Texas International Law Journal

Volume 45 Winter 2009 Number 2

Volume 45, Issue 2

Articles

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The University of Texas School of Law

TEXAS INTERNATIONAL LAW JOURNAL

Volume 45
Number 2
Winter 2009

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Texas International Law Journal

In the rapidly expanding discipline of international law, the *Texas International Law Journal* helps readers stay abreast and informed of recent developments and new scholarship by providing access to leading international legal, theoretical, and policy analysis. The *Journal* publishes academic articles, essays, and student notes in the areas of public and private international law, international legal theory, the law of international organizations, comparative and foreign law, and domestic laws with significant international implications. The editors and staff aim to fulfill these needs by concentrating on groundbreaking articles that will be useful to both practitioners and scholars. We hope you enjoy this latest issue.

The *Journal* is among the oldest and best-established student-published international law journals in the United States. In the wake of the Bay of Pigs disaster and the Cuban Missile Crisis, our publication began as an offshoot of the Texas International Law Society.[1] In January 1965, under the guidance of Professor E. Ernest Goldstein, we planted the Texas flag in the international arena with our first issue, entitled *The Journal of the University of Texas International Law Society.* Publications thereafter were biannual, taking the name *Texas International Law Forum* until summer 1971, when the *Journal* adopted its present title and began publishing three or four issues per year. Of the more than one hundred student-published international law journals across the country, only three schools have an older international heritage: Harvard, Columbia, and Virginia.

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1. E. Ernest Goldstein, *Thank You Fidel! Or How the International Law Society and the* Texas International Law Journal *Were Born*, 30 TEX. INT'L L.J. 223 (1995).

of International Law, chief reporter of the Restatement of Foreign Relations Law of the United States, and former editor-in-chief of the *American Journal of International Law*; **the Honorable Richard J. Goldstone**, member of the Constitutional Court of South Africa and former chief prosecutor of the United Nations International War Crimes Tribunal for the former Yugoslavia and Rwanda; and **the Honorable Dalia Dorner**, Associate Justice of the Supreme Court of Israel.

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Cite as: TEX. INT'L L.J.

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Exceptional Engagement: Protocol I and a World United Against Terrorism

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This article challenges the prevailing view that U.S. "exceptionalism" provides the strongest narrative for the U.S. rejection of Additional Protocol I to the 1949 Geneva Conventions. The United States chose not to adopt the Protocol in the face of intensive international criticism because of its policy conclusions that the text contained overly expansive provisions resulting from politicized pressure to accord protection to terrorists who elected to conduct hostile military operations outside the established legal framework. The United States concluded that the commingling of the regime criminalizing terrorist acts with the jus in bello rules of humanitarian law would be untenable and inappropriate. In effect, the U.S. concluded that key provisions of Protocol I actually undermine the core values that spawned the entire corpus of humanitarian law. Whether or not the U.S. position was completely accurate, it was far more than rejectionist unilateralism because it provided the impetus for subsequent reservations by other NATO allies. More than two decades after the debates regarding Protocol I, the U.S. position provided the normative benchmark for the subsequent rejection of efforts by some states to shield terrorists from criminal accountability mechanisms required by multilateral terrorism treaties. This article demonstrates that the U.S. policy stance regarding Protocol I helped to prevent the commingling of the laws and customs of war in the context of the multilateral framework for responding to transnational terrorist acts in the aftermath of September 11. In hindsight, the "exceptional" U.S. position was emulated by other nations as they reacted to reservations designed to blur the distinctions between terrorists and privileged combatants. U.S. "exceptionalism" in actuality paved the way for sustained engagement that substantially shaped the international response to terrorist acts. This article suggests that reservations provide an important mechanism for states to engage in second-order dialogue over the true meaning and import of treaties, which in turn fosters the clarity and enforceability of the text.

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SUMMARY

I. INTRODUCTION

The United States was one of the influential drivers in the promulgation of the principles regulating hostilities which define the lawful scope of participation in armed conflicts. This line of treaties, derived from the strong political and military support of the United States, ended during the negotiations for the 1977 Protocols to the 1949 Geneva Conventions.[1] Protocol I is applicable to armed conflicts of an international character, but the final text incorporated highly controversial changes to the types of conflicts that could legally be characterized as interstate wars, with the attendant consequence of conveying combatant immunity to a far broader class of persons. Many Third World nations, supported by the negotiating muscle of socialist states, hijacked the Protocol to achieve explicitly political objectives. This treaty is accordingly unique in having been described as "law in the service of terror."[2] The United States concluded that the most controversial aspects of

1. Protocol Additional to the Geneva Conventions of 12 Aug. 1949, and relating to the Protection of Victims of International Armed Conflicts (Protocol I) Annex I, Dec. 7, 1979, 1125 U.N.T.S. 3 [hereinafter Protocol I]; *see also* Douglas J. Feith, *Law in the Service of Terror*, 1 NAT'L INT. 36, 39–41 (1985) (discussing differences of opinion held by "Westerners" and "Socialists" during the negotiations for Protocol I and how arguments made by the United States ultimately did not prevail leading to their abstention from voting).

2. Feith, *supra* note 1, at 36–37; *see also* Abraham Sofaer, *Terrorism and the Law*, 64 FOREIGN AFF. 901, 901–03 (1986) ("At its worst the [international] law [applicable to terrorism] has in important ways actually served to legitimize international terror, and to protect terrorists from punishment as criminals.").

Protocol I represented an impermissible altering of the cornerstone concepts of combatancy more than a natural and warranted evolution of the laws of war. The U.S. rejection of Protocol I represented far more than hypocritical "exceptionalism" however, as the underlying policy position provided the template for sustained engagement with other nations. The overwhelming solidarity of states sharing the U.S. position that international law affords no protection for the criminal acts of terrorists became clear over more than two decades and was revalidated following the shock of September 11.

Terrorism in all its forms and manifestations constitutes one of the most serious threats to international peace and security, as well as perhaps the most pernicious threat to the fundamental human rights of private, peace-loving citizens. There is universal and strongly articulated support for the positivist legal premise that "any acts of terrorism are criminal and unjustifiable, regardless of their motivation, whenever and by whomsoever committed and are to be unequivocally condemned."[3] The U.N. General Assembly reaffirms that "no terrorist act can be justified in any circumstances."[4] By extension, this dominant consensus led to the modern framework of multilateral conventions obligating states to cooperate together in eradicating terrorism and to use their domestic legal systems to the fullest extent possible in the detection and prosecution of persons involved with the perpetration or support of terrorist activities. Article 6 of the International Convention for the Suppression of the Financing of Terrorism, *inter alia*, requires acceding states (169 at the time of this writing)[5] to "adopt such measures as may be necessary, including, where appropriate, domestic legislation, to ensure that criminal acts within the scope of this Convention are under no circumstances justifiable by considerations of a political, philosophical, ideological, racial, ethnic, religious or other similar nature."[6] This bright line bar is replicated in every major multilateral terrorism convention. Furthermore, the modern conventions seeking to prevent and punish terrorist acts embody the broadest possible jurisdictional authority for domestic courts[7] as well as

3. S.C. Res. 14565, Annex, U.N. Doc. S/RES/1456 (Jan. 20, 2003). The United Nations Global Counterterrorism Strategy expresses "strong condemnation of terrorism in all its forms and manifestations, committed by whomever, wherever and for whatever purposes." G.A. Res. 60/228, para. 2, U.N. Doc. A/RES/60/288 (Sept. 20, 2006).

