs issued in the United States will request a U.S. court to enjoin hostile tender offer claiming a violation of the WILLIAMS ACT. But *cf.*, Plessey Company Plc. v. General Electric Company Plc., 628 F.Supp. 477 (D. Del. 1986) (dismissing plaintiff's motion for injunctive relief based upon comity and application of the balancing of interests test). For extraterritorial application of tender offer rules, see generally GUNNAR SCHUSTER, DIE INTERNATIONALE ANWENDUNG DES BÖRSENRECHTS 557-89 (1996).

147. The major Korean corporate groups have recently been reported to purchase such insurance for their key managers to protect them from minority shareholders' lawsuit for damages. *See* HAN-GUK KYONGJE SHINMUN, Feb. 19, 1998, at 11; MAEIL KYONGJE, Feb. 19, 1998, at 1. According to the Korea Financial Supervisory Commission, a total D&O insurance premium of 22.5 billion won was paid by them in 1998.

148. Commenting on Roe, Professor Romano points out that "the lesson to be drawn from the mutability of the corporate form is opaque" because "the legal and institutional differences across the three nations [Germany, Japan, and the United States] make it difficult to ascertain whether one approach to corporate governance is superior to another and whether a superior organizational form could be successfully transplanted into another setting." Romano, *supra* note 3, at 2021. However, in my opinion, her view cannot be interpreted as negating the necessity of learning the advanced institutional and organizational wisdom from efficient corporate governance institutions by emerging market economies.

149. Milhaupt, *supra* note 71, at 867.

As far as Korean firms are concerned, the globalization of financing may enhance the efficiency of corporate governance without radical formal changes in its structural relationships with capital markets and financial institutions. The rules of international financial markets and/or the desire and necessity to be recognized as credible participants in global markets will cause Korean firms to innovate their governance structure and endeavor towards more transparent and responsible management. The functional approaches to corporate governance issues described above should be promoted through the opening of capital markets and continuous efforts to reform the infrastructure of domestic capital markets.[150] The international lending agencies involved in the restructuring of Korea's industrial organization and corporate governance should encourage the functional improvements of the Korean system by introducing fair market discipline to the Korean market and refraining from "recommending" sweeping formal changes in the structural relationships between capital markets, financial institutions, and corporate governance. Both market internationalization and the globalization of Korean firms' financing activities can assure effective market discipline in Korea. Active involvement in international financial markets will facilitate functional convergence of corporate governance institutions.

150. Professor Gilson observes a functional rather than a formal convergence of major (U.S., German, and Japanese) systems because "each system's governance institutions have sufficient flexibility to find a solution [to the question of replacing poorly-performing senior management] within their path dependent limits." According to Professor Gilson, "[the] functional convergence is driven by selection: [a] system that allows poor managers to remain in control will not succeed." Gilson, Globalizing Corporate Governance, *supra* note 1, at 8.

TABLE 1. THIRTY LARGEST *CHAEBOLS* IN KOREA (1997)

(billion won, %, as of April 1, 1997)

Member Firms:		Shareholders' Equity (A)	Cross Guarantees(B):	B/A:
Hyundai	57	9,842	10,085	102.47
Samsung	80	14,070	2,474	17.59
LG	49	8,314	2,338	28.13
Daewoo	30	7,824	10,123	129.38
Sunkyoung	46	4,702	790	16.80
Ssangyoung	25	3,217	2,974	92.47
Hanjin	24	2,119	8,178	385.92
Kia	28	2,289	2,535	110.77
Hanwha	31	1,243	1,982	159.34
Lotte	30	2,658	553	20.81
Kumho	26	1,281	1,555	121.37
Halla	18	306	2,727	891.01
Dongah	19	1,383	2,799	202.39
Doosan	25	807	711	88.07
Dealim	21	1,117	2,863	256.18
Hansol	23	1,234	627	50.82
Hyosung	18	878	369	42.11
Dongkuk Steel	17	1,117	626	56.06
Jinro	24	109	518	473.31
Kolon	24	918	778	84.80
Kohap	13	529	425	80.28
Dongbu	34	946	878	92.82
Tongyang	24	663	609	91.91
Haitai	15	465	265	57.02
New Core	18	211	364	172.48
Anam	21	464	1,677	361.31
Hanil	7	383	827	215.76
Keopyung	22	527	1,867	354.27
Miwon	25	444	667	150.41
Shinho	25	387	1,162	300.12
Total	819	70,460	64,361	91.34

Source: Korea Fair Trade Commission

TABLE 2. MAJOR EVENTS IN THE TURMOIL (NOV. 97–FEB. 98)

11.21	Korea applied for the bailout funds with the IMF
12.02	Business at 9 merchant banks suspended
12.03	Korea-IMF agreement
12.05	Coryo Securities suspended
12.06	Halla Group filed for court protection
12.08	Daewoo's takeover of Ssangyong Motor announced
12.10	Business at 5 additional merchant banks suspended Mandatory tender offer requirements lessened
12.11	Foreign ownership ceiling raised to 50 percent
12.12	Dongsuh Securities suspended, filed for court protection
12.15	Guidelines for financial-sector M&A unveiled
12.16	Currency fluctuation restrictions removed
12.18	Presidential election
12.19	Shinsegi Investment Trust suspended
12.22	Moody's and S & P's downgraded the foreign currency credit rating of Korea to Ba1 and B+, respectively
12.24	Moratorium speculated in financial sector Korea-IMF first supplementary agreement
12.25	G-7 countries' advancement of the bailout package announced
12.26	Chong-gu Group filed for court protection
12.29	18 financial reform bills passed, including amendments to the "real name" system in financial transactions
12.30	Foreign ownership ceiling raised to 55 percent Domestic bond markets fully opened to foreigners
01.13	President-elect met CEOs of 4 largest *Chaebols* for reform talks
01.14	Nasan Group filed for court protection
01.15	Labor-Reform Committee organized to discuss a layoff bill
01.29	New York agreement for the rescheduling of Korea's short-term corporate foreign debts
02.06	Labor law reform accord
02.14	17 "IMF reform bills" passed, including layoff bill
02.17	Korea-IMF second supplementary agreement

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Cradle to Border: U.S. Hazardous Waste Export Regulations and International Law

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Cradle to Border: U.S. Hazardous Waste Export Regulations and International Law

By
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I.
INTRODUCTION

This paper explores current U.S. law regulating the transboundary shipment and export of hazardous waste, specifically examining both the Resource Conservation and Recovery Act (RCRA)[1] as well as applicable treaties. This paper attempts to untangle the various overlapping strands of domestic law, including treaties, statutes, and common law, in the context of current international agreements. This paper also examines the legal remedies that are available in the United States to alien plaintiffs harmed by the violation of these laws.

One goal of U.S. environmental laws regarding hazardous waste is to ensure the environmentally sound treatment and disposal of domestically generated hazardous wastes.[2] This paper looks at two distinct types of hazardous waste exports as defined under RCRA. First, this paper examines the class of hazardous waste that falls within the definition of hazardous waste used by the Environmental Protection Agency (EPA) to regulate exports, "RCRA-designated" waste. Second, this paper examines the much larger class of hazardous waste that is exempt from EPA hazardous waste export requirements, mainly under the recycling and recovery exemptions to RCRA, "RCRA-exempt" waste. RCRA-exempt waste is exported without any monitoring or regulatory control by the EPA. One major problem with any analysis of how well the U.S. is meeting the goal of ensuring environmentally sound disposal of U.S.-generated

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1. Resource Conservation and Recovery Act, 42 U.S.C. §§ 6901-6992 (1998) [hereinafter RCRA].

2. On March 1, 1994 President Clinton asked Congress to pass legislation curbing U.S. exports of hazardous waste. EPA Administrator Carol Browner concurred, stating that the United States "must set an example for the world by taking responsibility for our own waste. Citizens in other countries should not be asked to bear the burden of U.S. pollution." *Hazardous Waste Export Curb Cited as 'Example to World,'* HAZARDOUS WASTE NEWS, March 1, 1994, *available in* LEXIS, Nexis Library, IAC Database.

hazardous wastes is the consistent lack of data collection for RCRA-exempt waste by the EPA or any other federal agency.[3]

In general, as hazardous waste regulations are increased within the U.S., disposal, recycling, and recovery of hazardous wastes become more costly. As costs rise, the incentive increases for hazardous waste generators to export hazardous waste to countries where disposal, recycling and recovery are less costly. If the cost savings in other countries are due primarily to weaker environmental protections in those countries, then hazardous waste exports frustrate the articulated goal of ensuring that the U.S. takes responsibility for its own hazardous waste. These exports may be undermining protection of the global environment as a result of U.S. environmental regulations designed to protect the domestic environment. This result is contrary to the stated policy that the U.S. "set an example for the world by taking responsibility for our own waste."[4]

This paper concludes that the goal of ensuring environmentally sound disposal of U.S.-generated hazardous waste can only begin to be achieved by expanding current export regulations to both classes of hazardous waste. This expansion is within the regulatory discretion of the EPA. Further, the expansion of the current U.S. notice and consent requirements to RCRA-exempt hazardous waste will significantly increase the ability of importing countries to assume responsibility for the environmentally sound handling and disposal of imported hazardous waste within their own countries. Finally, hard data will inform the debate over the "acceptable balance between economic growth and environmental sustainability"[5] in the waste-receiving countries and in the U.S.

This paper also examines what forms of relief may be available under U.S. law to an alien plaintiff who is harmed outside of the U.S. by the treatment or disposal of hazardous waste that was generated within the U.S. Currently, when RCRA-exempt hazardous waste is transported across the border, responsible parties in the U.S. are able to escape most liability for any harm caused by these wastes.[6]

The paper is organized as follows: Part II examines U.S. law regarding the two classes of hazardous waste identified above; Part II-E considers administrative law issues that arose when the EPA promulgated its current rules. Part III looks at the current liability of exporters under RCRA, focusing on the *Amlon*

3. "Given the uncertainties associated with such basic statistics, it is difficult to come up with a good estimate of how much hazardous waste is being shipped overseas." Kofi Asante-Duah et al., *The Hazardous Waste Trade: Can It Be Controlled?*, 26 ENVTL. SCI. & TECH. 1684, 1684 (1992).

4. *Hazardous Waste Export Curb Cited as 'Example to World,' supra* note 2.

5. Asante-Duah et al., *supra* note 3 at 1690. In contrast to Asante-Duah, I conclude that the chance of finding an "*acceptable* balance between economic growth and environmental sustainability for the waste-receiving countries," *Id.* (emphasis added), will depend on an open exchange of information and data collection between exporting-generator countries and importing countries. More extensive information in this area will determine whether it is true that "[p]olicies and actions that protect the environment can at the same time contribute to economic progress." *Id.*

6. New case law in this area shows a trend towards greater accountability. *See* Jota v. Texaco, Inc., 157 F.3d 153 (2nd Cir. 1998) (holding in part that a *forum non conveniens* dismissal is erroneous absent agreement or condition requiring Texaco to submit to jurisdiction in Ecuador).

Metals decision.[7] Parts IV through VI examine how the current U.S. laws and regulatory definitions interface with existing international agreements on the transboundary shipment of hazardous waste. Specifically, Part IV examines bilateral treaties to which the U.S. is a party.[8] Part V examines the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal (Basel), to which the U.S. is a signatory but not yet a party.[9] Part VI considers other multilateral agreements to which the U.S. is bound, including: the Organization for Economic Cooperation and Development (OECD) Decision C(92)39;[10] the North American Free Trade Agreement (NAFTA);[11] and the World Trade Organization / General Agreement on Tariffs and Trade (WTO / GATT).[12] Part VII revisits the issue of liability in light of the present international agreements and changing interpretations of the Alien Tort Claims Act.[13]

II.
CURRENT UNITED STATES LAW GOVERNING THE EXPORT OF HAZARDOUS WASTE

Congress passed the RCRA and the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)[14] as comprehensive statutes to regulate solid waste, including hazardous waste, and to establish liability for cleanup and response costs.[15] Subchapter III of the RCRA includes provisions for identification of hazardous wastes[16] as well as standards for generators, transporters, and treatment, storage and disposal facilities (TSDFs).[17] The Environmental Protection Agency (EPA) regulations implementing the RCRA

7. Amlon Metals, Inc. v. FMC Corp., 775 F. Supp. 668 (S.D.N.Y. 1991).

8. Agreement Between the United States of America and the United Mexican States on Cooperation for the Protection and Improvement of the Environment in the Border Area, Aug. 14, 1983, U.S.-Mex., T.I.A.S. No. 10827 [hereinafter U.S.-Mexico Treaty]; Agreement Between the Government of the United States of America and the Government of Canada Concerning the Transboundary Movement of Hazardous Waste, Oct. 28, 1986, U.S.-Can., T.I.A.S. No. 11099 (entered into force Nov. 8, 1986; amended Nov. 4 & 25, 1992) [hereinafter U.S.-Canada Treaty].

9. Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, Mar. 22, 1989, 28 I.L.M. 657 (also available at UNEP/IF.80/3) [hereinafter Basel Convention].

10. *Decision of the Council Concerning the Control of Transfronteir Movements of Wastes Destined For Recovery Operations*, OECD Council Decision C(92)39, T.I.A.S. No. 11880 (Mar. 30, 1992) [hereinafter OECD Council Decision C(92)39].

11. North American Free Trade Agreement, Dec. 8-17, 1992, 32 I.L.M. 289, 32 I.L.M. 605 (entered into force Jan. 1, 1994) [hereinafter NAFTA].

12. General Agreement on Tariffs and Trade, October 30, 1947, T.I.A.S. No. 1700, 55 UNTS 188 (became the World Trade Organization on January 1, 1995 pursuant to the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, April 14, 1994, 33 I.L.M. 1145 (1994)) [hereinafter WTO / GATT].

13. 28 U.S.C. § 1350 (1998).

14. When first enacted, RCRA did not have any export provision; it was amended to include this provision in 1984. Pub. L. No. 98-616, 98 Stat. 3262 (codified as amended at 42 U.S.C. § 6938 (1984)). CERCLA has no export provision.

15. Resource Conservation and Recovery Act, 42 U.S.C. §§ 6901-6992 (1998); Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §§ 9601-9675 (1994) [hereinafter CERCLA].

16. 42 U.S.C. § 6921 (1998).

17. 42 U.S.C. §§ 6921-6939e (1998).

include both the definitions of hazardous wastes[18] and exemptions from regulation for certain types of waste, including universal waste,[19] batteries,[20] and waste to be recycled or recovered.[21] The regulations include two different ways to define hazardous waste: (1) by hazardous substances lists,[22] and (2) by characteristics that make a substance hazardous.[23]

Congress enacted both RCRA and CERCLA under its Commerce Clause power. A series of Supreme Court decisions have held that domestic transport and disposal of solid waste are forms of commerce even if the waste itself may be valueless or of negative value.[24] As such, waste cannot be burdened by state or local laws that discriminate against out-of-state, or out-of-locale, waste. This "free trade" paradigm for waste within the U.S. is increasingly becoming the model used in world trade agreements. The emerging presumption, and the one followed by the U.S, is that waste is freely traded as an item in commerce unless otherwise limited by binding international treaties or agreements.[25]

A. Export of Hazardous Waste: RCRA Section 3017

The export of hazardous waste is regulated by statute as part of the Resource Conservation and Recovery Act at 42 U.S.C. § 6938 (RCRA section 3017).[26] The statute establishes notification,[27] consent,[28] manifest,[29] and re-

18. 40 C.F.R. § 261 (1998).
19. 40 C.F.R. § 273 (1998).
20. 40 C.F.R. § 266.80 (1998).
21. 40 C.F.R. § 261 (1998).
22. 40 C.F.R. § 261.3 (1998).
23. Listed characteristics include corrosivity, ignitability, toxicity. 40 C.F.R. §§ 261.20-261.24 (1998). Reactivity is also considered. *See* 40 C.F.R. § 261.3(a)(2); 40 C.F.R. § 261.3(c)(2). *But see* Shell Oil Co. v. Envtl. Protection Agency, 950 F.2d 741 (D.C. Cir. 1991) (Invalidating portions of the rules for procedural reasons, particularly notice requirements. However, Congress has reinstated the rules until new rules are promulgated).
24. *See* City of Philadelphia v. New Jersey, 437 U.S. 617, 621-23 (1978) (even "valueless" out-of-state wastes fall within the Commerce Clause definition of "commerce," thus a state's ban on importation of commerce implicates the constitutional protections of the Commerce Clause); Fort Gratiot Sanitary Landfill, Inc. v. Michigan Dep't. of Natural Resources, 504 U.S. 353 (1992) (overturning local law which limited waste from both in-state and out-of-state sources); C&A Carbone, Inc. v. Town of Clarkston, 511 U.S. 383 (1994) (local waste flow control ordinance that increased costs for disposal of some out-of-state waste invalid where alternative non-discriminatory means exist to address local health and safety concerns). *See also*, Philip Weinberg, *Congress, the Courts, and Solid Waste Transport: Good Fences Don't Always Make Good Neighbors*, 25 ENVTL L. 57 (1995) (arguing that Congressional attempts to overrule this line of cases are misplaced and that greater emphasis should be placed on reduction of waste and increased recycling).
25. The European Court of Justice took a similar position to that of the U.S. on the free trade in waste within the EEC. *See* Commission v. Belgium, 1 C.M.L.R. 365 (1993) at para 36 (case dealt primarily with import restrictions on nonhazardous waste, but the Court reached the issue of hazardous waste as well).
26. Part of the larger Solid Waste Disposal Act, 42 U.S.C. §§ 6901-6992 (1976). Regulations that implement the RCRA are found at 40 C.F.R. §§ 262.50-262.58 (1987) (Subpart E—Exports of Hazardous Waste) and 40 C.F.R. §§ 262.80-262.89 (1987) (Subpart H—Transfrontier Shipments of Hazardous Waste for Recovery within the OECD).
27. 42 U.S.C. § 6938(c) (1984) (Notification to EPA administrator); 40 C.F.R. § 262.52(a) (1987) and 40 C.F.R. § 262.53 (1987).
28. 42 U.S.C. § 6938(a)(1)(B) (1984) (requiring written consent by receiving country); 40 C.F.R. § 262.52(b) (1987).

porting[30] requirements for the export of hazardous waste. However, where a valid international agreement regarding hazardous waste exports exists between the United States and the receiving country, the shipments must conform with the terms of that agreement,[31] and only the annual report requirement of RCRA section 3017 ("Section 3017") applies. In fact, 99% of all U.S. hazardous waste exports[32] fall under one of two bilateral treaties, one between the U.S. and Mexico and the other between the U.S. and Canada.[33] Both treaties have requirements that closely match the general regulations promulgated by EPA to enforce Section 3017.