4. Measures to Eliminate International Terrorism, G.A. Draft Res., at 3, U.N. Doc. A/C.6/62/L.14 (Nov. 13, 2007).

5. Status Report on International Convention for the Suppression of the Financing of Terrorism, *available at* http://treaties.un.org/Pages/ViewDetails.aspx?src=IND&mtdsg_no=XVIII-11&chapter=18&lang=en.

6. International Convention for the Suppression of the Financing of Terrorism, 2175 U.N.T.S. 197, art. 6, U.N. Doc. A/RES/54/109 (Dec. 9, 1999) [hereinafter Terrorism Financing Convention].

7. *See, e.g.*, *id.* art. 7 stating:

> 1. Each State Party shall take such measures as may be necessary to establish its jurisdiction over the offences set forth in article 2 when:
>
> (a) The offence is committed in the territory of that State;
>
> (b) The offence is committed on board a vessel flying the flag of that State or an aircraft registered under the laws of that State at the time the offence is committed;
>
> (c) The offence is committed by a national of that State.
>
> 2. A State Party may also establish its jurisdiction over any such offence when:

expressly removing terrorist acts from the class of political offenses that might otherwise hinder extradition or requests for mutual legal assistance.[8]

The clarity with which international law categorizes and condemns discrete manifestations of terrorism actually masks the indeterminacy of the underlying definitional framework. "Terrorism" is a concept caught in a kaleidoscope of conflicting sociological, political, psychological, moral, and yes, legal perspectives. The claim that "what looks, smells and kills like terrorism is terrorism"[9] belies the reality that the international community has unsuccessfully sought to reach agreement on a comprehensive definition of the term for more than a century.[10] No comprehensive definition has achieved universal acceptance, whether approached from a moral,[11] psychological,[12] or historical[13] perspective. Despite the fact that non-

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(a) The offence was directed towards or resulted in the carrying out of an offence referred to in article 2, paragraph 1, subparagraph (a) or (b), in the territory of or against a national of that State;

(b) The offence was directed towards or resulted in the carrying out of an offence referred to in article 2, paragraph 1, subparagraph (a) or (b), against a State or government facility of that State abroad, including diplomatic or consular premises of that State;

(c) The offence was directed towards or resulted in an offence referred to in article 2, paragraph 1, subparagraph (a) or (b), committed in an attempt to compel that State to do or abstain from doing any act;

(d) The offence is committed by a stateless person who has his or her habitual residence in the territory of that State;

(e) The offence is committed on board an aircraft which is operated by the Government of that State.

3. Upon ratifying, accepting, approving or acceding to this Convention, each State Party shall notify the Secretary-General of the United Nations of the jurisdiction it has established in accordance with paragraph 2. Should any change take place, the State Party concerned shall immediately notify the Secretary-General.

4. Each State Party shall likewise take such measures as may be necessary to establish its jurisdiction over the offences set forth in article 2 in cases where the alleged offender is present in its territory and it does not extradite that person to any of the States Parties that have established their jurisdiction in accordance with paragraphs 1 or 2.

5. When more than one State Party claims jurisdiction over the offences set forth in article 2, the relevant States Parties shall strive to coordinate their actions appropriately, in particular concerning the conditions for prosecution and the modalities for mutual legal assistance.

6. Without prejudice to the norms of general international law, this Convention does not exclude the exercise of any criminal jurisdiction established by a State Party in accordance with its domestic law.

8. *Id.* art 14.

9. U.N. GAOR, 56th Sess., 12th plen. mtg. at 18, U.N. Doc. A/56/PV.12 (Oct. 1, 2001).

10. *See* Thomas M. Franck & Bert B. Lockwood, Jr., *Preliminary Thoughts Towards an International Convention on Terrorism*, 68 AM. J. INT'L L. 69, 72–82 (1974) (tracing historical definitions of "terrorism" from the French Revolution to 1974).

11. *See* C. A. J. Coady, *The Morality of Terrorism*, 60 PHIL. 47, 52 (1985) ("As amended then, the definition of a terrorist act would go as follows: 'A political act, ordinarily committed by an organized group, which involves the intentional killing or other severe harming of non-combatants or the threat of the same or intentional severe damage to the property of non-combatants or the threat of the same'. The term 'terrorism' can then be defined as the tactic or policy of engaging in terrorist acts.").

state participants in a Common Article 3 conflict are fully subject to prosecution for their warlike acts,[14] and will often be simultaneously subject to the jurisdiction of courts with substantive authority over terrorism, criminal law generally disfavors reliance on terms such as "terrorism" that are perceived to lack objectivity, precision, and emotive neutrality.[15] Some have even argued that applying the label "terrorist" to a non-state actor in a non-international armed conflict carries a pejorative taint that creates an undesirable disincentive to abide by the laws and customs of war.[16] The paradox in a post-September 11 world is that the United Nations Security Council *requires* nations to "accept and carry out"[17] resolutions that oblige them to act against "terrorists" and "terrorism."[18] Giving operative legal significance to vaguely defined terms could be seen as undermining the world's "normative and moral stance against terrorism."[19] As a result, rather than relying on an overarching definitional framework with uncertain pedigree and feigned international acceptance, the international community developed a patchwork of

12. Martha Crenshaw, *The Psychology of Terrorism: An Agenda for the 21st Century*, 21 POL. PSYCHOL. 405, 406 (2000) ("The problem of defining terrorism has hindered analysis since the inception of studies of terrorism in the early 1970s. One set of problems is due to the fact that the concept of terrorism is deeply contested. The use of the term is often polemical and rhetorical. It can be a pejorative label, meant to condemn an opponent's cause as illegitimate rather than describe behavior. Moreover, even if the term is used objectively as an analytical tool, it is still difficult to arrive at a satisfactory definition that distinguishes terrorism from other violent phenomena. In principle, terrorism is deliberate and systematic violence performed by small numbers of people, whereas communal violence is spontaneous, sporadic, and requires mass participation. The purpose of terrorism is to intimidate a watching popular audience by harming only a few, whereas genocide is the elimination of entire communities. Terrorism is meant to hurt, not to destroy. Terrorism is preeminently political and symbolic, whereas guerilla warfare is a military activity. Repressive "terror" from above is the action of those in power, whereas terrorism is a clandestine resistance to authority. Yet in practice, events cannot always be precisely categorized.").