RCRA section 3017 essentially creates a monitoring and consent program for the export of hazardous wastes. The EPA is responsible for enforcement of the procedures. Because the EPA has no direct independent authority to seize or detain shipments of hazardous waste that violate the procedures of Section 3017, the EPA has entered into a Memorandum of Understanding (MOU) with the U.S. Customs Service, which does have that direct enforcement authority.[34] Customs officials collect manifests at the border, verify the completeness and consistency of the data on the export documents, submit them to the EPA, and watch for illegal hazardous waste exports (*i.e.* those without the proper documents).[35]

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29. 42 U.S.C. § 6938(a)(1)(c) (1984) (requiring that a copy of written consent accompany manifest of each waste shipment); 40 C.F.R. § 262.52(c) (1987).

30. 42 U.S.C. § 6938(g) (1984) ("[A] report summarizing the types, quantities, frequency, and ultimate destination of all such hazardous waste exported during the previous calendar year."). *See also* 40 C.F.R. § 262.52(d) (1987).

31. 42 U.S.C. § 6938(f) (1984) ("Where there exists an international agreement . . . establishing notice, export, and enforcement procedures for the transportation, treatment, storage, and disposal of hazardous wastes, only the requirements of subsection (a)(2) and (g) of this section shall apply"); 42 U.S.C. § 6938(a)(2) (1994) (requiring that "shipment conforms with the terms of such agreement").

32. This refers to RCRA-designated waste only. *See discussion infra* p. 8.

33. U.S.-Mexico Treaty, *supra* note 8; U.S.-Canada Treaty, *supra* note 8.

34. Original MOU December 29, 1986, renewed March 5, 1996. Susan Bromm, The United States' Enforcement Approach to the Export and Import of Hazardous Waste, 7 (1994) (director of RCRA Enforcement Division, Office of Waste Programs Enforcement, US EPA) (unpublished manuscript, on file with the author). The new agreements include training for U.S. Customs officers in identification and monitoring of hazardous waste shipments. The EPA also has MOUs on hazardous waste matters with Department of Transportation (DOT), Federal Bureau of Investigation (FBI), Occupational Safety and Health Administration (OSHA), and the Coast Guard. The EPA works closely with the State Department and DOJ on these issues. *Id.* at 7.

35. GAO, Hazardous Waste Exports: Data Quality and Collection Problems Weaken EPA Enforcement Activities, GAO/PEMD-93-24 at 26 [hereinafter 'GAO Report']. The EPA hopes that by improving the computer database interfaces, Customs officers will at minimum be able to identify hazardous waste export documents that are inconsistent with the information reported to EPA by the exporter. Currently, Customs officials can phone EPA if they suspect a problem and hold the shipment at the border while EPA staff researches the data problems. There are much more complex problems that would be associated with actual inspections of the trade at the border. First, chemical testing is highly technical, not widely available, and time consuming. Second, the volume of trade and individuals crossing the border makes it unwieldy for Customs officials to stop every truck to assure that the cargo is not hazardous waste (therefore Customs examines only on those that self-report as hazardous waste). Third, public policy has dictated that Customs officers' priority (especially on the U.S.-Mexican Border) be interdiction of drug traffic and illegal entry of aliens. *See also* David Eaton, *NAFTA and the Environment*, 27 ST. MARY'S L.J. 715, 731-33 (discussing the border enforcement problems along the Mexican-U.S. border as a "situation ripe for illegal dumping.").

B. *Quantity of Waste Covered by RCRA Section 3017*

Under the RCRA, a waste is considered hazardous for export if: (1) it meets the definition of hazardous waste in 40 C.F.R. section 261.3, and (2) it is subject to either the federal manifesting requirements at 40 C.F.R. 262, Subpart B, the universal waste management standards of 40 C.F.R. section 273,[36] or state requirements analogous to 40 C.F.R. section 273.[37]

In 1995, the total amount of RCRA-designated hazardous waste exported according to the regulations found in RCRA section 3017 was 226,393.2 tons, representing only 1.05% of the 214,092,505 tons of RCRA-designated hazardous waste generated in the U.S. that year.[38] The vast majority of RCRA-designated hazardous waste exported from the U.S. in 1995 was sent to Canada and Mexico under the bilateral treaties between the U.S. and each of these countries.[39]

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36. 40 C.F.R. § 273 (1995) (Standards for Universal Waste Management). These regulations, promulgated in 1995, exempt from solid waste rules recycling and recovery operations for batteries, mercury thermostats, and pesticides.

37. *See* 40 C.F.R. § 262.80(a) (1996). Waste covered by RCRA section 3017 is coextensive with hazardous waste subject transportation manifesting requirements and universal waste (otherwise exempt from manifesting requirements). The fact that the domestic definition of hazardous waste under Section 3017 does not match the definitions of other countries or Basel has caused some of the resistance to ratifying Basel within the U.S. If Basel is ratified the regulations for export will have to be substantially reworked. *See infra* note 174. Many hazardous substances are covered by other acts. These include Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA), 7 U.S.C. §§136-136y (1998) and the Federal Hazardous Substances Act (FHSA), 15 U.S.C. §§ 1261-1278 (1998). In addition, PCB-containing wastes are subject to separate export requirements and export of PCBs at or exceeding 50 ppm is banned. Toxic Substances Control Act (TSCA), 15 U.S.C. §§ 2601-2692 (1998). *See also* Custom Entry Requirements 15 U.S.C. § 2612; notice to receiving country for export of chemicals, 15 U.S.C. § 2611; requirements for disposal of asbestos 15 U.S.C. § 2643(h). In fact, PCBs are currently being imported to the U.S. from Canada for disposal, and more disposal capacity is developed specifically for this end. 40 C.F.R. §761.93 (1998) (Import for Disposal); 40 C.F.R. § 761.60 (h), (f) (Disposal rules). Nuclear waste and other radioactive wastes are also excluded from the category of hazardous wastes under U.S. law. Nuclear Waste Policy Act (NWPA), 42 U.S.C. §§ 10101-10270 (1998); Low Level Radioactive Waste Policy Act (LLRWPA), 42 U.S.C. §§ 2021b-2021j, 2023 (1998); Uranium Mill Tailings Radiation Control Act (UMTRLA) 42 U.S.C. §§ 2014 et seq. (1998).

38. ENVTL. PROTECTION AGENCY, 1995 NATIONAL BIENNIAL RCRA HAZARDOUS WASTE REPORT (BASED ON 1995 DATA); EXECUTIVE SUMMARY, 7 (August, 1997) <http://www.epa.gov/epaoswer/hazwaste/data/br95/execsumm.txt> [hereinafter EPA 1995 REPORT]. This data is gathered from biennial self-reporting by 20,873 large quantity generators throughout the U.S. and territories. *Id.* at 8. The reported figure for treatment and disposal (not including treatment for storage only) at TSDs was 208,272,032 tons managed by 1,983 TSD Facilities. *Id.* at 8-9. EPA notes the discrepancy and attributes it to: "off-year generation (generation that occurred at the end of a non-biennial reporting year but was shipped during a reporting year) and wastes received for management from generators in foreign countries." *Id.* at 3.

39. U.S. Customs Service reports that an estimated 16 to 20 million tons of waste is exported from the U.S. each year that is not covered by U.S. export controls as hazardous waste but is covered under Basel as hazardous waste. *Hazardous Waste: Mishandled Exports Would Be Returned to U.S. Under Administration's New Policy*, DAILY ENV'T REP. NEWS at d10, March 2, 1994, *available in* BNA, LEXIS, Nexis Library, BNA-ENV file.

Year *	1989	1990	1991	1992	1993	1994	1995
Total RCRA designated waste exported from the U.S. in short tons**	131,093.8 st	130,530.5 st	119,562.6 st	145,556 st	142,708.4 st	191,458.2 st	226,393.2 st
Total imports to Canada from the U.S.	94,156.68 st	86,314.88 st	65,011.7 st	71,969 st	70,297.72 st	115,133.8 st	121,014.3 st
Exports to Canada as percent of total U.S. RCRA designated hazardous waste exports	72%	66%	54.4%	49.4%	49.26%	60.1%	53.5%
Exports of hazardous waste to Mexico from the U.S.	28,101 st	39,208.98 st	51,383.9 st	72,178 st	71,596.78 st	75,581.6 st	104,408.2 st
Exports to Mexico as percentage of total U.S. hazardous waste exports	21.5%	30%	43.0%	49.6%	50.17%	39.6%	46.1%
Exports of RCRA designated hazardous waste outside of North America	8,837.2 st	5,004.5 st	3,166.9 st	1,409 st	813.95 st	472.8 st	970.7 st
Percent of U.S. exports of RCRA designated hazardous waste outside of North America	6.5%	4%	2.6%	1.0%	0.57%	0.3%	0.4%
Percent of U.S. RCRA designated hazardous waste exports reported as being exported for reclamation and recycling	not available	not available	60.7%	62.7%	62.49%	54%	59.9%

* All data collected from ENVTL. PROTECTION AGENCY, *U.S. EPA Hazardous Waste Export Annual Reports* (1989-1995) (unpublished reports, on file with the author. Available from Anna Cherson, Environmental Protection Agency, 703-308-8805).

** st = short tons, or 2000 lbs. U.S. Totals from 1989 through 1991 converted from metric tons to short tons using conversion 907.19 kg/ton.

C. Regulatory Framework and Requirements

The EPA promulgated regulations to establish requirements for exporters of hazardous waste.[40] The generator and shipper must notify the EPA, in writing, of the intent to export at least 60 days before the date of the initial intended shipment. The notification must include: the estimated total quantity of waste; the frequency of export; a description of the waste with EPA hazardous waste number and ID;[41] shipment means; destination;[42] manner in which waste will be treated, stored, or disposed of in the receiving country; and transit country information, if any.[43] The EPA must notify the receiving country, which must consent to accept the hazardous waste.[44] In accepting the waste, the receiving country may place conditions on the export shipment.[45] A copy of the EPA "Acknowledgment of Consent" form, indicating that consent has been given by the receiving country, must be attached to the manifest.[46] If any of three enumerated problems arise or if any of the shipping details change, an "Exception Report"[47] must be submitted to the EPA. This report describes the problems that were encountered with the shipment and corrects the original notification. These problems include: (1) return of a shipment to the U.S. for any reason; (2) the exporter's failure to receive a copy of the manifest from the transporter; and (3) the exporter's failure to receive confirmation of delivery from the receiving facility within the specified time frame.[48]

For the most part, the EPA uses discrepancies in reporting to trigger enforcement inquiries.[49] Inaccurate data that matches inaccurate annual reports will likely not trigger enforcement inquiries. The facilities of exporters of haz-

40. 40 C.F.R. §§ 262.50-262.58 (1986).

41. One notice may have multiple kinds of waste, or waste streams; with the increase in regulations in general and greater sophistication of waste handlers, these finer classifications are being used more widely. The EPA has begun keeping a database that tracks each of the waste streams on a notification and later matches it to the annual reports. Discrepancies may trigger an investigation of the exporter. However these figures are all gathered by self-reporting; those seeking to circumvent the system may not leave gaps in their paper work. Robert Heiss, *A U.S. Perspective on the Import and Export of Hazardous Waste*, Presentation at the 19th Canadian Waste Management Conference (September 1997) (on file with the author).

42. The EPA is improving its databases and beginning to compile data on the facilities available in other countries and their compliance records with applicable laws. This tracking and enforcement project was set up through NAFTA and the Commission for Environmental Cooperation. There may be uniform notification and manifest forms developed and implemented in the future between the three countries. Heiss, *supra* note 29, at 7.

43. *See* 40 C.F.R. § 262.53 (1986). This is not an exhaustive list.

44. 40 C.F.R. § 262.52(b) (1986).

45. 42 U.S.C. § 6938(a)(1)(D) (1984) (terms of the consent).

46. 40 C.F.R. § 262.52(c) (1986). "A copy of the EPA Acknowledgment of Consent to the shipment accompanies the hazardous waste shipment and, unless exported by rail, is attached to the manifest (or shipping paper for exports by water (bulk shipment))."

47. 40 C.F.R. § 262.55 (1986) (Exception Reports).

48. GAO Report, *supra* note 35, at 23.

49. *See* Bromm, *supra* note 34, at 5. *See also* Scott C. Fulton, *EPA's Enforcement Priorities for Fiscal Year 1993*, NAT'L ASS'N OF ATT'YS GEN. ENVTL. ENFORCEMENT J., Feb. 1993, at 6. " The RCRA enforcement program will continue to use its Import/Export Data tracking system to ensure compliance with notification, reporting, and manifest requirements regarding the shipment of hazardous waste."

ardous waste are subject to inspection by the EPA regional offices and state environmental agencies, providing an opportunity for the EPA to reconcile the data by examining the exporters' own copies of confirmations of delivery and reshipments from importers. However, because of the EPA's funding limitations, such data reconciliation is rare.

The time lag between notification to the EPA and acknowledgment of consent from the EPA has led some exporters to submit speculative notices or "protective notices." These notices allow the exporter to ship waste at some point within the following year if it negotiates a contract. While there is no regulation explicitly prohibiting protective notices, they add to the agency's burden of processing consents and may slow down the process as a whole. EPA staff time is thus consumed by a purely bureaucratic exercise, which may have no relation to any actual need of the exporter, or to any actual export of hazardous waste.[50] These notices also add to the burden of reconciling the information contained in notices, manifests, and delivery confirmations.

In 1983, Representative Mike Synar, then Chair of the Subcommittee on Environment, Energy, and Natural Resources of the House Committee on Government Operations, requested that the General Accounting Office (GAO) evaluate the EPA's hazardous waste export data. The resulting report found systematic data quality and collection problems:

> GAO found (1) unreliable hazardous waste quantity estimates, (2) exported waste quantities that went unreported, (3) shipment frequency not reported, (4) incomplete reporting of waste codes describing the type of wastes, (5) non-hazardous waste counted as hazardous, and (6) exception reports not submitted by exporters to EPA.[51]

Since the report was issued, the EPA has tightened oversight of compliance with the use of waste codes and consistent units of measure, and provided better reporting guidance for exporters.

The GAO report found that importers in receiving countries had not relied on the data from either the EPA or the exporters for decisions about accepting wastes, but rather relied on their own assessment of the proposed wastes[52] and their capacities to treat or dispose of the waste. In addition, both Mexico and Canada generally give consent *pro forma* for additional individual shipments to

50. One alternative is to have exporters pay a fee to EPA for the processing of all notices. Fees to process notices would both deter protective notices and place costs of monitoring export notices on generators. Apparently, Canada is currently considering a cost recovery scheme for administration of its program which would be paid for by Canadian hazardous waste generators and receiving facilities. Telephone interview with Robert Heiss, EPA Office of Enforcement and Compliance Assurance (March 1998). *See also* Thomas Mounteer, *Codifying Basel Convention Obligations into U.S. Law: The Waste Export Control Act*, 21 ENVT'L. L. REP. 10085, 10088 n. 47 (stating that some Canadian facilities had only received 20% of the waste indicated on export notifications).

51. GAO Report, *supra* note 33, at 4. These problems may be inherent in self-reporting and call into question the accuracy of the raw data that the EPA is relying on in its upgrades of its own systems. No matter how sophisticated EPA's tracking and computer systems become, or how well integrated with other countries, if the initial data is unreliable and not independently verified then the system will nonetheless have a fatal flaw.

52. Generally, samples have already been sent to the importer for analysis by the time a consent is requested. Shipment of samples is exempt from exporting requirements under 40 C.F.R. § 261.4(e) (1998) (Treatability Study Samples).

the same importers, at the same disposal and treatment facilities, after the initial consent process and investigation.[53]

D. RCRA-Exempt Hazardous Wastes as Defined Under Section 3017 and Exemptions for Recycling and Recovery: Opening the Loophole

Generally, substances exempt from RCRA hazardous waste regulation for any reason are also exempt from the export controls.[54] The RCRA statutory definition of hazardous waste and the accompanying regulations include many exemptions. Shipments of RCRA-exempt hazardous waste are not subject to hazardous waste export restrictions under Section 3017.[55] Because many counties use different criteria for defining hazardous waste and exemptions, the use of the term "hazardous waste" internationally is quite confusing. Moreover, little effort has been made to harmonize the U.S. definition of hazardous waste for export purposes with the definition used in the country of import.[56] This has generated much confusion in statistical data collection and reporting of "toxic" or "hazardous" waste exports and imports worldwide. Many hazardous substances which are exempted from RCRA hazardous waste regulations in the U.S. meet the general hazardous waste criteria but are exempt from regulations for specific reasons, *e.g.*, to encourage recycling and recovery of industrial chemicals.

Some of the definitions used by the domestic recycling and recovery exemptions are controversial. For example, hazardous wastes that are defined as "recyclable materials"[57] "used in a manner constituting disposal"[58] are exempt from requirements for generators, transporters, and storage facilities.[59] The phrase "used in a manner constituting disposal"[60] means that the recyclable materials are applied to or placed on the land: essentially they are used as fertilizers or combined with other materials to make fertilizers.[61] The hazardous

53. GAO Report, *supra* note 35, at 29-31.

54. The only exception is industrial ethyl alcohol that is exported for reclamation. Though ethyl alcohol is generally exempt from RCRA under the recycling rules, generators still must comply with notice and consent requirements of 262.53, et al. in order to export it. 40 C.F.R. § 261.6(a)(3)(i)(A) (1998).

55. 40 C.F.R. §§ 262.50-262.89 (1986).

56. In 1996, the OECD regulations were incorporated into the regulations for export 40 C.F.R. §§ 262.80-262.89 (1996). Even these regulations continue to be based on U.S. definitions of hazardous waste. They only harmonize labeling for those wastes that are "considered hazardous under U. S. national procedures and are destined for recovery operations" in OECD member countries besides Canada and Mexico. *See generally* F. James Handly, *Hazardous Waste Exports: A Leak in the System of International Legal Controls,* 19 ENVT'L L. REP. 10171, 10178 (Apr. 1989).

57. 40 C.F.R. § 261.6(a)(1) (1997) ("Hazardous wastes that are recycled will be known as ' recyclable materials.'")

58. 40 C.F.R. § 261.6(a)(2)(i) (1997).

59. 40 C.F.R. § 261.6(a)(1) (1997) (This includes an exemption from manifesting requirements).

60. 40 C.F.R. §§ 266.20-266.23 (1998) (Subpart C - Recyclable Materials Used in a Manner Constituting Disposal).

61. *See generally* Duff Wilson, *Wasteland: Every Day Hazardous Waste is Made into Fertilizer and There is Not a Law in Place to Make Sure That it is Safe*, 66 AMICUS J. 34 (Spring 1998); ENVTL. WORKING GROUP, *Toxic Wastes 'Recycled' as Fertilizer Threaten U.S. Farms and Food*

materials that qualify as recyclable materials under this regulation include K061 waste from steel manufacturers, which is used to make zinc fertilizers.[62] The K061 residues may contain contaminants that include: arsenic, barium, cadmium, chromium, lead, mercury and selenium. Fertilizers containing K061 that are produced for use by the general public are expressly exempt from regulation.[63] When these same K061 wastes are recycled for metals recovery in high temperature metals recovery processes the residues from that process are not deemed hazardous if the original K061 waste met EPA standards for acceptable levels of certain contaminants.[64] However, these same tests are not required for land disposal of K061. Ironically, K061 exports for metals recovery are regulated under Section 3017, but K061 exports are not regulated if they are destined to be used as fertilizer. In addition, if the K061 wastes are used to make fertilizer within the U.S., the export of that fertilizer is not regulated under Section 3017.[65]

Another example of RCRA-exempt hazardous waste that is exported without notice and consent requirements is the export of used lead acid batteries. Lead acid batteries are exempted from hazardous waste criteria domestically to encourage recycling and recovery operations, and are also therefore exempt from export controls.[66] The liquid acids and the lead contained in these batteries both independently meet the RCRA definition of hazardous waste. The do-

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Supply (Mar. 26, 1998) [hereinafter *Toxic Wastes Recycled*] <http://www.ewg.org/pub/home/reports/factoryfarming/fertpress.html>.

62. K061 is distinct from K061 slag; the latter is the end product after K061 has undergone metals recovery. K061 slag was the subject of several court cases including: American Mining Congress v. Envtl. Protection Agency, 824 F.2d 1177 (D.C. Cir. 1987) (holding that RCRA expanded EPA's regulatory reach to include K061 slag and other end products of recycling and recovery operations, and that post-recovery slag left on the ground for six months was not in a recovery process); Steel Manufacturers Ass'n v. Envtl. Protection Agency, 27 F.3d 642 (D.C. Cir. 1994) (EPA can regulate concentrations of toxins in post-recovery slag).

63. 40 C.F.R. § 266.20(b) (1998). *See also* 40 C.F.R. § 268.40 (1998) (Land Disposal Regulations); Wilson, *supra* note 61; *Toxic Wastes Recycled, supra* note 61 (stating that the land disposal regulation threshold is too low, industry sent more than 270 million pounds of toxic waste to fertilizer companies from 1990-1995, and that the exemption allows millions of pounds of heavy metals, carcinogens, and dioxins to be applied to the nation's farmlands).

64. 40 C.F.R. § 261.3(c)(2)(ii)(C)(1) (1997). Includes requirements for frequency of testing and table of constituent levels.

65. 40 C.F.R. § 266.20(b) (1989). Total 1996 U.S. exports of fertilizer grossed $3,076,000,000. *Facts & Figures for the Chemical Industry: U.S. Trade, By Products,* CHEMICAL & ENGINEERING NEWS, June 23, 1997, at 38. A search by the author failed to reveal any statistics that break down fertilizer manufacture or export by components, including hazardous waste components.

66. 40 C.F.R. § 266.80 (1998) (Subpart G—Spent Lead-Acid Batteries Being Reclaimed, Applicability and Requirements). Persons who generate, transport, or collect whole spent lead-acid batteries for reclamation are not subject to the federal manifest requirements. Spent lead-acid batteries being reclaimed are exempt from federal manifest requirements, i.e. they are not considered hazardous under U.S. national procedures. *See* 40 C.F.R. § 266.80 (1998); 40 C.F.R. § 261.6 (a)(2)(iv) (1997). *See also* 61 Fed. Reg. 16290, 16305, (1996) (new regulations promulgated by the EPA to incorporate OECD Council Decision C(92)39) ("Thus, persons exporting whole spent lead-acid batteries for reclamation are not subject to today's import/export requirements. However, they may be required to notify the importing country of their intention to export lead-acid batteries, pursuant to contracts they execute with foreign consignees, because lead-acid batteries are found on the amber list and are considered to be hazardous under the national procedures of many OECD countries.").

mestic policies for recycling of batteries require ongoing regulation of the process of materials recycling or recovery.[67] At the point in the life of a hazardous product where it is exempt from control as waste, *e.g.* because it is in a recycling or recovery category, or because it is explicitly exempt to encourage recycling as is the case with lead acid batteries, it can be exported without any monitoring or control under RCRA section 3017. In fact, Section 3017 completely fails to distinguish these exempt but hazardous shipments from non-hazardous waste shipments.

There is evidence that batteries exported to Mexico, Brazil, and India have caused serious environmental damage.[68] Such damage is not surprising. When an Oregon battery plant closed in 1986, it subsequently shipped the battery wastes to a plant in Saraburi, Thailand for "recycling."[69] Although the costs of recycling are much lower in Thailand, the environmental standards are not as strict or as strictly enforced as environmental standards in the U.S. Researchers have gathered samples around the Saraburi plant that reveal high levels of lead and manganese in the ground and in the water.[70]

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67. Ongoing regulation includes: standards for battery manufacturing plant which also engage in lead reclamation, 40 C.F.R. §§ 60.370 - 60.375 (1998); emissions standards for secondary lead smelters, 40 C.F.R. § 63.542 (1998); and the universal waste rules, 40 C.F.R. § 273 (1995). In addition, EPA regulation domestically includes detection and prosecution of "sham recycling," and reissue of regulations to close loopholes in recycling/recovery regulations. *See* Marine Shale Processors, Inc. v. Envt'l Protection Agency, 81 F.3d 1371 (5th Cir. 1996) (upholding denial of incinerator permit for waste recovery to processor who EPA determined was using incineration for disposal and not for recovery), Owen Electric Steel Co. v. Browner, 37 F.3d 146 (4th Cir. 1994) (upholding EPA determination that slag from steel production process left on ground to cure for six months was subject to regulation under RCRA as a TSDF). *See generally* Michael Sweeney, *Reengineering RCRA: The Command Control Requirements of the Waste Disposal Paradigm of Subtitle C and the Act's Objective of Fostering Recycling—Rethinking the Definition of Solid Waste, Again*, 6 DUKE ENVTL. L. & POL'Y FORUM 1 (1996) (through and detailed analysis with the problems in the definition of solid waste and the confusion which has ensued, especially noting a risk-based approach that departs from the current characterization of recycling as a subset of waste may be more useful); Barry Needleman, *Hazardous Waste Recycling Under the Resource Conservation and Recovery Act: Problems and Potential Solutions*, 24 ENVT'L. L. 971 (1994) (complexity of regulations causes many of the problems as well as creating the loopholes); Phillip L. Cornella, *Understanding a Sham: When is Recycling, Treatment?*, 20 B.C. ENVT'L. AFF. L. REV. 415 (1993) (a somewhat dated but informative look at the lack of objective criteria to distinguish recycling from treatment).

68. *See* Kenny Bruno, *Serious Problem Which Needs Attention*, Letter to the Editor, SOUTH CHINA MORNING POST, October 19, 1994, at 22 (noting that Australia, Canada, UK, Germany and U.S. shipped more than 5.4 million tons of waste to Asian countries including 50,000 tones of lead); Asante-Duah et al., *supra* note 3, at 1689 ("One concern is the mushrooming of recycling plants in developing countries, particularly lead recycling plants in Brazil, Taiwan, Mexico, India, China, South Korea, and South Africa."); CENTER FOR INVESTIGATIVE REPORTING & BILL MOYERS, GLOBAL DUMPING GROUND: INTERNATIONAL TRAFFIC IN HAZARDOUS WASTE, Seven Locks Press, Washington, DC (1990) (documenting lead recovery plants in Brazil, Mexico, and Taiwan where workers are exposed to high levels of lead and acid is simply drained onto the ground. The Brazil plant is owned by the same firm that owned a battery recycling plant in Pennsylvania which went bankrupt and was subsequently declared a Superfund site).

69. Edward Worder, *EPA, Lead in Dilemma on Insurance*, 94 AMERICAN METALS MARKET 1, (1986) (reporting that new standards for insurance would force most of the remaining 25-30 secondary lead smelters in the U.S. to close. "Lead battery recycling would be brought to a halt at all but a few smelters which are capable of self-insurance." Domestic regulations for lead smelters lead to closure of half the plants in the U.S. between 1980-1986).

70. Eliza Teoh, *Effective Policing Needed as Asia Becomes Waste Dumping Ground*, THE STRAITS TIMES (Singapore), June 21, 1995, at 29. *See also The Poisonous effects of Lead Waste*

There is no question that lead-acid batteries contain hazardous materials, and while within the U.S. any recovery operations and eventual disposal of by-products continues to be regulated and subject to liability for environmental harm under CERCLA.[71] However, whether batteries are exported "for recovery" or for disposal, the lack of regulation eliminates any ongoing CERCLA or RCRA liability of the generator under Section 3017.[72] Because these operations are exempt from even the minimal notification and reporting requirements of Section 3017 and there is no domestic penalty for exporting these hazardous wastes, the EPA does not keep any export data on these wastes. Therefore, the extent of the problem is unknown.

These RCRA-exempt hazardous wastes move across the U.S. border through a large loophole in the export regulations. The EPA has tightened the regulation of recycling and recovery operations within the U.S.,[73] but this has not been translated to an expansion of RCRA section 3017. Within the U.S., ongoing hazardous waste recovery or recycling operations are subject to RCRA standards for site contamination, final waste disposal, and treatment and storage of hazardous products from the recycling or recovery operation.[74] The recycling operations are also subject to CERCLA liability from cradle to grave. By exporting the product at the stage when it is not labeled hazardous, when it is exempt expressly to encourage *responsible* recycling and recovery operations, the hazardous waste generator can escape from both the RCRA export restrictions that have some monitoring and tracking functions, and from RCRA and CERCLA liability. Cradle to grave liability thus becomes cradle to border liability.[75]

Under current practice, the receiving countries are given no notice and thereby have less opportunity to refuse the import or to condition it on safe practices or insurance coverage. Once the waste enters a country without direct

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Exports, ENVIRONMENT BUSINESS, March 23, 1994, *available in* LEXIS, Nexis Library, IAC Database (stating that 61,000 mg/kg of lead were found in Thailand in soils around lead recycling plants as compared with the 85 mg/kg Dutch standard, and 140 mg/kg typically found in soils near European lead smelters.).

71. *See supra* notes 6, 7.

72. Currently, there are no penalties under RCRA section 3017 for labeling waste as "for recycling" when it is eventually disposed of after export. Such a regulation could serve a deterrence function, and facilities found to violate the export requirements once could be closely monitored for future compliance. A search by the author found no cases with explicit penalties for noncompliance with Section 3017 on this basis.

73. Handly, *supra* note 56, at 10179.

74. At least for municipal incinerator ash, the Supreme Court appears to have closed the major loophole. In *City of Chicago v. Envt'l Defense Fund*, 511 U.S. 328 (1994), the Supreme Court held that the fact that municipal waste incinerators were exempt from regulation as hazardous waste treatment facilities under RCRA § 3001(i) did not explicitly or automatically exempt the residual ash generated from regulation as hazardous waste under RCRA. The Court reasoned that depending on the actual composition and properties of the ash, the waste may independently qualify as hazardous under RCRA. The export of such ash, when it qualifies as hazardous, is now governed by Section 3017 as well.

75. The polluter-pays principle followed by U.S. law makes the generator responsible for insuring environmentally sound disposal of hazardous waste. However, these principles are meaningless if the generator can escape that responsibility and liability simply by shipping the waste across the border. *See* discussion *infra* Section III(B).

notice to the government it is much harder to trace and monitor for enforcement purposes.[76] Because the exemptions mean that the EPA or any other government agency does not track export of this waste, it is impossible to know the magnitude of waste that moves through this loophole.[77]

E. Did Congress Intend This Loophole or Did the EPA Create It in Promulgating the Regulations?

The EPA promulgated the regulations for RCRA section 3017 on August 8, 1986.[78] During the public comment period, comments were made that specifically addressed the narrow scope of the proposed rules and the fact that hazardous wastes that were then exempt from the manifest requirements would now be exempt from the export requirements. One individual specifically pointed out that the statutory language "no person shall export any hazardous waste identified or listed under this subchapter unless . . ."[79] indicated a Congressional intent to subject all hazardous wastes to the export requirements of Section 3017.[80] The EPA responded that:

> EPA's regulatory definition of 'hazardous waste' is a broad one. It includes all solid wastes which are listed as hazardous wastes or which exhibit the characteristic of ignitability, corrosivity, reactivity or EP toxicity. Generally, hazardous wastes (whether listed or characteristic) are subject to the generally applicable regulations governing their generation, transportation, treatment, storage and disposal. . . . However, there are some wastes which EPA, for one reason or another, has exempted from domestic regulation. . . . It is highly unlikely that Congress would have been more concerned about wastes exported than about wastes in its own backyard.[81]

This statement of congressional intent is not founded on any express congressional exemptions in the statute but on exemptions found only in other EPA regulations. Further, even if the export regulations of section 3017 applied to these hazardous wastes it would not be a case of these exports being *more* regulated than the domestic wastes: these exports would still be *much less* regulated for export than for domestic treatment and disposal. There is no question that those substances that are considered hazardous but are exempted from regulation

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76. I am not arguing that the U.S. government should be responsible for all actions which impact the environment in other countries stemming from hazardous waste originally generated in the U.S. I am making a much narrower claim: that facilitating notice and consent of hazardous shipments is a minimal form of comity between nations that would greatly increase the likelihood that this U.S.-generated waste is dealt with responsibly and that any harms caused by that waste in the receiving country can be accurately traced to the responsible parties (whether they are the U.S. generator or transporter, or the importer or waste handler in the country of import). Expanding data collection and notice and consent requirements would be a minimal expense for the U.S. to incur, in order to help ensure effective and efficient environmental enforcement and regulation in the receiving countries. I argue that this is true both from an equitable standpoint and from a cost-benefit analysis.

77. *See* chart *infra* p. 307 and accompanying text; *see also* Asante-Duah *supra* note 3.

78. Final Rule, 51 Fed. Reg. 28,682 (Aug. 8, 1986) (Summary and response to comments for final rule begin at 51 Fed. Reg. 28,664).

79. 42 U.S.C. § 6938(a) (1984).

80. 51 Fed. Reg. 28,670 (1986).

81. 51 Fed. Reg. 28,670 (1986).

"for one reason or another"[82] are still "regulated domestically" by the EPA as solid waste in order to protect the environment,[83] even if they are no longer defined as "hazardous wastes."

Next, the EPA contended that the regulation was not clear on its face regarding the scope of its coverage. The reasoning behind this contention was twofold. First, the EPA contended that "section 3017(a) includes language prohibiting the export of 'any hazardous waste' unless certain conditions are met, one of those conditions is the requirement to attach a copy of the receiving country's consent 'to the manifest accompanying the hazardous waste shipment.'"[84] Second, the EPA noted that the statute requires that "a description of the Federal regulations which would apply to the treatment, storage, and disposal of the hazardous waste in the United States"[85] be forwarded to the receiving country along with the consent request. The EPA claimed that these requirements evidence "an intent on Congress's part to encompass something less than 'all hazardous wastes' since where a waste is not regulated domestically, consent could *not* be attached to the manifest nor would there be any regulations for EPA to describe which govern the domestic treatment, storage or disposal of such wastes."[86]

First, it is wrong that these exempt wastes are not regulated under RCRA. Waste that is "exempt" *is* regulated under RCRA hazardous waste regulations; an exemption is part of the regulatory structure. Those parts of the hazardous waste regulations which specifically exempt these categories of waste could be sent to the receiving country. Second, should any of the wastes that are exempt for recycling domestically be disposed of instead, at that point they would again be subject to RCRA guidelines for the disposal of hazardous wastes.[87] The EPA cannot really mean to say that once a substance is exempt for one purpose, *e.g.* recycling, it can be disposed of domestically without meeting *any* regulatory standards within the U.S.

The stronger claim by the EPA is that the direct reference to the manifest is a signal that Congress only meant to regulate for export hazardous wastes subject to the transportation manifest requirements.[88] "In EPA's view, the function served by the manifest domestically is similar to the function served by the noti-

82. Generally, wastes have been exempted to encourage recovery or recycling options over disposal or for very small generators. 40 C.F.R. § 261.5 (1998) (Special Requirements for Hazardous Waste Generated by Conditionally Exempt Small Quantity Generators).