13. Gilbert Guillaume, *Terrorism and International Law*, 53 INT'L & COMP. L.Q. 537, 540 (2004) ("In the context of international law, it would appear to me that the adjective 'terrorist' may be applied to any criminal activity involving the use of violence in circumstances likely to cause bodily harm or a threat to human life, in connection with an enterprise whose aim is to provoke terror. Three conditions thus have to be met: (a) the perpetration of certain acts of violence capable of causing death, or at the very least severe physical injury. Certain texts of domestic and European law go further than this, however, and consider that the destruction of property even without any danger for human life may also constitute a terrorist act; (b) an individual or collective enterprise that is not simply improvised, in other words an organized operation or concerted plan reflected in coordinated efforts to achieve a specific goal (which, for example, excludes the case of the deranged killer who shoots at everyone in sight); (c) the pursuit of an objective: to create terror among certain predetermined persons, groups or, more commonly, the public at large (thus differentiating terrorism from the political assassination of a single personality, such as that of Julius Caesar by Brutus).").

14. *See* YORAM DINSTEIN, THE CONDUCT OF HOSTILITIES UNDER THE LAW OF INTERNATIONAL ARMED CONFLICT 31 (2d ed. 2004) (clarifying that jus in bello merely prescribes the offenses under which lawful combatants can be brought to trial. With regard to unlawful combatants, jus in bello "merely takes off a mantle of immunity from the defendant, who is therefore accessible to penal charges for any offence committed against the domestic legal system.").

15. M. CHERIF BASSIOUNI, INTERNATIONAL TERRORISM: MULTILATERAL CONVENTIONS (1937–2001) 3 (2001).

16. M. Cherif Bassiouni, *The New Wars and the Crisis of Compliance with the Law of Armed Conflict by Non-State Actors*, 98 J. OF CRIM. L. & CRIMINOLOGY 711, 739 (2008).

17. U.N. Charter, art. 25.

18. S.C. Res. 1377, Annex, U.N. Doc. S/RES/1377 (Nov. 12, 2001).

19. The Secretary-General, *A More Secure World: Our Shared Responsibility: Report of the Secretary-General's High-Level Panel on Threats, Challenges, and Change*, para. 159 (2004), *available at* http://www.un.org/secureworld/.

norms and conventions that seeks to prevent and punish specific manifestations of terrorist activities.[20] By breaking down the macro problem of terrorism into identifiable manifestations, nation states have negotiated and ratified a web of occasionally overlapping multilateral conventions built on the cornerstone of sovereign enforcement of applicable norms. The persistence of transnational terrorism as a feature of the international community shows that the plethora of conventional approaches is no panacea.[21] September 11 highlighted this striking systematic failure.

International law restricts the class of persons against whom violence may be applied during armed conflicts, even as it bestows affirmative rights to wage war in accordance with accepted legal restraints.[22] Because of the central importance of these categorizations, the standards for ascertaining the legal line between lawful and unlawful participants in conflict provided the intellectual impetus for the evolution of the entire field of law relevant to the conduct of hostilities.[23] From the outset, states sought to prescribe the conditions under which they owed particular persons affirmative legal protections derived from the laws and customs of war.[24] The recurring refrain in negotiations can be described as "to whom do we owe such

20. *See* Convention on Offenses and Certain Other Acts Committed on Board Aircraft, Sept. 14, 1963, 20 U.S.T. 2941, 704 U.N.T.S. 219 [hereinafter Tokyo Hijacking Convention]; Hague Convention for the Suppression of Unlawful Seizure of Aircraft, Dec. 16, 1970, 22 U.S.T. 1641, 860 U.N.T.S. 105 [hereinafter Hague Hijacking Convention]; Convention for the Suppression of Unlawful Acts Against the Safety of Civil Aviation, Sept. 23, 1971, 24 U.S.T. 565, 974 U.N.T.S. 177 [hereinafter Montreal Hijacking Convention]; Protocol on the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, Feb. 24, 1988, 1589 U.N.T.S. 474 [hereinafter Montreal Protocol]; Convention on the High Seas, Apr. 29, 1958, 13 U.S.T. 2312, 450 U.N.T.S. 82; United Nations Convention on the Law of the Sea, Dec. 10, 1982, 1833 U.N.T.S. 396; Convention on the Prevention and Punishment of Crimes Against Internationally Protected Persons, Including Diplomatic Agents, Dec. 14, 1973, 28 U.S.T. 1975, 1035 U.N.T.S. 167 [hereinafter Diplomats Convention]; Convention on the Safety of United Nations and Associated Personnel, Dec. 9, 1994, 2051 U.N.T.S. 363 [hereinafter U.N. Personnel Convention]; Convention for the Suppression of Unlawful Acts Against the Safety of Maritime Navigation, Mar. 10, 1988, 1678 U.N.T.S. 221; Protocol for the Suppression of Unlawful Acts Against the Safety of Fixed Platforms Located on the Continental Shelf, Mar. 10, 1988, 1678 U.N.T.S. 304; International Convention Against the Taking of Hostages, Dec. 17, 1979, 1316 U.N.T.S. 205 [hereinafter Hostage-Taking Convention]; International Convention for the Suppression of Terrorist Bombings, Dec. 15, 1997, 2149 U.N.T.S. 256 [hereinafter Terrorist Bombing Convention]; Terrorism Financing Convention, *supra* note 6, at art. 7.

21. M. CHERIF BASSIOUNI, INTERNATIONAL TERRORISM: MULTILATERAL CONVENTIONS (1837–2001) 6 (2001); M. Cherif Bassiouni, *Legal Control of International Terrorism: A Policy-Oriented Assessment*, 43 HARV. INT. L. J. 83, 90–91 (2001).

22. Bassiouni, *supra* note 16, at 720.

23. The field is frequently described as international humanitarian law. This vague rubric is increasingly used as shorthand to refer to the body of treaty norms that apply in the context of armed conflict as well as the less distinct internationally accepted customs related to the treatment of persons. The core of the international law of war includes the Geneva Convention for the Amelioration of the Condition of the Wounded and Sick in Armed Forces in the Field, Aug. 12, 1949, 6 U.S.T. 3114, 75 U.N.T.S. 31 (replacing previous Geneva Wounded and Sick Conventions of 22 August 1864, 6 July 1906, and 27 July 1929 by virtue of Article 59); Geneva Convention for the Amelioration of the Condition of Wounded, Sick, and Shipwrecked Members of Armed Forces at Sea, Aug. 12, 1949, 6 U.S.T. 3217, 75 U.N.T.S. 85 (replacing Hague Convention of 18 October 1907, 36 Stat. 2371); Geneva Convention Relative to the Treatment of Prisoners of War, Aug. 12, 1949, 6 U.S.T. 3316, 75 U.N.T.S. 135 (replacing the Geneva Convention Relative to the Protection of Prisoners of War of 27 July 1929, 47 Stat. 2021); Geneva Convention Relative to the Protection of Civilians in Time of War, Aug. 12, 1949, 6 U.S.T. 3516, 75 U.N.T.S. 287 [hereinafter Civilians Convention].