83. *See* discussion *supra* at notes 74-75 and accompanying text. Under RCRA/SWDA hazardous wastes which are exempt are still regulated as solid waste.

84. 51 Fed. Reg. 28,670 (citing at 42 U.S.C. § 6938(a)(1)(c) (1984)).

85. 42 U.S.C. § 6938(d)(4) (1984).

86. 51 Fed. Reg. 28,670 (1986)

87. Because there is no monitoring of shipments of hazardous waste that are "exempt for recycling and recovery" there is no data on the overall amount of this waste exported each year and no tracking of what percent of the waste is actually recycled and not disposed of. *See* Asante-Duah, *supra* note 3, at 1688.

88. *But see* 40 C.F.R. § 262.52(c) (1998). EPA's own regulations allow for attachment of consent to "shipping paper" for bulk shipments by water and exempt rail shipments from the attachment requirement.

fication and consent internationally."[89] The notification and consent form serves both as a tracking document and as an informative document about the nature of the waste transported. This information assists the receiving country in making an informed decision to accept or reject the shipment. It is unclear why the EPA believed that Congress did not intend similar information about hazardous wastes intended for recycling to perform an equally important function. The EPA's response, that it "is doubtful that Congress intended to regulate waste for export more stringently than domestically,"[90] is misleading in a context where export regulations are significantly weaker than domestic regulations. The EPA did not show that Congress intended the current result of exempting a large class of hazardous waste exports altogether. The plain text of the statute would not necessarily lead to this conclusion.

The next section will address two questions. First, is it too late to challenge the regulations? Second, could the EPA re-issue the rules with a new, broader interpretation of the scope?

1. Administrative Law Challenges to the Regulations

The regulations could have been challenged under the APA at the time that they were promulgated, but they were not. In order to challenge the regulations at this late date, a plaintiff would have to show that he or she had been harmed due to the EPA's failure to promulgate these regulations properly. It is hard to imagine a domestic plaintiff that would be able to challenge the export regulations at this stage and, as discussed below, foreign plaintiffs have a myriad of difficulties in bringing suit on these issues. However, a domestic plaintiff who suffered a direct injury-in-fact related to the scope of the domestic hazardous waste regulations could challenge those regulations and this could in turn result in an expansion of the scope of the export regulations. For instance, a party harmed domestically by a transportation accident involving waste exempted from the transport manifest requirement (because it was destined for recycling) could challenge the regulation under the APA in the context of a tort suit against the agency. Such a plaintiff would have to allege that the lack of a hazardous waste transport manifest had contributed to the harm suffered in the accident. If the recycling regulations, which currently exempt some hazardous waste for the transport manifest requirements, were changed as a result of this litigation to require a transport manifest for all recycled waste (*e.g.*, as part of an effort to keep better data and for tracking), then that domestic manifesting requirement would automatically expand the scope of Section 3017 as well.

2. The EPA's Authority to Revise the Rules

The EPA has the authority to expand the export requirements of Section 3017 to other hazardous wastes identified under Section 261.3, thereby closing the export loophole. In *Motor Vehicle Manufacturers Association v. State*

89. 51 Fed. Reg. 28,670 (1986)
90. 51 Fed. Reg. 28,671 (1986).

Farm[91] the Supreme Court acknowledged that an agency could reevaluate earlier regulations in light of the ensuing practice and changed circumstances,[92] although the reasons for doing so must be compelling and clearly stated. In this case the EPA's original reasoning was flawed and opened a large loophole in the regulation of hazardous waste exports. The statute could reasonably be analyzed more broadly to close or narrow this loophole in a revised rulemaking. The EPA has the authority to rewrite the regulations and expand them to cover all hazardous wastes under section 261.3, rather than only those subject to manifesting requirements and 273 universal waste rules.[93] In effect, this would bring the export requirement into line with the EPA's general definition of hazardous waste by ending the exemption of hazardous waste for recycling or recovery from the export requirements of notification, consent, and monitoring.[94] This would comport with the purpose of the regulations, to encourage recycling or recovery of disposal domestically.[95] Broadening the export requirements to include notification, consent and monitoring of hazardous waste shipments intended for recycling would rationalize the export requirements under Section 3017 and bring U.S. export requirements closer to prevailing international standards.[96]

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91. Motor Vehicle Manufacturers Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29 (1983).

92. "A 'settled course of behavior embodies the agency's informed judgment that, by pursuing such a course, it will carry out the policies committed to it by Congress.' . . .[A]n agency changing its course by rescinding a rule is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance. . . . [W]e fully recognize that 'regulatory agencies do not establish rules of conduct to last forever' and that an agency must be given ample latitude to 'adapt their rules and policies to the demands of changing circumstances.'" *Id.* at 41-42 (citations omitted). Rehnquist's dissent even more clearly stated the position that a change in executive leadership would unremarkably cause an administrative agency to change its evaluation/interpretation of some statues. "A change in administration brought about by the people casting their votes is a perfectly rational basis for an executive agency's reappraisal of the costs and benefits of its programs and regulation. As long as the agency remains within the bounds established by Congress, it is entitled to assess administrative records and evaluate priorities in light of the philosophy of the administration." *Id.* at 59.

93. This could be seen to contradict current Congressional intent evidenced by the refusal to ratify Basel, but Congressional debate has been sparse and it is not clear on what grounds the refusal is based (i.e. monitoring, expansion to other waste, liability, or sovereignty issues). *See generally* WILLIAM ESKRIDGE & PHILLIP FRICKEY, CASES AND MATERIALS ON LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY (2d. ed. 1995) (post-enactment legislative history and the rejected proposal rule).

94. These RCRA section 3017 requirements are not particularly burdensome at this time as they require only notification, consent of the receiving country and tracking, there is as yet no U.S. law which would extend liability or require reshipment in the event of a problem.

95. *See* CHRISTOPHER HILZ, THE INTERNATIONAL TOXIC WASTE TRADE (1992) (identifying three basic kinds of hazardous waste export activities: (1) compliant waste handlers, who export waste exempted from the regulation or not considered hazardous categorically these include incinerator ash and contaminated soil; (2) sham recycling waste, exported for recycling but treated in a manner constituting disposal including incineration; and (3) criminal activities).

96. *See* discussion *infra* Section V on Basel and discussion *infra* Section VI on OECD.

III.
LIABILITY

A. *Domestic Disposal vs. Export Liability*

Liability of exporters of hazardous waste is minimal under both RCRA and CERCLA, because once a material is exported RCRA and CERCLA no longer apply.[97] By contrast, within the U.S., generators, transporters, and treatment, storage and disposal facilities (TSDFs) have comprehensive and extensive liability for the proper treatment, storage, transport and disposal of all hazardous wastes.[98] Even wastes that are exempt from hazardous waste rules (e.g. solid wastes and wastes exempt from hazardous waste rules for recycling and recovery) are subject to safe handling and disposal regulations and liability at all stages. In addition, the EPA has revised the regulations for recycling and recovery of hazardous waste repeatedly[99] in order to close loopholes that allowed for "sham recycling."[100]

Once hazardous wastes cross the border any damages they cause are largely beyond the reach of RCRA and CERCLA.[101] RCRA generally provides for enforcement by the EPA for violations of the requirements of the statute through both civil and criminal penalties and possible injunctive relief.[102] Under these provisions the EPA has the power to prosecute illegal exports for failure to comply with Section 3017 requirements. The few cases the EPA has prosecuted under this provision[103] were brought to its attention either through paperwork discrepancies[104] or by the regulated community.[105]

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97. *See* discussion *infra* Section III B. (Discussion of *Amlon Metals, Inc. v. FMC Corp.*, 775 F.Supp. 668 (S.D.N.Y. 1991), which found no congressional intent for extraterritorial application of RCRA, and presumably the same analysis will hold for CERCLA.)

98. CERCLA imposes liability on generators, owners, and transporters for damages, cleanup costs and damage to natural resources, 42 U.S.C. § 9607 (1998). In fact, these regulations cover liability for all waste disposal and treatment, not just hazardous waste. Responsible parties may also be liable for nuisance and trespass at common law. In addition, in some situations (emergencies and responsible party unable, unwilling or unavailable) the federal government will takeover clean-up or disposal of wastes and then litigate against responsible parties for contribution. 42 U.S.C. § 9607(a)(4) (1998) includes liability for costs of removal or remedial action incurred by government, damages to natural resources, and health assessment costs.

99. 40 C.F.R. § 266.100(a) (1992) regulates burning of waste for energy recovery only. 1988 Guidance- amendments to the definition of solid waste 53 Fed. Reg. 519 (1988), 40 C.F.R. § 273 (1998) (promulgated to aid in recycling of batteries, pesticides and thermostat mercury). The EPA is continuing to redefine solid waste and find ways to remove hazardous wastes which are disposed of as household waste and thus currently exempt from hazardous waste definition. 40 C.F.R. § 261(b)(1) (1998).

100. *See* Marine Shale Processors v. Envt'l Protection Agency, 81 F. 3d 1371 (5th Cir. 1996).

101. *See* discussion *infra* Section III B.

102. *See generally* 42 U.S.C. § 6928 (1998) (Federal Enforcement).

103. This does not mean that the EPA has not settled more cases that included an export component, but they are not in the public record. *See, e.g., infra* note 105, discussing Borden and Kodak settlements.

104. *See* Susan Bromm, *supra* note 34, at 5 (Most enforcement actions undertaken after detecting violations of the documentation requirements).

105. *Id.* at 14. (The EPA's reliance on the regulated community to forward illegal solicitations, and for tips on illegal activity). *See* United States v. Ahmad & Asran, 67 F.3d 309 (9th Cir. 1995) WL 579646 (Pakistani authorities intercepted shipment bound for dumping in family-owned mineshaft, Ahmad was found guilty of illegally transporting and exporting hazardous waste for dis-

Although RCRA's citizen suit provision provides for suits against polluters[106] or against the EPA for failure to perform non-discretionary duty,[107] no such suits have been successfully brought to date. This is in part because plaintiffs in federal court must still meet federal standing requirements[108] to sue under the citizen suit provisions. Furthermore, any direct harm from the waste will occur in a foreign country. Domestic plaintiffs will rarely be able to allege direct injury due to illegal or mishandled hazardous waste exports and will rarely be able to sue hazardous waste exporters directly or to sue the EPA for any failure to monitor compliance with the export provisions.[109]

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posal and money laundering); Borden Charged With Illegal Hazardous Waste Disposal, November 2, 1994, available in LEXIS, Nexis Library, IAC Newsletter Database (Borden was charged with failure to determine that used mercuric chloride catalyst was a hazardous waste and then shipping over 300,00 pounds of the waste to Thor Chemicals in South Africa for recycling without notifying EPA or complying with Section 3017. Little or none of the waste was actually recycled and the plant closed in 1996. Borden defended its action by saying that it had relied on Louisiana Department of Environmental Quality for determination that the substance was not a waste. Borden ultimately paid a 3.6 million dollar fine as part of the settlement of this claim, signed in 1998). GREENPEACE MEDIA CTR., *U.S. Company About to Escape Prosecution for Illegally Shipping Toxic Waste to South Africa,* Jan. 2, 1999, <http://www.greenpeaceusa.org/media/press_releases/99_1_22text.html>. *See also* Steve Herman, *Innovative Kodak Settlement: A Model for Future Enforcement Efforts*, NAT'L ASS'N OF ATTYS GEN. NAT'L ENV'TL. ENFORCEMENT J., November 1994 (Eight million dollar settlement with Eastman Kodak Co. was mostly focused on wastewater, waste disposal, storage and unpermitted incinerator, but also included charge of noncompliance with import/export requirements of RCRA). Sometimes the EPA acts in conjunction with other agencies. *See* United States v. Nweke & Nwosu, No. A:96-CR-180 (N.D. Ga. July ll, 1996) (sting operation after which defendants pled guilty to conspiracy to illegally export hazardous wastes from Georgia to Nigeria).

106. 42 U.S.C. § 6972(a)(1)(A), (B) (1998). "Any person" includes organizations, government agencies, but it is not clear whether it includes aliens. In *Amlon* the court refers to "considerable legislative history supporting the view that Congress intended an entirely domestic focus for RCRA's citizen suit provision." Amlon Metals, Inc. v. FMC Corp., 775 F. Supp. 668, 674 n.8. Aliens affected by transboundary pollution face similar problems. *See* Joel A. Gollub, *Birth of the North American Transboundary Environmental Plaintiff: Transboundary Pollution and the 1979 Draft Treaty for Equal Access and Remedy*, 15 HARV. ENVTL. L. REV. 85 (1991) (exploring the possibilities and limitations of the draft treaty to provide access to courts and remedies for transboundary pollution between Canada and the U.S., including issues of jurisdiction, standing, and choice of laws).

107. 42 U.S.C. § 6972(a)(2) (1998) (however, prosecution by the EPA or the Department of Justice is generally discretionary).

108. *See* Lujan v. Defenders of Wildlife, 504 U.S. 555, 559-61 (1992) (plaintiffs must meet Article III standing requirements even under citizen suit provisions). *See also* Lujan v. National Wildlife Federation, 497 U.S. 871, 882 (1990) ("plaintiff must fall within zone of interest sought to be protected by statute"). It is arguable that even if aliens could bring citizen suits they would be outside the zone of interest of RCRA and CERCLA, but not ATCA. *See also* Data Processing Service Orgs., Inc. v. Camp, 397 U.S. 150 (1970) (zone of interest issues).

109. Hypothetically, if hazardous waste was exported under the guise of a new product (i.e. willfully mislabeled) to a foreign country, the receiving party (or a neighbor or worker in the other country) could not bring a citizen suit against the EPA for failure to prosecute illegal export because prosecution is discretionary. In addition, the party may not be able to bring a citizen suit at all as a non-citizen. If the injured party was a U.S. citizen then they might be able to bring a citizen suit against the exporter for illegal export even if the injury in fact was extraterritorial, because the violation of RCRA was domestic (failure to notify and gain consent). The U.S. citizen who was harmed extraterritorially might have standing if the injury in fact for standing does not have to be completely commensurate with cause of action. *See* Duke Power Co. v Carolina Envtl. Study Group, 438 U.S. 59, 95 (1978) (J. Stewart dissenting) ("Surely there must be some direct relationship between the plaintiff's federal claim and the injury relied on for standing"). *See also* Stevens'

B. *Amlon Metals, Inc. v. FMC Corp.*[110]

In 1988 Amlon Metals, Inc., a New York Corporation (as agent for Wath Recycling and Euromet, United Kingdom corporations) entered into a contract with FMC, a Delaware Corporation, for reclamation of copper residue produced at FMC's pesticide plant in Baltimore, Maryland. The contract included an agreement "that the copper residue would be treated for metallic reclamation purposes, that the material would be free from harmful impurities as per sample tested earlier by Amlon, that the material was not hazardous waste, and that the material typically contained 33% copper."[111] In 1989, when the second shipment from FMC of 20 containers arrived at Leeds, England, Wath personnel noticed a strong odor. Nonetheless, thirteen of the containers were shipped to Wath and seven remained in Leeds. Those seven were eventually rejected by Wath and reshipped to FMC.[112] When Wath contacted FMC they were told that the odor was probably due to xylene, a hazardous substance, in very small quantities of 0-100ppm. However, when the smell did not dissipate FMC admitted that xylene might be present in much higher concentrations. Wath eventually contacted the British government whose tests showed xylene and several other hazardous materials in the mixture. The Health and Safety Executive required Wath to store the material in steel drums for safety. Wath then brought suit in the Queen's Bench against FMC and FMC moved to "dismiss on the grounds that all the actions claimed to be taken by FMC took place in the United States and U.S. law would apply."[113] Wath then filed suit in federal district court alleging that "FMC misrepresented the composition and characteristics of the copper residue and failed to disclose the presence and concentrations of organic chemicals in the material . . . and that the material may represent imminent and substantial danger to human health and the environment"[114] under RCRA and the Alien Tort Claims Act.[115] Wath further alleged "common law fraud, strict liability, breach of express and implied warranty and negligence."[116] The published case involved a 12(b)(1) motion to dismiss for lack of jurisdiction and a 12(b)(6) motion to dismiss for failure to state a claim upon which relief may be granted. Ultimately, the court allowed the common law claims to go forward[117]

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similar objection that plaintiff's standing would be too speculative. *Id.* at 102-03 (J. Stevens dissenting). Of course, *Duke Power* may not be very reliable as a standing case, but is better seen as an instance in which the Court reached out past strict standing requirements to settle a case because of its larger policy implications at the time. There may also be problems if any redress beyond money damages or fines are sought. Often, RCRA cases demand that the polluter clean up the problem, or the EPA arranges for cleanup and then recovers the costs from the polluter. Neither of these standard remedies would be available or enforceable extraterritorially.

110. Federal courts have rarely had the chance to examine these issues. The leading case is *Amlon Metals, Inc. v. FMC Corp.*, 775 F. Supp 668 (S.D.N.Y. 1991).

111. *Id.* at 669.

112. Reshipment assumed from facts.

113. *Id.* at 670.

114. *Id.*

115. 28 U.S.C. § 1350 (1998).

116. *See* Amlon Metals, 775 F. Supp. at 670.

117. These were presumably settled because there are no further references to them in the court docket.

but granted the 12(b)(1) motion to dismiss for lack of jurisdiction on claims brought under the Alien Tort Claims Act, and granted the 12(b)(6) motion for failure to state a claim under RCRA.

The court's analysis of the Alien Tort Claims Act turned on the lack of violation of a specific treaty or "the law of nations," which is a threshold requirement under the statute.[118] The court found that the complaint had failed to allege a particular treaty violation because it only referred to agreements that laid down general principles[119] and not "express international accords" whose violation could form the basis for a cause of action under the Act.[120]

The court noted jurisdiction under RCRA[121] but declined to apply RCRA in this case. The court stated that there is a presumption against extraterritorial application of laws and that the standard for extraterritorial application of U.S. law is the intent of Congress that the law applies extraterritorially.[122] "Having examined the relevant legislative history and structure and language of RCRA, this Court is unpersuaded by plaintiffs' contention that Congress desired RCRA to apply extraterritorially."[123] The court found that the plaintiffs had failed to meet the threshold requirement of congressional intent for extraterritorial application of RCRA.

Furthermore, the court found that it did not need to reach the question of whether the conduct at issue occurred within the U.S. or outside of the U.S.[124] Unfortunately, the court's reasoning that enabled it to avoid the issue of where the conduct occurred is circular. FMC had moved to dismiss the case in Eng-

118. "The District Courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States." 28 U.S.C. § 1350 (1998). The standard of review for a 12(b)(1) motion establishing a treaty violation is a threshold jurisdictional requirement for claims brought under ATCA. Courts typically engage in a more searching preliminary review of the merits for ATCA than is required for most "arising under" or federal question jurisdiction. *See* Amlon Metals, 775 F. Supp. at 671 (quoting Filartiga v. Pena-Irala, 630 F.2d 876, 880 (2d Cir. 1980)).

119. Plaintiffs cited: the Stockholm Principles, UN Conference on the Human Environment, June 16, 1972, 11 ILM 1416 (1972); and the Restatement (Third) of Foreign Relations Law § 602(2) (1987).

120. *See* Amlon Metals, 775 F. Supp at 671 (quoting Filartiga v. Pena-Irala, 630 F.2d 876, 888 (2d Cir. 1980)).

121. *See* Amlon Metals, 775 F. Supp at 670 n.1.

122. *See* Equal Employment Opportunity Comm'n v. Arabian American Oil Co., 449 U.S. 244, 249 (1991); Foley Bros. v. Filardo, 336 U.S. 281, 285 (1949).

123. *See* Amlon Metals, 775 F. Supp. at 676. The analysis used by the court to deny that RCRA applies extraterritorially would be much the same under CERCLA. *But see* Kourtney Twenhafel, *Freeport McMoran's Midas Touch: Testing the Application of the National Environmental Policy Act to Federal Agency Action Governing Multinational Corporations*, 4 TUL. J. INT'L & COMP. L. 303 (1996) (arguing that NEPA could meet standards for extraterritorial application. Attempts to apply NEPA to Indonesian mining project based on U.S. government loans to the project. Such application would ensure information about the project at a minimum and some accountability from U.S. multinational corporations. The article acknowledges that if there was a "major federal action" then extraterritoriality may not be necessary for NEPA to apply).

124. *See* Amlon Metals, 775 F. Supp. at 672, 673 n.5 (referring to the Leasco test "when, as here, there has been significant conduct within the territory, a statute cannot properly be held inapplicable simply on the ground that, absent the clearest language, Congress will not be assumed to have meant to go beyond the limits recognized by foreign relations law." Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1334 (2d Cir.1972)).

land based on the fact that the relevant conduct took place in the U.S. and therefore an U.S. court should hear the case. Moreover, if it was determined that the conduct (i.e., the illegal export of hazardous waste) took place within the U.S., then the conduct would fall under RCRA and the question of extraterritorial application of RCRA would be moot. The defendant characterized the plaintiff's claim for imminent and substantial endangerment as turning not on conduct, but only on "the existence of the condition." Because the condition occurred entirely overseas the defendant maintained that it was reach of RCRA.[125] Here, however, the defendant contradicted its own claim for dismissal from the Queen's Bench.

Next, the court examined whether the citizen suit provisions of RCRA would be applicable to a Section 3017 claim. The court found that Congress intended the citizen suit provision to have only a domestic focus. Therefore, citizen suit provisions did not apply to violations of Section 3017.[126] Under the court's analysis, if the shipment was found to be hazardous waste and subject to RCRA export requirements only the EPA could bring a suit for violation of Section 3017, not Amlon as an alien plaintiff, nor any other citizen who had been harmed.[127]

Even if citizen suits are limited to domestic issues, that limitation should not categorically bar a citizen suit action under Section 3017, because the actual violation of Section 3017 export requirements is always domestic. This is because Section 3017 only applies to waste that is generated in and shipped from the U.S.

IV.
BILATERAL TREATIES

The U.S. currently has bilateral import-export agreements for the transboundary movement of hazardous wastes with both Canada and Mexico.[128] This section will examine these treaties and how their provisions interface with those of the RCRA.

A. Mexico

1. La Paz

In 1983, the U.S. and Mexico signed a bilateral agreement on Environmental Cooperation in La Paz, Mexico.[129] The treaty went into force in 1984 and

125. *See* Amlon Metals, 775 F. Supp. at 673.

126. *Id.* at 674 nn.7,8.

127. The EPA may have brought suit in this case but this information is neither in the record nor on line.

128. Where treaties and statutes directly conflict, the last in time will generally control. *See, e.g.*, Weinberger v. Rossi, 456 U.S. 25 (1982).

129. U.S.-Mexico Treaty, *supra* note 8. *See also* Luis R. Vera-Morales, *Dumping in the International Backyard: Exportation of Hazardous Wastes to Mexico*, 7 TULANE ENVTL. L. J. 353, 365 (1994) (tracing environmental cooperation to the 1889 Convention Between the United States and Mexico to Facilitate Carrying Out the Principles Contained in the Treaty of November 12, 1884 to resolve issues that would affect boundary waters).

was primarily focused on the border area,[130] but its scope extends to all environmental issues of common concern. In 1987, Annex III to the agreement was signed and went into force regarding the transboundary shipments of hazardous wastes and hazardous substances.[131] The agreement contains provisions for: written notification;[132] readmission of exports for any reason;[133] sharing of research data on mitigation and avoidance of adverse affects to health, property and the environment;[134] enforcement cooperation;[135] and the requirement that all hazardous waste shipments be governed by both the terms of the Annex and domestic laws and regulations.[136] In 1988, Mexico banned the import of all hazardous wastes solely for disposal or storage, thereby excepting import for recovery or recycling.[137] At the present time, the only RCRA-regulated hazardous waste exports from the U.S. to Mexico are those of bag house dust, a by product of electric arc furnaces' emission control filters used in steel manufacturing. In 1996, the entire U.S. hazardous waste export to Mexico was 104,408.2 short tons of this emission control dust.

2. *Maquiladora Program: Free Trade Zones and Hazardous Waste*

As part of the La Paz Agreement Annex III, the U.S. and Mexico agreed that hazardous waste generated in maquiladora industries on the U.S.-Mexico border from raw materials allowed into these "free trade zones" without payment of customs tariffs would be returned to the U.S. for disposal.[138] However, some estimates are that over 25% of the hazardous waste generated is unaccounted for,[139] and "much of the hazardous waste that should be coming back to the United States for proper disposal is probably not being returned."[140]

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130. The treaty defines border area as "the area situated 100 kilometers on either side of the inland and maritime boundaries between the Parties." U.S.-Mexico Treaty, *supra* note 8, at art. 4.

131. U.S.-Mexico Treaty, *supra* note 8, Annex III, T.I.A.S. 11269 [hereinafter Annex III].

132. *Id.* at art. III(2).

133. *Id.* at art. IV.

134. *Id.* at art. X(1).

135. *Id.* at art. XII.

136. *Id.* at art. II.

137. Mexico General Law on Ecological Equilibrium and Environmental Protection 1988, Chapter V, art. 153, sec. III, *reprinted in* PHILIP T. VON MEHREN, DOING BUSINESS IN MEXICO 3 (Transnational Publishers) (1999) [hereinafter Mexico General Law].

138. Annex III, *supra* note 131 at 28, art. XI, (Hazardous Waste Generated From Raw Materials Admitted In-Bond.) ("Hazardous waste generated in the processes of economic production, manufacturing, processing or repair, for which raw materials were utilized and temporarily admitted, shall continue to be readmitted by the country of origin of the raw materials in accordance with applicable national policies, laws and regulations.") *See also* Mexico General Law, *supra* note 123, at art. 153 (hazardous waste produced from raw materials imported in-bond must be returned to exporting country).

139. *See* Eaton, *supra* note 35 (citing article by Alberto Bustani, entitled *Environmental Needs and Infrastructure in Mexico 3* (1995) on file with the St. Mary's Law Journal).

140. Testimony attributed to "GAO representatives" as part of findings after year-long review of maquiladoras by GAO. H.R. Rep No. 1086, 102nd Cong. 2nd Sess. (1992). For a discussion of tracking problems of waste generated in maquiladoras, *see also* Elizabeth Rose, *Transboundary Harm: Hazardous Waste Management Problems and Mexico's Maquiladoras*, 23 INT'L LAW. 223, 231-32 (1989). The EPA has prosecuted at least two waste companies who re-imported maquiladora hazardous wastes without notice and consent to the EPA. In the Matter of Rollins Envt'l Services, Inc., Doc. No. RCRA-VI-106-H U.S.E.P.A. (June 16, 1994) (the ALJ found that even though the

3. Border XXI Program

In 1996, the U.S. and Mexico agreed to a five-year plan of coordination and cooperation between environmental agencies in both countries on issues affecting the environment and sustainable development along the border.[141] The agreement subdivides the border into five geographic regions and provides for public participation, decentralized management, and cooperation among national, state and local agencies in both countries. On the U.S. side, agencies that have been actively involved include: the EPA, the Department of the Interior, the Department of Agriculture, and the Department of Health and Human Services. Participation on the Mexican side includes: the Secretariat for the Environment, Natural Resources, and Fisheries (SEMERNAP),[142] the Secretariat for Social Development (SEDESOL),[143] and the Secretariat of Health (SSA). The heart of the agreement is nine workgroups[144] that meet to determine policy directions in these areas of environmental concern. The workgroups are: Natural Resource, Water, Environmental Health, Air Quality, Hazardous and Solid Waste, Contingency Planning and Emergency Response, Environmental Information Resource, Pollution Prevention, and Cooperative Enforcement and Compliance. The Hazardous Waste and Solid Waste Workgroup focuses on transboundary movements of waste, transboundary effects from hazardous waste disposal,[145] development of new disposal sites, and the maintenance or clean up of old sites. Coordination of monitoring and enforcement are primary goals of the workgroup.

B. Canada

In the early 1980s, over 85% of the hazardous waste exports from the U.S. were sent to Canada.[146] In recent years the total amount of hazardous waste

Annex III treaty provision required re-importation of the waste, notice to the U.S. was not superfluous but rather "essential to the U.S. fulfilling its monitoring obligations under the Executive Agreement and that EPA has interpreted the Agreement as allowing temporary detention of the waste until e.g., RCRA marking and labeling requirements have been complied with and a proper destination supplied on the manifest."); In the Matter of Chem. Reclamation Services, Doc. No. RCRA-VI-104-H U.S.E.P.A. (Nov. 30, 1995).

141. ENVIRONMENTAL PROTECTION AGENCY, BORDER XXI DOCUMENTS, E.P.A. No. 1 60-R-96-003, U.S.-MEXICO BORDER XXI PROGRAM FRAMEWORK DOCUMENT, EXECUTIVE SUMMARY (1996).

142. Analogous to the Department of the Interior.

143. Analogous to the EPA and in charge of enforcement.

144. Six of the Workgroups had already been established to work on these issues under the La Paz agreement.

145. Of special concern is the contamination of aquifers which straddle the border. *See also International Markets: Mexico Publishes Hazwaste Policy; Would Create Confinement Zones.* HAZARDOUS WASTE NEWS, October 28, 1996, Available in LEXIS, Nexis Library, IAC Database (reporting that Mexico had issued an inventory of 55 geographical zones "suitable" for hazardous waste confinement and treatment sites, the proposal for new sites would include strengthening enforcement and reporting. The report also notes that Mexican officials' report that currently 88 percent of hazardous wastes are "improperly managed").

146. Mounteer, *supra* note 50, at 10087 (quoting *U.S. Waste Exports: Hearings on H.R. 2525 Before the Subcomm. on International Organizations and the Subcomm. on International Economic Policy and Trade of the House Comm. on Foreign Affairs*, 101st Cong. 11 (July 12, 1989) (statement of Rep. Conyers)).

sent to Canada has risen while the percent of U.S. hazardous waste it receives has fallen to approximately 50% of total U.S. exports.[147] Waste trade with Canada is governed by the bilateral treaty signed in Ottawa on October 28, 1986.[148] The treaty provides for notification and documentation nearly identical to that in the U.S. regulations. However, the treaty also provides for tacit consent if the importing country fails to respond within 30 days of notification.[149] Issues raised by exports to Canada are somewhat different than those that have been raised by export to Mexico or non-OECD or developing countries.[150] This may be based on a perception that Canada can more effectively protect itself. Canada has strict environmental laws and comprehensive enforcement at much the same "level" as the U.S. However, Canada uses a very different system, one that is risk-based, to determine hazardous waste treatment and disposal requirements.[151] Concerns do not generally focus on whether these practices are sufficient to protect Canada, but whether they will protect U.S. interests across the border and protect the Great Lakes, our shared resource.[152]

The difference in types of risk assessment noted between Canada and the U.S. is reflected in proposals that have been made in Congress to allow export to countries that have environmental laws "no less strict than"[153] or an "equally effective set of preventative controls as"[154] those in the U.S. This seemingly straightforward criterion, however, calls for complex and subjective judgments on a case-by-case basis. Many countries, whether or not they enforce their own comprehensive environmental protection regulations, use different models and assumptions to develop their regulations. This makes it difficult to make accurate comparisons between countries. For example, many countries have strong environmental laws on the books but do not enforce them rigorously.[155] Crimi-

147. *See* Chart *supra* at 101.

148. U.S.-Canada Treaty, *supra* note 8. On November 4 & 25, 1992. The treaty was amended to include "non-hazardous wastes," in part to allow Canada to reconcile Basel definitions and U.S. definition. Canada can now regulate the import of RCRA-exempt wastes and municipal waste under the bilateral treaty if necessary to conform with Basel. *See Hazardous Waste, Toxics are Main Focus of 1997 Plan*, ECO-LOG WEEK, January 24, 1997, Available in Lexis, NEXIS Library, IAC Database.

149. U.S.-Canada Treaty, *supra* note 8, at art. 3(d) (this does not contradict the RCRA requirement for written notice and consent because 3017(f) provides that international agreements between the U.S. and the receiving country can establish their own procedures). *But cf.* James T. O'Reilly and Lorre B. Cuzze, *Environmental Law and Business in the 21st Century: Trash or Treasure? Industrial Recycling and International Barriers to the Movement of Hazardous Wastes*, 22 IOWA J. CORP. L. 507, 522 (1997) ("This provision appears to contradict the RCRA requirement for written notice and written consent.").

150. *See* F. James Handly, *Exports of Waste from U.S. to Canada: The How and the Why*, 20 ENVT'L L. REP. 10061, 10087 n.38, Feb. 1990 (arguing that for RCRA regulated wastes sent to Canada the incentive is often geographical proximity rather than economics).

151. *Id.* at 10087. *See also* Mounteer, *supra* note 50.

152. *See generally* Handly, *supra* note 150; Mounteer, *supra* note 50 at 10087 n.45 (reporting that the two largest importing facilities do not use double liners or leachate collection in certain geological areas and that some Canadian facilities may be unable to meet RCRA standards) .

153. *See* Mounteer, *supra* note 50, at 10092-94.

154. *Id.* at 10095.

155. There are various reasons for lack of enforcement, including lack of money for enforcement, lack of consensus in country about environmental harm versus economics, or lack of consensus on short-term gains in industry and economy versus long-term environmental harm. *See* Paul

nal behavior and fraudulent labeling make it more difficult still to ensure that strict enforcement of regulations and environmental protection goals will be met, despite monitoring, manifests, and integrated databases.

V.
THE BASEL CONVENTION: THE U.S. REMAINS A SIGNATORY BUT NOT A PARTY

A. Basel Convention

The Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal (Basel)[156] currently has 121 parties.[157] While much has been written and debated about the Basel Convention, perhaps the most salient fact is that the United States has not yet ratified it. The U.S. remains a signatory but is not a party. Therefore, the treaty lacks the force of law within the United States, the world's largest single producer and exporter of hazardous wastes.[158]

The Basel Convention includes agreements that: (1) the transboundary movement of hazardous waste should be reduced to a minimum consistent with environmentally sound management;[159] (2) hazardous waste should be treated and disposed of as close to the source of generation as possible; and (3) the generation of hazardous waste should be reduced and minimized at the source. These common sense objectives are not problematic in themselves, but the more expansive definition of hazardous waste under Basel may be the crucial issue blocking U.S. participation.[160] The main regulatory mechanisms of Basel are: notice, consent, and either reshipment to the exporter or proper on-site disposal of waste,[161] paid for by the exporter when so requested by the country of import. Many counties that are parties to Basel are also members of other interna-

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Ekins and Michael Jacobs, *Environmental Sustainability and the Growth of the GDP: Conditions for Compatibility*, in THE NORTH, THE SOUTH AND THE ENVIRONMENT 9, 28-31 (V. Bhaskar & Andrew Glyn, eds., United Nations University Press 1995) (attempting to devise a policy formula to determine the costs and benefits of environmental harms to developing economies).

156. Basel Convention, *supra* note 9.

157. Status as of June 17, 1998: 53 signatories. Most other signatories subsequently ratified. *See* <http:www.unep.ch/basel/index>. Basel completed its fourth session in February 1998 at Kuching, Malaysia.

158. The U.S. is the largest hazardous waste generator both as defined by Basel and under the narrower Section 3107 definition. Basel has continued to refine its definitions of hazardous waste; at Kuching the Convention adopted new comprehensive lists of hazardous wastes presented by the parties. *See infra* at note 169.

159. For example, exceptions for countries without disposal capacity (e.g. Luxembourg) or geological features making environmentally sound facilities nearly impossible (e.g. Holland).

160. *See infra* text accompanying note 172 on attempts to ratify Basel.