24. GEOFFREY BEST, WAR AND LAW SINCE 1945, at 128–133 (1994).

protections?" The constant effort to be as precise as possible in describing the classes of persons entitled to those protections was essential because the same criteria prescribe the select class who may lawfully conduct hostilities with an expectation of immunity. Terrorists commit criminal acts and are liable for those acts; they cannot hide behind a shield of combatant immunity in the same manner as lawful combatants.

The declarative norm that the "right of belligerents to adopt means of injuring the enemy is not unlimited"[25] is one of the organizing principles that unifies the framework of the law of armed conflict. Persons outside the framework of international humanitarian law who commit warlike acts do not enjoy combatant immunity and are therefore common criminals subject to prosecution for their actions.[26] The imperative that logically follows is that the right of *non-belligerents* to adopt means of injuring the enemy is *nonexistent.* Those persons governed by the law of armed conflict derive rights and benefits but are also subject to bright line obligations. Prisoners of war, for example, enjoy legal protection *vis-á-vis* their captors; because they are legally protected, they have no right to commit "violence against life and limb."[27] Conversely, lawful combatants become "war criminals" only when their actions transgress the established boundaries of the laws and customs of war.[28] Taken together, these principles form the backbone of the law of armed conflict, and terrorist acts represent the precise point of tension between the law of armed conflict and the default norms of international criminality. Lawful combatants use violence to achieve sociologically and legally permissible ends while terrorists use some of the same techniques impermissibly in violation of established criminal norms.

Nevertheless, the lack of a specific and all-encompassing definition of the term "terrorism" has a sinister potential that could allow states to exploit the existing norms of treaty interpretation, endangering civilian lives and objects by creating legal confusion over agreed treaty terms and thereby preventing effective and timely prosecution of terrorists. As noted above, the United States chose not to adopt the Protocol based on policy conclusions that its provisions were the result of politicized

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25. Hague Convention IV Respecting the Laws and Customs of War on Land, 1907, Annex art. 22, Jan. 26, 1910, *reprinted in* ADAM ROBERTS & RICHARD GUELFF, DOCUMENTS ON THE LAWS OF WAR 73, 77 (3d ed. 2000) [hereinafter 1907 Hague Regulations].

26. In a classic treatise, Professor Julius Stone described the line between lawful participants in conflict and unprivileged or "unprotected" combatants as follows:

> The . . . distinction draws the line between those personnel who, on capture, are entitled under international law to certain minimal treatment as prisoners of war, and those not entitled to such protection. "Non-combatants" who engage in hostilities are one of the classes deprived of such protection . . . Such unprivileged belligerents, though not *condemned* by international law, are not protected by it, but are left to the discretion of the belligerent threatened by their activities.

JULIUS STONE, LEGAL CONTROLS ON INTERNATIONAL CONFLICT 549 (1954).

27. *See* Geneva Convention Relative to the Treatment of Prisoners of War, *supra* note 23, art. 93.

28. 42 INTERNATIONAL LAW REPORTS 481 (E. Lauterpacht ed., 1971) ("Similarly, combatants who are members of the armed forces, but do not comply with the minimum qualifications of belligerents or are proved to have broken other rules of warfare, are war criminals as such . . . ."); Protocol I, *supra* note 1, art. 85 ("Without prejudice to the application of the Conventions and of this Protocol, grave breaches of these instruments shall be regarded as war crimes.").

pressure to accord protection to terrorists who elected to conduct hostile military operations beyond the accepted legal framework. In effect, the United States concluded that Protocol I actually undermined the humanitarian goal of protecting innocent civilian lives and property because its most contentious provisions could provide a legal smokescreen behind which transnational terrorists could kill with impunity. Every commander in chief since 1977 has shared this assessment. Whether the U.S. position was based on an accurate assessment of Protocol I, U.S. opposition to the treaty framed the debate regarding the relative status of the new categories of conflict and of combatants.

This Article challenges the prevailing view that American exceptionalism provides the strongest rationale for the posture taken regarding U.S. accession to Protocol I to the 1949 Geneva Conventions. The United States endured scathing criticism for these positions that has waned only marginally with the passage of time. U.S. opposition to Protocol I served as the catalyst for subsequent reservations taken by other NATO allies, which in turn provided a vital impetus for clarifying those norms as newly prescribed treaty provisions rather than preexisting customary international law. Rather than representing a rejection and withdrawal of the international legal regime, the U.S. position provided the normative benchmark against which other states measured later attempts to deliberately shield terrorists from criminal accountability mechanisms in the aftermath of September 11.

This Article puts this instance of so-called "exceptionalism" into proper perspective by identifying the substantively identical positions that became manifest in the wake of September 11 as several of the most important multilateral terrorism treaties entered into force on the heels of a wave of state accessions. Several states used the pretext that Protocol I had established expansive protections for non-state actors engaged in hostilities to propose reservations effectuating that same language in the multilateral terrorism conventions. Nearly thirty years after the United States rejected Protocol I, many other nations reacted decisively to reject the attempts to redefine to the treaty definition of "terrorism." The U.S. policy stance regarding Protocol I presaged the line drawn by many other nations to prevent the commingling of the laws and customs of war with the multilateral framework for responding to terrorist acts. U.S. "exceptionalism" represented a principled policy decision based on national interests which provided the impetus for deeper engagement in shaping the legal norms applicable to terrorist acts. The U.S. position accurately reflected underlying community interests of states engaged in a struggle against terrorists and thus established the normative standards that prevented later attempts to blur the distinctions between terrorists and privileged combatants.

In the case of Protocol I, what has been framed as U.S. "exceptionalism" was in fact proven over time to represent the overwhelming policy consensus of states. The mosaic of reservations and reactions by other states demonstrated a substantive solidarity with the underlying U.S. concerns. The experience with the definition of terrorist acts demonstrates that an a priori reliance on the process of diplomacy during negotiations would place the weight of multilateral enforcement on an uncertain and perhaps shifting fulcrum. Rather than accepting a treaty definition that is the product of compromise and consensus, the patterns of state practice, reaction to the diplomatic forays of other states, and the context of real world events provides a far more reliable gauge to measure the real depth of international agreement and the real meaning of otherwise vague treaty terms. This Article concludes by suggesting that eliminating the opportunity for states to make

reservations as the tools of a second order dialogue over the true meaning and import of treaty provisions endangers the utility of multilateral treaties. An ex ante preference for prohibiting reservations serves to short circuit healthy dialogue of diplomatic perspectives that minimizes uncertainty in the adoption and application of multilateral treaties. Rather than sole reliance on the words accepted by the negotiators, subsequent state practice based on overarching objectives is the best measure for the true agreement of states. The United States paved the way for this process through the politically disadvantageous steps taken in reaction to the objectionable provisions found in Protocol I.

Part II of this Article will review the development of the law related to belligerent status in order to provide the necessary predicate to understanding the revolutionary developments enshrined in Protocol I. Part II will also review the actions of the United States in response to Protocol I and examine the responses of other states, as well as briefly considering the counterarguments that potentially undercut the U.S. position. Part III suggests that some exceptionalism is a necessary and healthy component of lawmaking between sovereign states. In retrospect, the U.S. response to Protocol I provided the platform for an extended international dialogue and accurately predicted the larger global priorities that manifested themselves in the wake of September 11. Part IV documents the attempted redefinitions of terrorism and the reactions of states from around the world. In the final analysis, the rigid distinction between the laws and customs of armed conflict and terrorist acts has been solidified and clarified. Protocol I provides an example of global engagement in the guise of American exceptionalism.

II. FRAMING THE PROBLEM OF UNLAWFUL BELLIGERENCY

A. The Pragmatic Context

Military commanders and their lawyers do not approach the law of armed conflict as an esoteric intellectual exercise. The foundational principle of military necessity defines the necessary predicate for the lawful application of force in pursuit of the military mission, but it cannot concurrently serve as a convenient rationale for any level of unrestrained violence in the midst of an operation.[29] The law of armed conflict developed as a restraining and humanizing necessity to facilitate commanders' ability to accomplish the military mission even in the midst of fear, moral ambiguity, and horrific scenes of violence.[30] The incremental development of what became a complex body of law from the baseline of foundational necessity prompted one of the Nuremberg prosecutors to muse that "the law of war owes

29. *See* Francis Lieber, WAR DEP'T., ADJT. GEN. OFFICE: INSTRUCTIONS FOR THE GOVERNMENT OF ARMIES OF THE UNITED STATES IN THE FIELD (1863), *reprinted in* THE LAWS OF ARMED CONFLICTS: A COLLECTION OF CONVENTIONS, RESOLUTIONS, AND OTHER DOCUMENTS 6, art. 16 (Dietrich Schindler & Jiri Toman eds., 2004) [hereinafter Lieber Code] (a reproduction of texts on armed conflicts and the law as it applies to U.S. armies).

30. *See* THE LAWS OF ARMED CONFLICTS: A COLLECTION OF CONVENTIONS, RESOLUTIONS, AND OTHER DOCUMENTS vi (Dietrich Schindler & Jiri Toman eds., 2004) ("During the second half of the nineteenth century, a growing conviction spread over the Western world that civilization was rapidly advancing and that it was therefore imperative 'to restrain the destructive forces of war'.").

more to Darwin than to Newton."[31] In fact, the laws and customs of war originated from the unyielding demands of military discipline under the authority of the commander or king whose orders must be obeyed. Writing in 1625, Hugo Grotius documented the Roman practice that "it is not right for one who is not a soldier to fight with an enemy" because "one who had fought an enemy outside the ranks: and without the command of the general was understood to have disobeyed orders," an offense that "should be punished with death."[32] The modern law of armed conflict is nothing more than a web of interlocking protections and legal obligations held together by the thread of respect for humankind and a reciprocal expectation that other participants in armed conflict are bound by the same normative constraints. This explains its historical roots in conflicts between states and those acting under the authority of states.

Nevertheless, the detailed provisions of the laws and customs of war relate back to the basic distinction between persons who can legally participate in conflict and the corresponding rights and obligations they assume. The courts of many ancient nations punished those who violated these norms, and the king's right to punish those who "excessively violate the law of nature or of nations in regard to any persons whatsoever" was well established.[33] Beginning in 1874, states accepted the principle that "the laws of war do not recognize in belligerents an unlimited power in the adoption of means of injuring the enemy."[34] During the Thirty Years' War, the Swedish king mandated that "no Colonel or Captain shall command his soldiers to do any unlawful thing; which who so does, shall be punished according to the discretion of the Judge."[35] By 1907, this concept morphed into the phrase "the right of belligerents to adopt means of injuring the enemy is not unlimited."[36] The modern formulation of this foundational principle is captured in Article 35 of Protocol I as follows: "In any armed conflict, the right of the Parties to the conflict to choose methods or means of warfare is not unlimited."[37] Military codes and manuals across the planet communicate the gravity and importance of such behavioral norms.[38]

The law of armed conflict emerged as the benchmark for military professionalism because its precepts are intended to restrain the application of raw power and bloodlust, even in the midst of chaos, mind-numbing fear, and

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31. Thomas F. Lambert, *Recalling the War Crimes Trials of World War II*, 149 MIL. L. REV. 15, 23 (1995).

32. 3 HUGO GROTIUS, DE JURE BELLI AC PACIS, ch. 18 (1625), *available at* http://www.lonang.com/exlibris/grotius/gro-318.htm. Grotius explained the necessity for such rigid discipline as follows: "The reason is that, if such disobedience were rashly permitted, either the outposts might be abandoned or, with increase of lawlessness, the army or a part of it might even become involved in ill-considered battles, a condition which ought absolutely to be avoided." *Id.*

33. EVE LA HAYE, WAR CRIMES IN INTERNAL ARMED CONFLICTS 105 (2008) (quoting 2 HUGO GROTIUS, DE JURE BELLI AC PACIS 504 (F. Kelsey trans., 1925) (1625)).

34. The Brussels Project of an International Declaration Concerning the Laws and Customs of War art. 12, *reprinted in* DIETRICH SCHINDLER & JIRI TOMAN, THE LAWS OF ARMED CONFLICTS 21–28 (2d ed. 1981) [hereinafter Brussels Declaration].

35. M. CHERIF BASSIOUNI, CRIMES AGAINST HUMANITY IN INTERNATIONAL CRIMINAL LAW 59 (2d. ed. 1999) (quoting GUSTAVUS ADOLPHUS, ARTICLES OF WAR TO BE OBSERVED IN THE WARS (1621)).

36. 1907 Hague Regulations, *supra* note 25, art. 22 and accompanying text.