161. Basel has provisions for reshipment of wastes which violate the convention, placing liability for reshipment and safe disposal on the country of origin. "(2) "[T]he State of export shall ensure that the wastes in question are (a) taken back by the exporter or the generator, or, if necessary, by itself into the State of export, or, if impracticable, (b) are otherwise disposed of in accordance with the provisions of this Convention. . . ." Basel Convention, *supra* note 9, at art. 9 (Basel requirement of reshipment or environmentally sound disposal).

tional, multilateral, and bilateral treaties, as well as trade organizations. Therefore, it is not always clear which agreements trump on various issues.[162]

At the second session of the Basel convention, the Conference of the Parties adopted Basel II/12, a ban on the export of hazardous waste from OECD to non-OECD countries[163] which included a ban on the export of hazardous waste for recycling that was to go into effect in 1998.[164] This ban in particular has created confusion for parties to Basel, both OECD members and non-OECD members, who trade with the U.S. in hazardous waste. In addition, the U.S. regulations implementing the OECD decision are in conflict with the Basel II/12 ban.[165]

B. Definitions in Basel

Many news reports use the terms "toxic waste" and "hazardous waste" interchangeably to describe exports that may be considered hazardous waste under either the Basel convention or other standards, but are exempt under RCRA export standards.[166] Klaus Topfer, the executive director of the United Nations Environmental Program has estimated that 450 million tons of toxic waste are created annually. However, in 1995 the total U.S. generation of RCRA regulated hazardous waste was 214,092,505 tons,[167] of which only 226,393 tons[168] were exported.

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162. The U.S. position seems to be that the order of preference is bilateral over multilateral when agreements conflict. A number of parties also rank these agreements as such (i.e., NAFTA over OECD). Further, under U.S. law, more specific treaties always supersede more general agreements, and specific language supersedes general language.

163. Decison II/12, Second Conference of the Parties to the Basel Convention, March 25, 1994 <http://www.ban.org/about_basel_ban/copsII_12.html>.

164. Although too few parties have actually ratified the changes adopted at the Second Conference of the Parties for the ban to go into effect, many have begun to try to implement the ban. Confusion about what would come under the ban is one impediment to its ratification. Under Basel, green list wastes are considered hazardous, but under EU and OECD standards they are not.

165. *See supra* text accompanying note 204.

166. Confusion is not limited to the U.S. definitions. European Union countries have had a hard time adjusting to and sorting out definitions as various bans on exports for disposal or recovery go into effect. *See Legal Trouble Brews As Chaos Hits Waste Recovery*, ENVT. BUS., June 15, 1994, available on LEXIS, Nexis Library, IAC Database; *OECD to Conduct General Review of Product/ Waste Distinction*, ENVT. WATCH W. EUR., Nov. 4, 1994, available in LEXIS, Nexis Library, IAC Database (discussion the status of scrap metal as 'legitimately traded' worldwide as a feedstock for industry, and discussion of industry's preference for looking at issue as waste versus product as distinct from hazardous versus non-hazardous waste). This points to other labeling problems which make enforcement of export controls especially difficult. Mislabeling of scrap metal most likely led to the Acerinox Steel plant accident in Algeciras, Cadiz, Spain in the Summer of 1998, involving scrap metal contaminated with Cesium-137 that created a radioactive plume over France, Italy, Switzerland and Germany that was not detected in Spain due to the wind patterns. *See Italian Justice Opens an Investigation on the Radioactive cloud of Algeciras*, EL PAIS, June 15, 1998, <http:www.el-pais.es> (noting that environmental groups pointed out that the incident raised issues of illegal traffic in toxic waste and recyclable remainders). *See also Smelter Contamination: Accidental Source Melting Reflects Insufficient Regulation of Users*, NUCLEAR WASTE NEWS, May 18, 1995, available in LEXIS, Nexis Library, IAC Database (reporting that NRC report identifies Cesium-137 contamination in scrap steel which not only contaminates the steel and the plant but also the dust effluent from which zinc is recovered, tracing the problem to the accountability of radioactive sources).

167. EPA 1995 REPORT, *supra* note 38.

The fourth session of the Basel Convention specifically dealt with lists of wastes which could be exported and those which would be banned from export. Included in the list of hazardous waste specifically banned for export under Basel are: wastes for disposal containing arsenic, asbestos, lead, and mercury.[169] Wastes which are allowable exports for recovery include: scrap iron, steel or copper, non-hazardous catalysts.[170] Lead-acid batteries are just one example of a waste that is exempt from RCRA section 3017 export controls but considered hazardous waste under Basel.[171]

C. Attempts to Ratify Basel in the United States

As early as 1988, the Waste Export Control Act was introduced in Congress.[172] The bill would have broadened the class of wastes subject to RCRA export restrictions and imposed the condition that treatment standards of importing facilities be "no less strict than" U.S. standards for treatment of hazardous wastes. The bill would also have imposed cleanup liability on waste exporters, required insurance or bond, and guaranteed EPA access to foreign facilities for inspections.[173] The bill failed to pass in 1988, but was re-introduced in 1989 and again failed to win support. In 1992, President Clinton proposed that the Senate ratify Basel and presented the treaty to the Senate for ratification along with a document describing the steps that would be necessary to change existing

168. *See* chart, *supra* page 101.

169. Jocelyn Gecker, *UN Urges Toxic Waste Dumping Ban*, Feb. 26, 1998, ASSOCIATED PRESS (reporting on Basel IV session in Kuching, Malaysia). The dangers of mercury contaminated waste were dramatically demonstrated when a Taiwanese firm dumped toxic waste near the town of Sihanoukville, Cambodia in 1998. Seth Mydans, *Cambodia Town's 'Luck' Leaves Illness in Its Wake*, N.Y. TIMES, Jan. 4, 1999, at A3.

170. *Scrap Metal Exempt from Basel Ban*, WASTE TREATMENT AND TECH. NEWS, March 1998, available in LEXIS, Nexis Library, News Database. The exemption of scrap metal for recycling was crucial and controversial. Although many scrap metals fit hazardous definitions (mostly due to hazardous paints and solvents found on them) they are used as raw material in less developed countries and it is often not economical to recycle scrap metals in many OECD countries. *OECD to destroy Ghana's Scrap Industry?*, HAZNEWS, Feb. 1, 1998, available in LEXIS, Nexis Library, IAC Database (stating that in confusion over exact terms of Basel, EU countries had already rejected requests to allow import of secondary materials (not all hazardous) for reuse to Ghana. The Ghanaian scrap industry employs over 4 million people); *OECD Hazwaste Export Ban by 1998*, HAZNEWS, May 1994, available in LEXIS, Nexis Library, IAC Database (lengthy negotiations on Basel ban and resistance to ban on export of "secondary materials" would result in landfill of low-value metal residues in industrialized countries). Approximately 5 million tons of scrap metal were sent to South Korea and India between 1990 and 1993. *OECD Countries Dump 'Toxic' Wastes in Asia?*, HAZNEWS, March 1994, available in LEXIS, Nexis Library, IAC Database. There has also been confusion over the distinction between incineration for disposal and incineration for recovery of valuable metals. *See, Varied Environmental Progress in '94 says CEFIC (European Chemical Industry Council)*, HAZNEWS, Sept. 1995, available in LEXIS, Nexis Library, IAC Database.

171. Basel IV must still be ratified by parties before the new definitions go into effect. The lists are quite detailed and include "lead acid batteries whole or crushed" as well as "ash from incineration of circuit boards." *See* Conference of Parties, Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, Annex VIII, List A. Wastes covered by the Conference of Parties (COP) 4 decisions include lead acid battery waste, <www.unep.ch/basel/index>.

172. Waste Export Control Act, S. 2598, 100th Cong. (1988); H.R. 3736, 101st Cong. (1988).

173. *See generally* Mounteer, *supra* note 50 (describing the features of the bill as reintroduced in 102nd Congress).

U.S. laws to conform with the treaty.[174] Though the Senate debated giving "advice and consent" on the Basel Convention, the ratification was not achieved.[175] In 1994, the Waste Export and Import Control Act (Synar-Swift Bill)[176] was introduced to the Congress, but also failed to pass into law. Again, in 1997, Rep. Towns introduced the Waste Export and Import Prohibition Act[177] in the House of Representatives where it died in committee.

All of these bills have essentially the same contours and any of them would have served to ratify the Basel Convention into law. Clearly the issues presented by the export of hazardous wastes are not hidden from the Congress; rather, they have been introduced and debated repeatedly. Congress has chosen not to ratify Basel and has also chosen not to independently expand the current hazardous waste export provisions.

Why has Congress failed to ratify Basel or to adjust U.S. laws to meet the emerging worldwide hazardous waste consensus, and what interests and constituencies are driving these results? Industries that generate hazardous wastes are a strong constituency that clearly see export as a cheaper alternative to environmentally sound disposal and management of hazardous waste within the U.S. In addition, public liability issues are also a likely factor.[178] However, the failure of environmental groups to mobilize around this issue is also a significant factor.

Environmentalists' concerns about international environmental justice clash with the commonly held "not in my backyard" attitude of legislators, U.S. citizens, and even domestic environmental groups. Domestic environmental groups do not want hazardous waste disposed of where it will damage the U.S. environment or public health within communities (and the environmental justice movement has broadened the definition of the term 'communities').[179] As groups with mostly grassroots constituencies, these domestic goals are the first priority of many domestic environmental groups. Internationally- or globally-focused environmentalists who address the issue of hazardous waste disposal stress that all countries must reduce the amount of hazardous waste generated, and that exporting waste to less developed nations is a form of environmental racism.[180]

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174. S. Exec. Rep. No. 102-36 at 15 (1992).

175. S. Treaty Doc. No. 102-5 at V (1992).

176. H.R. 3965, 103rd Cong. (1994) (introduced March 7, 1994).

177. H.R. 360, 105th Cong. (1997) (introduced Jan. 7, 1997); *see also Administration Commits to Begin Process of Implementing Treaty on Waste Transport*, 29 ENVT. REP. 18, Aug. 28, 1998, available in LEXIS, Nexis Library, BNA-ENV Database (administration planned to propose new legislation to implement parts of Basel in 1999).

178. *See supra* note 161. (Basel requests that the country of origin take responsibility for the waste, not just the private party exporter).

179. *See, e.g.*, David E. Camacho, *The Environmental Justice Movement: A Political Framework, in* ENVIRONMENTAL INJUSTICES, POLITICAL STRUGGLES: RACE, CLASS, AND THE ENVIRONMENT 11 (1998).

180. Greenpeace has taken this position. "Greenpeace has always believed in the fundamental principle that we should no longer needlessly dump wastes into the environment and that we must act responsibly to reduce waste, recycle non-hazardous waste and treat or contain harmful materials." *Brent Spar Meeting Between Greenpeace and Shell* <http://www.greenpeace.org/~comms/brent/sep08.html>. A first step towards the goal of reducing exports would be to expand U.S. regulations to cover the monitoring of these wastes, expansion of the scope of Section 3017 would at least accomplish this. *See also* Hugh J. Marbury, *Hazardous Waste Exportation: The Global Mani-*

Forcing the internalization of the costs of disposal by industry may be the only way to reduce the generation of hazardous waste in an essentially free market economy. Within the U.S., regulations are comprehensive and are generally enforced. If generators were forced to keep hazardous waste "at home" the current regulations would have the strongest economic effect. By taking into account the long-term global benefits of forcing generators to deal with the waste within the U.S., environmentalist may be able to mobilize support for stronger export regulations.

VI.
MULTILATERAL AGREEMENTS IN FORCE: OECD DECISION, NAFTA AND GATT

This section looks at three multilateral agreements to which the U.S. is a party: OECD, NAFTA, and GATT, and the terms of those agreements that directly affect U.S. hazardous waste exports.

A. The Role of the OECD In Framing the Issues for the International Debate on the Transfrontier Movement of Hazardous Waste

This section focuses on OECD and its ongoing efforts to utilize an economic model in dealing with environmental issues because it is a precursor to, and an essential model for, the newer global economic treaties and organizations which are now at center stage in the international debates on economics and the environment. Unlike NAFTA and WTO / GATT, environmental issues have been integrated into the OECD agreements with little fanfare or discord. This may be partly due to the relative economic homogeneity of OECD[181] members and the focus on trade policy over detailed regulation. During 1994, when the ratification of NAFTA in the U.S. and the environmental side agreements were hard fought, Mexico joined OECD. At that time all three countries in the NAFTA environmental side agreement became subject to quite similar existing OECD agreements that also deal with transboundary pollution and waste shipments.

The OECD Council took an early interest in the transfrontier pollution issues,[182] focusing on "the interrelationships between population, resource and

festation of Environmental Racism, 28 VANDERBILT J. OF TRANSNATIONAL L. 251 (1995) (arguing that the same issues raised by environmental justice on siting of waste facilities in the U.S. are present in the export of hazardous waste to other countries where the waste disproportionately impacts poor and minority populations; in essence, that the export of hazardous waste raises environmental justice issues on a global scale).

181. OECD member countries are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden. Switzerland, Turkey, the United Kingdom, and the United States. However, this is changing as more "mid-level" economies are being admitted to the OECD. In 1995 the Czech Republic was admitted, and in 1996 Hungary, Poland and Korea were admitted.

182. For example, the Environment Committee of the OECD held a special session on April 1st 1981 to address environmental challenges for the 1980s. OECD, ECONOMIC AND ECOLOGICAL INTERDEPENDENCE (OECD, 1982), at ii n.1.

environment issues on the one hand and sustainable economic development on the other."[183] The primary mandate of the OECD is multilateral economic co-operation and development, and the OECD realized that issues including production and consumption patterns, transboundary effects of pollution, resource management, soil degradation, and loss of genetic materials would "prove resolvable or avoidable only through increased co-operation among countries."[184] The OECD's focus on international movement of hazardous wastes was spurred by the discovery of abandoned waste sites throughout the world.[185] The OECD noted that the difficulty of siting hazardous waste disposal, long term costs of proper disposal, and ongoing liabilities associated with hazardous waste sites "provide strong incentives to 'export' such wastes to other regions or countries for treatment or for temporary or permanent storage."[186]

The OECD recognizes that there are legitimate reasons to export hazardous waste, such as geographic/geological limitations, lack of treatment or disposal capacity, highly specific treatment needs where the exporting country lacks the technology to treat the wastes adequately, transportation distances, or the economic use of the waste as raw material in another industry.[187] "[H]owever, under other conditions, the export of hazardous wastes may simply reflect a search for a jurisdiction in which environmental awareness and regulations are weak or non-existent."[188] OECD countries produce most of the hazardous waste worldwide;[189] this makes the need for cooperation among OECD countries particularly strong. The need for coordination of national policies and international cooperation led to the 1992 Decision calling for uniform labeling.[190] However, more work remains to be done in other areas. For example, uniform documentation, tracking and monitoring,[191] uniform definitions, meaningful in-

183. *Id.*

184. *Id.* at 3.

185. *Id.* at 29 (noting especially Love Canal (U.S.) and Lekkerkerk (Netherlands)).

186. *Id.* at 29.

187. For example: the Netherlands has a very high water table and had banned land disposal of hazardous wastes within the country. However, in 1990 a chemical waste dump was opened in Rotterdam's Maasvlakte to relieve some pressure from exports of chemical wastes from the Dutch chemical industry. The dump is fully sealed to prevent seepage and will hold less than half of the annual chemical waste output. *Dutch Open Chemical Dump to Cut Back on Waste Exports*, INT'L PETROCHEMICAL REP., April 19, 1990, at 5.

188. OECD, *supra* note 182 at 30. This statement is a bit dated, environmental awareness at least among the educated people and within governments worldwide is now widespread. In addition, environmental regulations are often excellent on paper. Currently it is more likely that the lack of consistent enforcement of environmental regulations and the dire needs for short term economic gain are the magnets for international hazardous waste export.

189. Approximately 80% in 1982; currently, the U.S. accounts for over 50%. *See* Asante-Duah, *supra* note 3, at 1684.

190. *See* OECD Decision 92(39), *supra* note 10. Discussion of U.S. incorporation of this standard shows that there will still be little uniformity.

191. *See* John Butlin, *Towards a Mutually Acceptable International Document to Monitor the Transfrontier Movement of Hazardous Waste*, *in* TRANSFRONTIER MOVEMENTS OF HAZARDOUS WASTES (OECD 1985) 145; F. Van Veen, *National Monitoring Systems for Hazardous Wastes*, *id.* at 82 (surveying 12 OECD members' monitoring systems and governing laws).

ternational notification, and insurance and liability[192] issues all still need to be agreed upon.

The OECD Council adopted the "polluter-pays principle" as an economic guideline for members in 1972.[193] This decision reflected the OECD's determination that "economic efficiency would be promoted and distortions of trade avoided if the pollution control policies of Member countries required polluters to internalize their external costs . . . [it] was intended to ensure that the full costs of pollution control or prevention measures should be reflected, in turn, in the costs of the goods produced and marketed."[194] The adoption of this principle was an acknowledgment that OECD countries, as the major investors and industrial producers worldwide, have obligations not to abuse the "global commons" by externalizing the costs of pollution to other countries, whether OECD members or not.[195] The OECD has endorsed the use of economic instruments for environmental protection because the experience of member countries has shown that economic instruments used in conjunction with domestic environmental regulation can: yield substantial cost-savings, create incentives to lower pollution below regulatory levels, increase flexibility of regulatory schemes, promote resource conservation, and may provided needed sources of financing for environmentally sound economic development.[196]

The OECD has specifically endorsed the use of environmental taxes (both emissions charges and product charges), marketable pollution permits, and deposit refund systems. Direct subsidies to industries for environmental protection and clean up may be acceptable, but the OECD does not endorse general subsidies to industries because they lead to market distortions, which are incompatible with the polluter-pays principle.[197] In the waste arena in particular, "user charges are aimed at the proper collection, processing and storage of waste or at restoration of old hazardous waste sites."[198] Both use and disposal charges create incentives to minimize waste generation, discourage generation of waste-intensive products, and promote the development and use of environmentally

192. *See also* Martine Remond, *The Carriage of Hazardous Waste and the Liability Question*, *id.* at 210 (examining the issue raised by insurance of "goods" of zero economic value which reverses the normal incentive of transporters not to lose or damage goods in transit, in fact creating strong incentives to "lose" these "goods" at sea); Rudiger Lummert, *Liability of the Generator and the Disposer of Hazardous Wastes*, *id.* at 230 (exploring the problems associated with differing liability regimes, choice of law, and purpose or incentives created by those differing liability regimes); S. Baumgartner & P. Tobler, *Contract Clauses with Respect to Transfrontier Movement of Hazardous Waste*, *id.* at 285 (arguing that contracts clauses are suitable to cover gaps in regulations within Europe, but written before the EC existed. There are presumably fewer choice of law issues now.).