37. Protocol I, *supra* note 1, art. 35.

38. W. Michael Reisman & William K. Leitzau, *Moving International Law from Theory to Practice: The Role of Military Manuals in Effectuating the Laws of Armed Conflict*, THE LAW OF NAVAL OPERATIONS, 64 NAVAL WAR COL. INT'L. L. STUD. 1, 5–6 (Horace B. Robertson, Jr. ed., 1991).

overwhelming uncertainty. Hence, the law of war is integral to the very notion of professionalism because it defines the class of persons against whom professional military forces can lawfully apply violence based on principles of military necessity and reciprocity.[39] Each individual military actor remains an autonomous moral figure with personal responsibility, and there is accordingly no defense of superior orders in response to allegations of war crimes.[40] The current context of armed conflict presents commanders with the challenge of implementing humanitarian restraints in an environment marked by an adversary's utter disregard for those bounds.[41] The overall mission will often be intertwined with political, legal, and strategic imperatives that cannot be accomplished in a legal vacuum or by undermining the threads of legality that bind together diverse aspects of a complex operation. The U.S. doctrine for counterinsurgency operations makes this clear in its opening section:[42]

> Globalization, technological advancement, urbanization, and extremists who conduct suicide attacks for their cause have certainly influenced contemporary conflict; however, warfare in the 21st century retains many of the characteristics it has exhibited since ancient times. Warfare remains a violent clash of interests between organized groups characterized by the use of force. Achieving victory still depends on a group's ability to mobilize support for its political interests (often religiously or ethnically based) and to generate enough violence to achieve political consequences. Means to achieve these goals are not limited to conventional forces employed by nation-states.

The objective of asymmetric warfare is achieved when professionalized military forces confront an enemy who seeks to gain an otherwise impossible military parity through a deliberate disregard for humanitarian law.[43] Even against a lawless enemy,

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39. *See generally* Leslie C. Green, *What is—Why is There—The Law of War?*, *in* ESSAYS ON THE MODERN LAW OF WAR (2d. ed. 1999) (providing a historical account of how and why the law of war developed).

40. Report of the International Law Commission Covering its Second Session, June 5–July 29, 1950, U.N. GAOR, 5th Sess., Supp. No. 12, U.N. Doc. A/1316, *reprinted in* THE LAWS OF ARMED CONFLICTS: A COLLECTION OF CONVENTIONS, RESOLUTIONS, AND OTHER DOCUMENTS, at 1265–66 (Dietrich Schindler & Jiri Toman eds., 1988).

41. *See, e.g.*, Letter from Gen. David H. Petraeus, Commanding Officer of Multi-National Force-Iraq, to Multi-National Force-Iraq (May 10, 2007), *available at* http://www.humanrightsfirst.org/blog/torture/2009/02/general-petraeus-what-sets-us-apart.asp (addressing a letter to all coalition forces serving in Iraq, "Soldiers, Sailors, Airmen, Marines, and Coast Guardsmen serving in Multi-National Force-Iraq: Our values and the laws governing warfare teach us to respect human dignity, maintain our integrity, and do what is right. Adherence to our values distinguishes us from our enemy. This fight depends on securing the population, which must understand that we—not our enemies—occupy the moral high ground. This strategy has shown results in recent months. Al Qaeda's indiscriminate attacks, for example, have finally started to turn a substantial proportion of the Iraqi population against it.").

42. DEP'T OF THE ARMY, FIELD MANUAL NO. 3-24, MARINE CORPS WARFIGHTING PUBLICATION NO. 3-33.5, COUNTERINSURGENCY 1 (2007).

43. Walter Laquer, *The Terrorism to Come*, 126 POL'Y REV 58–59 (Aug.–Sept. 2004):

there are two essential questions professional military forces must ask in this new style of conflict:

(1) How may we properly apply military force?

(2) If lawful means of conducting conflict are available, against whom may we properly apply military force?

The centrality of these themes in the development of the laws and customs of war cannot be overlooked when explaining the competing state interests embedded in the multilateral conventions that regulate conflicts. These themes also provide the golden thread of insight that is essential to understanding that the modern law of terrorism and the most fundamental aspects of humanitarian law are interrelated but distinct.

B. Early U.S. Leadership in Distilling the Law

Because only states enjoyed the historical prerogative of conducting warfare, the principles of lawful combatancy developed from the premise that only states had the authority to sanction the lawful conduct of hostilities.[44] Propelled by the classic view that "the contention must be between States" to give rise to the right to use military force,[45] the concept of combatant status developed to describe the class of persons operating under the authority of a sovereign state to wage war.[46] The intellectual roots of combatant immunity are thus grounded in the soil of state sovereignty. Then, as now, there was a stigma attached to being an unlawful combatant because the term carried implicit recognition that the sovereign power of the state was being thwarted without legal cause. For example, from 1777 to 1782, the British Parliament passed an annual act declaring that privateers operating under the license of the Continental Congress were pirates, hosti humanis generis, and as such could be prosecuted for their acts against the Crown.[47]

Combatant status conveys the necessary implication that lawful combatants enjoy protection under the laws of war to commit acts that would be otherwise be unlawful, such as killing persons and destroying property. Two essential implications follow from the conceptual foundation of combatant immunity as an offshoot of

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When regular soldiers do not stick to the rules of warfare, killing or maiming prisoners, carrying out massacres, taking hostages or committing crimes against the civilian population, they will be treated as war criminals.

If terrorists behaved according to these norms they would have little if any chance of success; the essence of terrorist operations now is indiscriminate attacks against civilians. But governments defending themselves against terrorism are widely expected not to behave in a similar way but to adhere to international law as it developed in conditions quite different from those prevailing today.

Terrorism does not accept laws and rules, whereas governments are bound by them; this, in briefest outline, is asymmetric warfare. If governments were to behave in a similar way, not feeling bound by existing rules and laws such as those against the killing of prisoners, this would be bitterly denounced.

44. L. OPPENHEIM, INTERNATIONAL LAW: A TREATISE 203 (H. Lauterpacht ed., 7th ed. 1952).

45. *Id.*

46. *See* Geneva Convention Relative to the Treatment of Prisoners of War, *supra* note 23.

47. ALFRED P. RUBIN, THE LAW OF PIRACY 154 (1988).

state sovereignty. First, although the application of international humanitarian law has expanded from international to non-international armed conflicts,[48] the concept of "combatancy" has been strictly confined to international armed conflicts. Even as the law expanded to grant combatant immunity for irregular forces that do not line up in military uniforms on a parade field, participants in non-international armed conflicts remain completely subject to domestic criminal prosecution for their warlike acts. Protections found in domestic law are grounded not on the status of a person, but on the basis of actual activities, because no one has an international law "right to participate in hostilities" in a non-international armed conflict.[49]

Even during the Civil War era, the tactical uncertainty faced by Union forces waging a campaign against rebel forces thrust lawyers and the importance of sound legal analysis into the spotlight. The first comprehensive effort to describe the law of war in a written code, the Lieber Code, began as a request from the General-in-Chief of the Union Armies, based on his confusion over the distinction between lawful and unlawful combatants.[50] General Henry Wager Halleck recognized that the law of armed conflict never accorded combatant immunity to every person who conducted hostilities and also could not provide pragmatic guidance to adapting to the changing tactics of war.[51] He knew, however, that the war could not be won without clear delineation to the forces in the field regarding the proper targeting of combatants and a correlative standard for the treatment of persons captured on the battlefield based on the legal characterization of their status. On August 6, 1862, General Halleck wrote to Dr. Francis Lieber, a highly regarded law professor at the Columbia College in New York, to request his assistance in defining guerrilla warfare.[52]

This request, which can be described as the catalyst that precipitated more than one hundred years of legal effort resulting in the modern web of international agreements regulating the conduct of hostilities, read as follows:

> My Dear Doctor: Having heard that you have given much attention to the usages and customs of war as practiced in the present age, and especially to the matter of guerrilla war, I hope you may find it convenient to give to the public your views on that subject. The rebel authorities claim the right to send men, in the garb of peaceful citizens, to waylay and attack our troops, to burn bridges and houses and to destroy property and persons within our lines. They demand that such persons be treated as ordinary belligerents, and that when captured they have extended to them the same rights as other prisoners of war; they also threaten that if such persons be punished as marauders and spies they will retaliate by executing our

48. *See, e.g.*, Rome Statute of the International Criminal Court art. 8(2)(e), July 1, 2002, 2187 U.N.T.S. 90, 139 [hereinafter Rome Statute].

49. MARCO SASSOLI & ANTOINE BOUVIER, HOW DOES LAW PROTECT IN WAR? 208 (Int'l Comm. of the Red Cross 1999).

50. Letter from General Halleck to Dr. Francis Lieber, Aug. 6. 1862, *reprinted in* FRANCIS LIEBER, LIEBER'S CODE AND THE LAW OF WAR 2 (Richard Shelly Hartigan ed., 1983).

51. *Id.*

52. *Id.*

> prisoners of war in their possession. I particularly request your views on these questions.[53]

The Union Army issued a disciplinary code governing the conduct of hostilities, known worldwide as the Lieber Code, as "General Orders 100 Instructions for the Government of the Armies of the United States in the Field" in April 1863.[54] General Orders 100 was the first comprehensive military code of discipline that sought to define the precise parameters of permissible conduct during conflict.[55] From this baseline, the principle endures in the law today that persons who do not enjoy lawful combatant status are not entitled to the benefits of legal protections derived from the laws of war, including prisoner of war status,[56] and are subject to punishment for their warlike acts.[57]

Lieber's description of unlawful combatancy is notable in light of operational uncertainties that have been prominent in current anti-terrorist operations. Though this language is dated, it suggests the al-Qaeda tactics in evocative terms:

> Men, or squads of men, who commit hostilities, whether by fighting, or inroads for destruction or plunder, or by raids of any kind, without commission, without being part and portion of the organized hostile army, and without sharing continuously in the war, but who do so with intermitting returns to their homes and avocations, or with the occasional assumption of the semblance of peaceful pursuits, divesting themselves of the character or appearance of soldiers—such men, or squads of men, are not public enemies, and therefore, if captured, are not entitled to the privileges of prisoners of war, but shall be treated summarily as highway robbers or pirates.[58]

While the military forces serving sovereign states enjoyed combatant status as an indisputable right, treaty provisions later developed in response to the changing face of warfare. There have been over sixty conventions regulating various aspects of armed conflict and a recognizable body of international humanitarian law has emerged from this complex mesh of conventions and custom.[59] In embarking on the

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53. *Id.*

54. Lieber Code, *supra* note 29, at 3. For descriptions of the process leading to General Orders 100 and the legal effect it had on subsequent efforts, *see generally* Grant R. Doty, *The United States and the Development of the Laws of Land Warfare*, 156 MIL. L. REV. 224 (1998); George B. Davis, *Doctor Francis Lieber's Instructions for the Government of Armies in the Field*, 1 AM. J. INT'L L. 13 (1907).

55. Lieber Code, *supra* note 29, at 3.

56. This statement is true subject to the linguistic oddity introduced by Article 3 of the 1907 Hague Regulations, which makes clear that the armed forces of a state can include both combatants and non-combatants (meaning chaplains and medical personnel), and that both classes of military personnel are entitled to prisoner of war status if captured. *See* 1907 Hague Regulations, *supra* note 25, art. 3 ("[t]he armed forces of the belligerent parties may consist of combatants and non-combatants. In the case of capture by the enemy, both have a right to be treated as prisoners of war.").

57. *See infra* note 66 (discussing the U.S. Military tribunal at Nuremberg's finding that resistance groups were not entitled to be treated as prisoners of war).

58. Lieber Code, *supra* note 29, art. 82.

59. *See generally* M. CHERIF BASSIOUNI, CRIMES AGAINST HUMANITY IN INTERNATIONAL CRIMINAL LAW (Kluwer Law Int'l 2d ed. 1999) (offering discussions of sources for the law of armed conflicts, the world's major criminal justice systems, and the Charter of the International Military Tribunal for the Prosecution of the Major War Criminals of the European Theater).

age of positivist legal development, states attempted to clarify the line between lawful combatants and unlawful criminals when they perceived gaps between humanitarian goals and the operational realities and the legal framework therefore appeared unresponsive to changing military requirements.

C. *The 1949 Geneva Conventions*

The provisions for according combatant status and for treating those entitled to combatant immunity must be followed unless states voluntarily expand the normative boundaries of the law. The Lieber Code provided the core around which the law developed, much like the grit around which a pearl is created layer by layer. The *franc-tireur* resistance during the Franco-Prussian War forced reexamination of the line between legally protected civilians and partisan combatants.[60] The topic of belligerency conducted by private citizens in occupied territory was much debated but little settled during the period, and the subject was therefore omitted from the Brussels Declaration of 1874, the Oxford Manual of 1880, and the 1907 Hague Regulations.[61]

As of 1907, the scope of lawful combatancy included the so-called levée en masse, when the populace spontaneously organized to fight against an oncoming enemy.[62] Once the occupation was successfully effected, local civilians in occupied territory no longer enjoyed a de jure right to fight the enemy occupier.[63] Otherwise, lawful combatancy applied only to forces fighting for a state. The Hague Regulations embodied this legal regime as follows:

> Article 1. The laws, rights, and duties of war apply not only to armies, but also to militia and volunteer corps fulfilling the following conditions:
>
> 1. To be commanded by a person responsible for his subordinates;
>
> 2. To have a fixed distinctive emblem recognizable at a distance;
>
> 3. To carry arms openly; and
>
> 4. To conduct their operations in accordance with the laws and customs of war.

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60. *See generally* Major R.R. Baxter, *So-Called Unprivileged Belligerency: Spies, Guerillas, and Saboteurs*, 28 BRIT. Y.B. INT'L L. 323 (1951) [hereinafter Baxter] (examining acts of "unlawful belligerents operating in areas which are not under belligerent occupation").