193. OECD, ECONOMIC AND ECOLOGICAL INTERDEPENDENCE (OECD 1982) 68 n.1 (discussing Guiding Principles Concerning International Economic Aspects of Environmental Policies, C(72)128 (1972)).

194. *Id.* at 68.

195. *Id.* at 70.

196. *See* OECD, ENVIRONMENTAL POLICY: HOW TO APPLY ECONOMIC INSTRUMENTS 14, (OECD 1991).

197. *See id.* at 15-18.

198. *Id.* at 39.

sound substitutes.[199] Marketable permits have not yet been used in this area and likely would have little efficacy without stronger controls and monitoring worldwide. Because waste is easily shipped and hard to recognize at border control points, the move towards greater free trade and fewer border controls makes it crucial to coordinate rules for waste management and to integrate environmental and trade policies so as to include the basic notion that waste is different from normal free-tradable products.[200]

1. OECD Declaration

On March 30, 1992, the OECD adopted Council Decision C(92)39 Concerning the Control of Transfrontier Movements of Hazardous Waste Destined for Recovery Operations.[201] This Decision was supported by the U.S. and imposes legally binding obligations on the United States.[202] Unlike the Basel Convention, to which the U.S. is a signatory but not a party, the OECD Council Decision C(92)39 is binding on the U.S. The OECD decision stemmed from recommendations, made during the Basel II meeting at Geneva, that exports of hazardous waste for disposal be banned between OECD and non-OECD countries, and that waste exports for recovery be limited to OECD countries and banned between OECD and non-OECD countries after January 1, 1998.[203] The EPA promulgated regulations[204] implementing the Decision which include uniform labeling of hazardous waste exports for recovery in other OECD countries. These EPA / OECD regulations are an attempt to facilitate shipment of waste for recycling and recovery between the U.S. and other OECD countries who are parties to the Basel Convention.

Although the U.S., Canada, and Mexico are all OECD members, the regulations do not appear to apply to hazardous waste exports from the U.S. to Canada and Mexico. The EPA has interpreted the bilateral agreements to supersede the OECD agreement.[205] Therefore, those exports continue to be regulated under the bilateral agreements and the U.S. regulations for export already in effect.

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199. *Id.* at 40. Charges for disposal or use should be based on toxicity, quantity, costs of disposal, direct environmental damages, and a "use" fee for residual environmental risks. *See id.* at 43. Deposit refund systems provide incentives to consumers to return spent products but do not directly impact the waste handling after that point, which is the focus of this paper.

200. *See id.* at 43.

201. OECD Council Decision 92(39), *supra* note 10.

202. Convention on the Organization for Economic Cooperation and Development, Dec. 14, 1960, 12 U.S.T. 1728, 888 U.N.T.S. 179, arts. 5(a), 6(2).

203. *See* discussion of Basel, *supra* notes 163, 164 and accompanying text. Not enough countries have ratified this decision for it to go into force.

204. 40 C.F.R. §§ 262.80-262.89 (1998).

205. Imports and Exports of Hazardous Waste: Implementation of OECD Council Decision C(92)39 Concerning Control of Transfrontier Movements of Wastes Destined for Recovery Operations, 61 Fed. Reg. 16,290 (1996). "These requirements will apply only to U.S. exporters and importers of RCRA hazardous wastes destined for recovery in OECD countries (except for Canada and Mexico; waste shipments to and from these countries will continue to move under the current bilateral agreements and regulations)." *Id.* at 16290. Furthermore, these regulations fail to address any limits on exports to non-OECD countries which were enacted by Basel II.

Basel explicitly states that bilateral and multilateral regional agreements with parties or non-parties override Basel requirements between the countries.[206] Because the U.S. is not a party to Basel, and both Canada and Mexico are parties, the bilateral treaties control transactions between the three countries under Basel as well. However, as parties to Basel, Canada and Mexico may still need to find ways to reconcile contradictory requirements in the Basel Convention and the OECD treaty, such as the inconsistent labeling standards and definitions.

2. EPA Response: New Regulations

In 1996 the EPA promulgated regulations designed to "harmonize" the OECD requirements for labeling of hazardous waste exports with the U.S. requirements under Section 3017.[207] In general, the regulations require: (1) that hazardous waste only be exported for recovery or recycling;[208] (2) the notification and consent of the importing country;[209] and (3) the additional labeling of the hazardous waste for export on a tracking document using the OECD system identifying "green-list", "amber-list" and "red-list" wastes. Green-list wastes "are subject to existing controls normally applied to commercial transactions," unless they are considered hazardous under U.S. law or are contaminated or mixed with wastes considered hazardous under U.S. law.[210] However, if the wastes are not considered hazardous under U.S. procedures, they "may move as though they appeared on the green list."[211] In essence, the U.S. definitions of hazardous waste for export still control how the wastes are labeled.

206. Basel Convention, *supra* note 9, at art. 11, "Bilateral, Multilateral, and Regional Agreements".

207. Transfrontier Shipments of Hazardous Waste for Recovery within the OECD, 40 C.F.R. §§ 262.80- 262.89 (1998).

208. Here, the exclusion of Canada becomes crucial for U.S. exporters because most of the hazardous waste exported to Canada is for disposal not recovery. *See supra* note 152 and chart *supra* at 101.

209. 40 C.F.R. § 262.83 (1998). Consent for red-list waste must be written and received prior to shipping. 40 C.F.R. § 262.83(c) (1998). Includes a provision for tacit consent for amber-list waste which is allowed after the importing country receives a 30 day notification of export. 40 C.F.R. § 262.83(b)(ii) (1998). However, "unlisted wastes not considered hazardous under [subpart H] are not subject to amber or red controls when exported or imported." 40 C.F.R. § 262.83(d) (1998).

210. 40 C.F.R. § 262.82(a)(1)(i)-(iii) (1998).

211. 40 C.F.R. § 262.82(4)(ii) (1998) (referring specifically to wastes not yet assigned to a list); *accord*, 40 C.F.R. § 262.82 note to paragraph (a)(3) ("Some wastes on the amber or red lists are not listed or otherwise identified as hazardous under RCRA (e.g., polychlorinated biphenyls) and therefore are not subject to the amber- or red-list controls of this subpart. Regardless of the status of the waste under RCRA, however, other Federal environmental statutes (e.g., the Toxic Substances Control Act) may restrict certain waste imports or exports. Such restrictions continue to apply without regard to this Subpart.") The reference to control of PCBs says nothing about other wastes which are listed as either amber- or red-list by the OECD but are not considered hazardous waste under U.S. law. As far as U.S. regulation is concerned, this waste can travel freely as green-list waste. This contradiction highlights the problems with having inconsistent definitions in the international trade arena so that the U.S. can appear to be complying with international "rules" by relabeling waste under this "universal" system but still not requiring the same standards for labeling as other countries.

These regulations were intended to facilitate transboundary movements of hazardous wastes for recovery, particularly between the U.S., which is not a party to the Basel Convention,[212] and OECD countries (other than Canada and Mexico) that are parties to the Convention. The regulations apply to the same hazardous wastes as covered by RCRA section 3017 and do not expand or override the tracking or notification procedures of that section. Rather, the regulations merely add another form of labeling. While the OECD Decision requires that hazardous waste exports only be made for recovery, the new U.S. regulations apply to a more limited class of waste. The new regulations restrict export for disposal only of waste already regulated under Section 3017, and only where a bilateral treaty does not exist that allows exports for disposal, such as that between the U.S. and Canada. The new regulations do not restrict export for disposal of waste exempt from Section 3017. Because the EPA originally interpreted Section 3017 to regulate exports of only a limited class of hazardous waste,[213] the EPA did not expand the scope of the export regulations beyond that limit[214] under the OECD Decision. Therefore, the EPA's OECD regulations[215] do not regulate wastes that are considered hazardous by other OECD members if those wastes are not defined as hazardous under RCRA. Nor do the new regulations broaden the scope of the regulations to include the export of RCRA-exempt hazardous waste. The new regulations primarily create another labeling requirement, without moving any closer to uniform definitions of hazardous waste. How the waste is labeled will still be dependent upon the definition of hazardous waste in the country of origin, where the label is attached.

B. NAFTA

The North American Free Trade Agreement (NAFTA)[216] between the United States, Mexico and Canada specifically incorporates as controlling the bilateral agreements between the U.S. and Canada, and the U.S. and Mexico, as well as other Multilateral Environmental Agreements (MEAs) between the parties (including Basel, to which both Mexico and Canada are parties).[217] NAFTA itself makes no specific reference to hazardous waste regulation, but includes a prohibition on lowering environmental standards to increase trade or attract investment.[218] The Environmental Side Agreement[219] provides for sanctions if a country fails to enforce its own environmental standards,[220] and allows

212. Basel Convention, *supra* note 9, 1995 Amendments.

213. This class was basically coextensive with the hazardous waste manifesting requirements. *See supra* notes 54-55 and accompanying text.

214. *See supra* Section III E, for discussion of the nature of the limit and decisions made in the original promulgation of export regulations.

215. 40 C.F.R. §§ 262.80-262.89 (1998).

216. NAFTA, *supra* note 11.

217. NAFTA, 32 I.L.M. at 297-98.

218. NAFTA, *supra* note 11, at art. 1114, *id.* at art. 5.

219. North American Agreement on Environmental Cooperation, 32 I.L.M. 1480, Jan 1, 1994.

220. NAFTA, *supra* note 11, at art. 5 (procedures for sanctions for failure to enforce include: fact-finding, "action plan" to remedy, penalties, and trade sanctions if party does not adhere to "action plan.") It is unclear if this provision could be used to hold the U.S. liable for failure to

countries to increase regulations to protect human, plant and animal health and life,[221] but it is silent on standardizing hazardous waste definitions between the countries. Therefore, Mexico is in a position to develop more recycling capacity and legally increase its hazardous waste imports for recycling and recovery. However, Mexico presumably can not change the import ban on disposal of hazardous waste in order to attract waste trade from other countries.[222]

The increase in cross-border traffic expected under NAFTA will make it more difficult to monitor shipments and to identify illegal shipments.[223] In addition, NAFTA will eventually eliminate all import duties between the three countries; at that time the current in-bond system and hazardous waste return provision for maquiladoras will become ineffective. Without import duties, manufacturers will not be able to gain any reduction in duties by complying with the requirement that they repatriate the waste to the U.S.[224]

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monitor and enforce RCRA section 3017 and the border in-bond system and, if so, what the penalties would be.

221. *Id.* at art. 712 (1).

222. Whether the import ban for disposal actually qualifies as an environmental standard to protect local health and safety, or whether it would be considered a different kind of legislation, and what standards are used to make this determination is unclear. Mexican standards for disposal are quite comprehensive on paper but unevenly enforced, and lack of enforcement can be sanctioned under NAFTA. This web of agreements could lead to a large number of cross suits over a single illegal export for disposal, and that litigation may not adequately compensate or clean up the problem. Mexico could claim that the U.S. failed to enforce export controls and the U.S. could claim that Mexico failed to enforce the prohibition against illegal dumping. Meanwhile, the responsible private party could escape most RCRA liability applicable only in U.S., except fines for illegal export under RCRA. However, a private Mexican citizen who was harmed by the illegal disposal would have to sue the private U.S. company using the Alien Tort Claims Act with NAFTA, or a side agreement, or the bilateral agreement as the international law violated. *See* discussion *infra* Section VII.

223. Eaton, *supra* note 27 at 719-22 (positing Mexico as the "path of least resistance" for illegal dumping in part because of the maquiladora trade, the high cost of disposal in the U.S. and the perception of lax enforcement within Mexico on waste issues). Industrial relocation under NAFTA will also increase the amount of hazardous waste produced in Mexico without necessarily expanding the treatment, storage and disposal capacity. *Id.* at 723-24. However, a parallel development is taking place with increased trade in environmental technology and investment for environmental infrastructure. Estimates are that 5 to 7 million tons of hazardous waste is generated in Mexico annually. Hazardous waste management is estimated to cost $115 million per year. U.S.-based waste management companies currently operating in Mexico include Waste Management Inc., Metalclad, Inc., and WMX Technologies. *Policy Proposals for Hazardous Waste in Mexico*, HAZNEWS, August 1994, available in LEXIS, Nexis Library, IAC Database. U.S. environmental technology exports to Mexico were expected to grow from $1.5 Billion in 1992 to $2.6 Billion in 1995. *Commerce Eyes Mexican Markets*, WASTE TREATMENT TECH. NEWS, January 1995, available in LEXIS, Nexis Library, News Database; *see generally U.S. Companies Should Not Fear Foreign Markets*, SUPERFUND WEEK, Nov. 21, 1997, available in LEXIS, Nexis Library, News Database; Armin Rosencranz et al., *Rio Plus Five: Environmental Protection and Free Trade in Latin America*, 9 GEO. INT'L ENVT'L. L. REV. 527, 535-36 (1997) (particularly noting competitive advantage of U.S companies whose products meet high international standards for equipment and efficacy, citing efforts by Cal/EPA to have International Standards Organization specifically adopt California standards).

224. Eaton, *supra* note 35, at 729-30.

C. GATT / WTO: Free Trade Agreements and Environmental Agreements on Hazardous Waste

The General Agreement on Tariffs and Trade[225] and the World Trade Organization[226] prohibit unfair trade practices between parties while accommodating the use of trade-related measures for environmental purposes in bilateral or multilateral environmental agreements (MEAs). The agreement allows for restrictions based on legitimate environmental concerns of nations. Article XX of the GATT allows WTO members to legitimately place public health and safety, and national environmental goals ahead of obligations not to raise trade restrictions.[227] Article XX(b) explicitly allows for measures which are "neither arbitrarily applied nor unjustifiable discrimination between countries" where the same conditions prevail.[228] However, such measures cannot be disguised as restrictions on trade, and are allowable only if they are necessary to protect human, animal or plant life or health.[229] This exception theoretically allows for both import and export controls on hazardous waste between countries, as long as such controls are applied evenhandedly among nations similarly situated, and the controls are imposed for legitimate environmental ends.[230] In sum, under the terms of the WTO, only MEAs between countries similarly situated in terms of trade are allowed, and only domestic environmental concerns can be valid motivations for trade barriers.

Sovereignty issues may arise when one country raises trade issues based on internal environmental conditions in another country, *e.g.*, conditioning exports on environmental regulations in the importing country and how they are enforced. Some commentators have urged an end to all export regulations and an integrated worldwide system of regulation of hazardous waste for processing and recycling.[231] While this suggestion is attractive in its simplicity, it does not address the sovereignty concerns of either importing or exporting nations.

The Committee on Trade and the Environment (CTE) is working within the WTO to encourage multilateral agreements and cooperation instead of unilateral solutions to transboundary environmental issues.[232] Trade restrictions are dis-

225. General Agreement on Tariffs and Trade, *supra* note 12.

226. *See supra* note 12.

227. General Agreement on Tariffs and Trade, *supra* note 12.

228. *Id.*

229. *Id. See generally*, Thomas J. Schoenbaum, International Trade and Protection of the Environment: The Continuing Search for Reconciliation, 91 AMERICAN J. INT'L LAW 268 (1997) (normative goals of free trade in GATT and interaction with environmental concerns).

230. For in-depth discussion of WTO provisions and environmental agreements in general, *see* Schoenbaum, *supra* note 229 at 304-305 (arguing that "emerging international hazardous waste regimes seem reconcilable under the WTO/GATT system."); *but see* Shannon Hudnall, *Towards a Greener International Trade System: Multilateral Environmental Agreements and the WTO*, 29 COLUM. J. L. & SOC. PROBS. 175 (1996).

231. *See* O'Reilly and Cuzze, *supra* note 149, at 529 (arguing generally that traditional notions of free trade economics and rational systems of oversight will promote pollution prevention among industrial recyclers worldwide more effectively than current agreements or proposed international agreements like Basel).

232. CTE is concerned primarily with disputes arising from trade provisions in MEAs. At the 1991 meeting the issues that were discussed included the interface between trade and domestic

couraged and are suspect under this model as presumptively not the least restrictive alternative. The WTO allows for trade measures that protect the domestic environment, but discourages any measures that distort trade "too much" or in the "wrong" way. For example: "The GATT Secretariat has recommended that countries rely on 'carrots' rather than 'sticks' to induce the participation of other countries in multilateral environmental agreements."[233] To date no cases directly dealing with the transboundary movement of hazardous wastes have been brought to WTO for resolution.[234] Whether international trade agreements will ultimately lead to a "trading up"[235] effect which eventually pulls all trading partners to higher regulatory standards[236] remains to be seen.

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development policy and how failure to domestically internalize costs to the environment can be a trade advantage. However, MEAs can themselves be viewed as unfair trade restrictions on the non-parties, by creating an "environmental window" for a few countries which agree on mutually acceptable environmental standards and exclude others. *See generally* <http:www.wto.org/environ/relation.html>.

233. Howard Chang, *Carrots, Sticks and International Externalities*, 17 INT'L REV. L. & ECON. 309, 309 (1997) (prompted by the Tuna-Dolphin decisions and using economic modeling, this paper explores how such a model in WTO / GATT would create perverse incentives for countries to pollute more to get more "carrots" in negotiating MEAs). However, the main concern of WTO / GATT is that any trade measures justified by reference to domestic environmental concerns could be used to disguise protectionist measures, and that the costs of the abuse of such trade measures would outweigh the benefits of environmental protection. *Id.* at 324. How an international trade organization would set out to measure the domestic benefits of environmental protection is far from clear and is not uncontroversial.

234. Schoenbaum, *supra* note 229, 304-305 (theorizing that WTO will use MEA and "safe harbor" provisions to uphold Basel or similar treaties which restrict trade between more and less developed countries, as well as an export ban to protect areas outside the territory of the trade restricting country); *but see* Chris Wold, *Multilateral Environmental Agreements and the GATT: Conflict and Resolution?*, 26 ENVTL L. 841, 888 (1991) (arguing that GATT would be violated by Basel distinctions between parties and non-parties). *See also* David Wirth, *Trade Implications of Basel*, INT'L ENVT'L REP., Sept. 4, 1996, BNA, available in LEXIS, Nexis Library, BNA-ENV Database. DAVID VOGEL, TRADING UP: CONSUMER AND ENVIRONMENTAL REGULATION IN A GLOBAL ECONOMY 140 (1995) (finding Basel would violate GATT rule against nondiscrimination, especially insofar as it includes "other wastes" including scrap metal which are commercially valuable (however, 1998 Basel IV specifically exempts scrap metal from agreement)). *See also id.* at 264-65 (discussing greening of GATT and how integration of trade will raise standards. However, unilateral export controls (not based on an agreement between the parties) by the U.S. would clearly violate the WTO if tied to importing country's environmental laws and enforcement).

235. *See generally* Vogel, *supra* note 234.

236. This is also called the "California" effect, in which higher regulatory standards do not lead to a "race to the bottom" by industry, but in an overall raising of regulatory standards among trading partners. *See generally* Vogel, *supra* note 234. The California effect is a model which functions best in the area of products standards, where both strong domestic and foreign markets exist for the products. *Id.* at 263. ("While this encompasses virtually all consumer protection regulations as well as those environmental regulations which apply to products, it excludes those environmental standards that seek to address the harms caused by how products are produced." *Id.*) Vogel theorizes that regulations of production standards and waste issues are left to international environmental agreements to accomplish rising regulatory standards between trading partners. Vogel's analysis does not address issues raised by exploitative trading practices in the interim or the actual enforcement of laws and regulations put in place by LDCs. He explicitly uses NAFTA as an example where the environmental side agreement "raised" the level of Mexico's environmental regulations on the books but says nothing about actual enforcement of those standards. The examples where developed countries push each other to both strengthen regulations domestically and increase trade opportunities are more compelling. While Vogel's long-term sense that international trade and environmental protection can create a win-win situation that both expands trade and raises the overall level of environmental protection regionally (and eventually globally) is analytically compelling, he declines

VII.
LIABILITY: FUTURE CLAIMS

A. *Possible Claims Under the Alien Tort Claims Act and Multilateral or Bilateral Environmental Agreements and Treaties*

Foreign nationals who are harmed by the lack of environmentally sound disposal of hazardous waste generated in the U.S. have few remedies against the U.S. waste generator or shipper. Whether the waste was legally shipped under RCRA section 3017 or shipped as exempt from that section for recycling or recovery, a foreign plaintiff who has no direct contract with the U.S. generator or shipper will find it hard to sue the responsible parties in the U.S. courts, in part because neither RCRA nor CERCLA apply extraterritorially. In addition, foreign court judgments are notoriously hard to enforce in the U.S. As discussed above, the *Amlon Metals* case did not provide a remedy for the plaintiffs under ATCA or RCRA, but only provided a remedy for the common law contract claims. However, *Amlon Metals* may point in the direction of possible remedies under ATCA when the countries involved are both parties to environmental treaties.

Cases brought under ATCA must generally: (1) allege a violation of a treaty or law of nations, (2) allege conduct constituting a tort against the person or property, (3) be brought by an alien, and (4) meet all other jurisdictional threshold requirements for suits in federal courts, including standing. The fatal flaw in *Amlon Metals* was that the plaintiff could not point to a specific treaty between the U.K. and the U.S. that was violated by the defendant's acts. Courts have generally followed a strict standard for what constitutes a "law of nations"[237] or a relevant treaty under ATCA, but there are now several U.S. treaties which specifically address hazardous waste exports.[238]

For example, taking a similar set of facts to *Amlon Metals*, if a shipment of waste intended for recycling, but tainted with hazardous waste, is sent to a Mexican recycling facility and the recycler is a Mexican national, then the bilateral treaty will have specifically been violated and could provide a cause of action to the recycler as a plaintiff in a U.S. court, or for a third part who was harmed. It is unclear precisely what kind of treaty violation is necessary to create a cause of action under ATCA, but the majority of cases have found that it is not necessary

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to deal with essential short-term and mid-range issues of environmental degradation and intentional dumping in LDCs before this rising tide of the California effect hits those countries.

237. Questions of what constitutes a "law of nations" for the purposes of ATCA have included the embedded issue of state action as a component. *See* Beanal v. Freeport-McMoran, Inc., 969 F. Supp. 362 (E.D. La. 1997) and unreported dismissal with leave to amend, 1997 WL 465283 (E.D. La.) (holding in part that plaintiff failed to allege state action in ATCA claim based on violation of human rights treaty and attempt to apply NEPA extraterritorially). The state action requirement can then lead to a motion to dismiss for failure to join an indispensable party if the foreign state refuses to consent to jurisdiction. *See* Aguinda v. Texaco, Inc., 945 F. Supp. 625 (S.D.N.Y. 1996); *see also,* Foreign Sovereign Immunities Act, 28 U.S.C. §§ 1602-1611 (1998); Jennifer Rankin, *U.S. Laws in the Rainforest: Can a U.S. Court Find Liability for Extraterritorial Pollution Caused by a U.S. Corporation? An Analysis of* Aguinda v. Texaco, B.C. INT'L & COMP. L. REV. 221 (1995).

238. *See, e.g.*, U.S.-Mexico Treaty, *supra* note 8; U.S.-Canada Treaty, *supra* note 8; and OECD Council Decision C(92)39, *supra* note 10.

for the treaty that is violated to provide an express cause of action[239] so long as the alleged conduct constituted a common law tort, e.g. fraud. Alternatively, a Mexican national whose property or person was damaged or harmed by illegal disposal of hazardous waste from a U.S. generator or transporter may be able to bring suit under ATCA also using the La Paz agreement and Annex III as the treaty violated. In this hypothetical case, a suit in federal district court that met other jurisdictional requirements[240] could survive a 12(b)(1) motion to dismiss for lack of jurisdiction under ATCA and a 12(b)(6) motion for failure to state a claim.[241]

Of course, *forum non conveniens* and choice of law issues would still be key to the resolution of either hypothetical case. To survive a *forum non conveniens* motion in U.S. courts, a Mexican plaintiff harmed by fraudulent shipment of U.S. hazardous waste, or by illegal disposal of such hazardous waste, would have to make a strong showing that a competent forum is not available in the country of import.[242] If the suit survives a *forum non conveniens* motion and Mexican law is chosen as controlling the suit, as is likely,[243] the Mexican laws will provide the plaintiff with reasonable remedies.[244] While the plaintiff would not have the benefit of RCRA and CERCLA causes of action and standards of proof, the court might be persuaded to use some of the procedures and remedies available under those statutes to fill in any gaps in the law of the country where the tort took place.

The availability of this kind of tort claim is especially important because it can be brought where a contract claim cannot be. Tort claims can be brought by injured third parties, for example, neighbors and workers at a recycling facility that was party to a contract. In addition, tort claims can be brought for harm resulting from illegal disposal in situations where no contract existed. At the

239. *See* Russell G. Donaldson, *Construction and Application of Alien Tort Statute (28 U.S.S.S. § 1350), Providing for Federal Jurisdiction Over Alien's Action for Tort Committed in Violation of Law of Nations or Treaty of the United States,* 166 A.L.R. FED. 387, 412-14.

240. Venue, personal jurisdiction, etc.

241. The author was unable to find any cases that were brought on this basis; perhaps because these cases do state a claim they are settled before litigation. In addition, if aliens can use citizen suit provisions the case could allege violation of RCRA section 3017 requirements as well. This hypothetical should work just as well for Canadian citizens, and other OECD country citizens.

242. Piper Aircraft Co. v. Reyno, 454 U.S. 235 (1981) (holding that an action brought against a U.S. company by a foreign plaintiff, based on harm suffered abroad, should be dismissed on *forum non conveniens* grounds. Specifically, the alternative forum was more appropriate for witnesses and discovery, plaintiff was not a U.S. citizen or resident, law in other forum is was less favorable but not inadequate so that the plaintiff is not deprived of remedy. A determination involves weighing both private interests of plaintiff and defendant, and public interest factors at the discretion of trial court); *see also In re* Union Carbide Corp. Gas Plant Disaster at Bhopal, 809 F. 2d 195 (2d Cir. 1987) (*forum non conveniens* dismissal of class actions arising from disaster in Bhopal but district court could not add as condition of dismissal defendant's submission to discovery in accordance with FRCP). *See* Aguinda v. Texaco, 945 F. Supp. 625 (S.D.N.Y. 1996) (class action suit not available in Ecuador and lack of meaningful discovery not enough to resist *forum non conveniens* motion by defendant).

243. For a discussion of difficulties faced by transboundary plaintiffs, *see* Gollub, *supra* note 107.

244. Mexican environmental laws on the books are detailed ant comprehensive. *See* Mexico General Law, *supra* note 137.

least, an ATCA tort claim is a non-frivolous claim which can be asserted in federal court. It might not survive a 12(b)(6) motion for other reasons, or a *forum non convienens* challenge on the facts of the individual case, but the claim might provide litigants with an initial forum in which to raise issues and pressure exporters of hazardous waste to change current practices or settle claims for past harms.

ATCA is a necessary tool for aliens harmed by hazardous waste generated in the U.S. for several reasons. First, in the future federal courts are likely to concur in the analysis of the lack of extraterritoriality of RCRA or CERCLA found in *Amlon Metals*,[245] and there is virtually no likelihood that Congress will expressly extend RCRA and CERCLA liability extraterritorially.[246] Second, citizen suits by aliens rest on a slim foundation. Even if allowed, such lawsuits would be limited to conduct occurring within the U.S. and perhaps violations of the RCRA export controls.[247] Third, U.S. citizens who are allies of aliens who are harmed by hazardous waste exports may fail to meet the standing requirements to bring citizen suits on their own behalf.[248]

B. Liability: An Issue for Future Agreements

There is another critical issue which cannot be fully explored here but should be mentioned. The Basel convention and other international treaties all lack clarity on liability issues. Basel itself requires the parties who export hazardous waste to take on ultimate financial responsibility for reshipment and proper disposal if a problem arises during or after export. But Basel has no insurance or bond requirements for the private party exporters. In effect, this requires the exporting countries themselves to develop domestic rules for insurance or bonding or to indemnify or guarantee the generators' and shippers' compliance with treaty obligations.[249] The crucial insight here is that under Basel,

245. *Accord,* Rankin, *supra* note 244 (excellent and detailed analysis of the issues as applied to *Aguinda v. Texaco, Inc*); Aguinda v. Texaco, Inc., 945 F. Supp. 625 (S.D.N.Y. 1996) (the case was eventually dismissed on *forum non conveniens* grounds, as well as international comity and failure to join indispensable parties, therefore ATCA issues pertaining to international law that were examined in Rankin's article were never reached).

246. *But see* Lee I. Raiken, *Extraterritorial Application of RCRA: Is Its Exportability Going to Waste?,* 12 VA. ENVTL. L.J. 573 (1993) (finding neither ATCA nor Basel sufficient and calling for expansion of RCRA by Congress to close loophole made visible in *Amlon Metals*).

247. *But see,* Amlon Metals, Inc. v. FMC Corp., 775 F. Supp. 668, 674 (S.D.N.Y. 1991) (dicta that citizen suits cannot be brought under Section 3017.) If the case would lie it might well provide plenty of liability if the "conduct" is characterized as the intent (and / or conspiracy) to dispose of hazardous waste illegally or to violate export requirements within the U.S., but generators will likely lay blame on transporters, who will try to lay blame on either employees' independent acts in another country or third parties who accepted the shipments and then mishandled them, again in another country. The problems of proof for intent or for the chain of causation will be just as high as under an ATCA suit. However, it is not clear that much would be gained by availability of the citizen suit to aliens in this context.

248. There may be a case for organizational standing of an organization with both U.S. and alien members, if some members had standing as citizens and others had injury in fact and the court allowed such a split.

249. *See generally* Gunther Handl, *State Liability for Accidental Environmental Damage by Private Persons*, 74 AM. J. OF INTL. L. 525, 527 (1980) ("It is a well-established principle of international law that the international liability a state may incur for acts of private persons is a function of

the country of origin (i.e. the waste generating country), would have to pay for the reshipment and proper disposal regardless of either their vigilance in enforcement, or the intentional acts of third parties.[250] This creates a strict liability regime, if of limited scope, for the countries that are parties.

To some extent the liability regime in Basel disconnects liability from both of its traditional functions, compensation of victims and prevention of future harm by the responsible party. Under the Basel approach the waste is either reshipped or disposed of properly, but no compensation is made to the country that received the illegal wastes or to the importer who may have significant damages, shipping costs, opportunity costs, or direct damages from the waste. In addition, no compensation is made to other individuals whose property or health may have been harmed by the lack of proper environmental safeguards. To the extent that Basel's provisions force the country of export to tighten enforcement of export regulations it is creating the "right" incentive on the country. But Basel creates much weaker incentives on the responsible parties themselves. Future debates on liability must include: responsible parties' liability for damages (standards for and types of liability e.g. joint and several liability, standards of proof and knowledge); consent to jurisdiction; availability of forums for dispute resolution; enforcement of judgments; and choice of laws.[251]

VIII.
CONCLUSION

The U.S. presently has the technology, the capital, and the capacity to treat, store, and dispose of all of its own hazardous waste. While it may be cheaper in the short run for domestic generators to export hazardous waste, the cost savings is really an externality, a cost of production foisted off onto other nations and the "global commons." As a foreign relations issue, the failure of U.S. laws to hold U.S. generators of hazardous waste responsible for the harm caused by those hazardous wastes overseas strains U.S. credibility and political capital[252] as a leader in the environmental arena. The costs of international environmental harms created by U.S.-generated hazardous wastes may eventually be paid by the U.S. as a nation through loss of prestige and influence in the environmental

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that state's control over the activities concerned.) RCRA and CERCLA are evidence of a high degree of regulation within the country, and control is presumed.

250. *See supra* note 9, Basel Convention, art. 9.

251. Choice of laws raises issues of where the act occurred, where the harm occurred, substantive and procedural law dilemmas, enforcement of judgments, jurisdiction and forum shopping. *See also* Elli Louka, *Bringing Polluters Before Transnational Courts: Why Industry Should Demand Strict and Unlimited Liability for the Transnational Movements of Hazardous and Radioactive Wastes*, 22 DENV. J. INT'L L. & POL'Y 63, 103-05 (1993) ("A Proposal For a Liability Regime." Author's proposal is based on common law ultra-hazardous activity tort law including strict or absolute and unlimited joint and several liability. Discusses whether liability should remain with generator or transfer to transporters, possible defenses of independent acts by third party or acts of god, and coverage for personal injuries).

252. Perhaps the U.S. has little credibility left on these issues in most other countries due to the history of U.S. pollution and dumping overseas. However, U.S. environmental statutes and regulations, if not our actions, have been a model for environmental protection worldwide.

arena. The U.S. is currently at the forefront of those countries calling for agreements on global issues like ozone depletion, biodiversity conservation, species habitat conservation, and global warming. We are asking other countries, especially less developed counties, to reduce emissions or forgo short-term economic benefits of timber harvesting and low-tech energy production to help conserve the biosphere for all. In that context, it is disingenuous to continue to allow U.S. companies to dispose of hazardous wastes without the notification to or consent of receiving countries and without any assurance of available environmentally sound methods of recycling, recovery or disposal in those countries.[253]

In an era when the insight that the world is a single biosphere is unexceptional, exporting environmental hazards cannot be merely a question of current economic benefits to private parties. At this point in the development of an international consensus on hazardous waste exports, the U.S. is the origin of the largest share of waste shipments considered hazardous under Basel but we have refused to ratify Basel or to more closely align U.S. law with this international consensus. Congress has the power to curb private actors from continuing to export "exempt" hazardous wastes without regulation, and at minimum Congress can and should expand the data collection, notification and consent requirements to all hazardous waste export. However, all recent attempts to change the laws along these lines have fizzled, not even eliciting strong debate. It is possible that the executive, directly or through agency action, can begin to change the rules in this area. A simple and effective way to begin to change the regulations would be by expanding the reporting and consent requirements of RCRA section 3017 to include hazardous waste exported for recycling or recovery. This change would facilitate data collection and tracking, and add needed facts and figures to a debate that is now largely based on dueling anecdotes. Hard data on the extent of the problem may help mobilize environmental constituencies within the U.S. and finally persuade Congress to act in the area.

If the "free trade" global marketplace becomes the norm of international trade, the goal of environmentally sound treatment and disposal of domestically generated hazardous wastes will only be achieved by enforcing the central tenets of U.S. environmental laws, the polluter pays principle, and cradle to grave liability for generators of hazardous wastes, even when those hazardous wastes cross the border. Cradle to border is not good enough.

253. Certainly one could construct other export criteria like transfer of environmentally sound technology to the country of import, or use of "as good as" methods (Basel). However, the problem with these solutions is that they require strong enforcement and tracking to which the U.S. would have to commit more funds. This again serves to shift the financial burden from the private generators (who could probably still save money operating U.S.-style disposal in other countries due to lower wages) to the government, which oversees the statutory scheme designed to save private parties money.