61. DORIS APPEL GRABER, THE DEVELOPMENT OF THE LAW OF BELLIGERENT OCCUPATION 1863–1914, 79 (Columbia Univ. Press 1949).

62. This concept brings to mind the uprising of Russian peasants in opposition to Napoleonic invaders. It was enshrined in Article 2 of the Hague Regulations and remains unchanged. 1907 Hague Regulations, *supra* note 23, art. 2 ("The inhabitants of a territory which has not been occupied, who, on the approach of the enemy, spontaneously take up arms to resist the invading troops without having had time to organize themselves in accordance with Article 1, shall be regarded as belligerents if they carry arms openly and if they respect the laws and customs of war.").

63. *See* 1907 Hague Regulations, *supra* note 25, arts. 1–2 (stating that inhabitants not covered by Article 2 are governed by the text of Article 1 and are no longer considered lawful combatants).

> In countries where militia or volunteer corps constitute the army, or form part of it, they are included under the denomination "army."[64]

This formulation enshrined the traditional linkage of the armed forces to the sovereign power of the state and included affiliated militia units that met the established criteria derived from customary international law. This language survived in essentially the same form until the 1977 Additional Protocols to the Geneva Conventions of 1949.

Because Hague Regulations extended protected status only to a defined subset of militia and volunteer forces but not to other irregular forces, the provision of the Lieber Code that unlawful combatants could be executed survived both in the letter of the law[65] and in the practice of courts[66] until after World War II. Private citizens in occupied territory therefore had no legally protected rights to rise up and oppose the forces of the occupying power.[67] Hence, rather than presuming that they represented the sovereign authority of the occupied state, private citizens were categorized as unlawful combatants subject to the penalty of death.[68]

The 1907 Hague delineations remained with only slight modifications until 1977, despite the wholesale evolution of warfare.[69] However, the patriotic resistance of partisan fighters to the German occupations in World War II and the horrific

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64. *Id.*

65. Lieber Code, *supra* note 29, art. 85 ("War-rebels are persons within an occupied territory who rise in arms against the occupying or conquering army, or against the authorities established by the same. If captured, they may suffer death, whether they rise singly, in small or large bands, and whether called upon to do so by their own, but expelled, government or not. They are not prisoners of war; nor are they if discovered and secured before their conspiracy has matured to an actual rising or to armed violence.").

66. For example, the U.S. Military tribunal at Nuremberg stated:

> The evidence shows that the bands were sometimes designated as units common to military organization. They, however, had no common uniform. They generally wore civilian clothes although parts of German, Italian and Serbian uniforms were used to the extent they could be obtained. The Soviet Star was generally worn as insignia. The evidence will not sustain a finding that it was such that it could be seen at a distance. Neither did they carry their arms openly except when it was to their advantage to do so. There is some evidence that various groups of the resistance forces were commanded by a centralized command, such as the partisans of Marshal Tito, the Chetniks of Draja Mihailovitch and the Edes of General Zervas. It is evident also that a few partisan bands met the requirements of lawful belligerency. The bands, however, with which we are dealing in this case were not shown by satisfactory evidence to have met the requirements. This means, of course, that captured members of these unlawful groups were not entitled to be treated as prisoners of war. *No crime can be properly charged against the defendants for the killing of such captured members of the resistance forces, they being franc-tireurs.*

The Hostages Trial (Trial of Wilhelm List and Others) (U.S. Military Trib., Nuremberg July 8, 1947–Feb. 19, 1948), *reprinted in* 8 The United Nations War Crimes Comm'n, Law Reports of Trials of War Criminals 34, 57 (emphasis added) [hereinafter The Hostages Trial].

67. *See* 1907 Hague Regulations, *supra* note 23, arts. 1–2 (stating that inhabitants not covered by Article 2 are governed by the text of Article 1 and are no longer considered lawful combatants).

68. A. PEARCE HIGGINS, WAR AND THE PRIVATE CITIZEN: STUDIES IN INTERNATIONAL LAW 42 (P.S. King & Son 1912).

69. *See* 1907 Hague Regulations, *supra* note 25; Protocol I, *supra* note 1 (presenting the 1977 changes); Protocol Additional to the Geneva Conventions of 12 Aug. 1949, and relating to the Protection of Victims of Non-International Armed Conflicts (Protocol II), art. 13, para. 2, 1125 U.N.T.S. 1 [hereinafter Protocol II] (presenting more 1977 changes).

crimes committed by German forces against the civilian populace in response[70] forced states to update the legal standards for obtaining combatant status during occupation. The fact that the provisions for regulating the status of irregular fighters did not become part of the 1949 Fourth Geneva Convention (designed to protect the civilian population) is itself legally significant. As one eminent commentator noted,

> The whole point about the lawful guerrilla fighter, so far as he could be identified and described, was that he was not a civilian. The Civilians Convention was for protecting civilians who remained civilians and whose gestures of resistance, therefore, would be punished as crimes, just as would any acts of guerrilla warfare which lay outside whatever lawful scope could be defined.[71]

Accordingly, the 1949 Geneva Conventions restated and updated the law of combatant status within the Third Geneva Convention on Prisoners of War. Under the Third Convention, the class of civilians entitled to prisoner of war status was described *inter alia* as:

> Members of other militias and members of other volunteer corps, including those of organized resistance movements, belonging to a Party to the conflict and operating in or outside their own territory, even if this territory is occupied, provided that such militias or volunteer corps, including such organized resistance movements, fulfil the following conditions:
>
> (a) That of being commanded by a person responsible for his subordinates;
>
> (b) That of having a fixed distinctive sign recognizable at a distance;
>
> (c) That of carrying arms openly;
>
> (d) That of conducting their operations in accordance with the laws and customs of war.[72]

This language reproduced the qualifications drawn from the 1907 Regulations, with the express addition of those operating on behalf of the displaced sovereign. The treaty also added a requirement for the detaining state to convene a "competent tribunal" to consider the facts relevant to a particular person's status, when that

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70. *See, e.g.*, United States v. Otto Ohlendorf (The Einsatzgruppen Case), 4 TRIALS OF WAR CRIMINALS BEFORE THE NUREMBERG MILITARY TRIBUNALS UNDER CONTROL COUNCIL LAW, NO.10 (Military Tribunal II-A, Nuremberg, Germany, July 8, 1947–Feb. 19, 1948), *reprinted in* HOWARD LEVIE, DOCUMENTS ON PRISONERS OF WAR 408 (1979) (describing directives that ordered the imprisonment and mass-murder of civilians); Italy, Sansoli and Others v. Bentivegna and Others, Court of Cassation, 24 INT. L. REP. 986 (1958), *reprinted in* SASSOLI & BOUVIER, *supra* note 49, at 701 (upholding the legal status of Italian irregulars in fighting against German occupation).

71. GEOFFREY BEST, WAR AND LAW SINCE 1945, 127–28 (Oxford Univ. Press 2002) [hereinafter BEST, WAR AND LAW].

72. Geneva Convention Relative to the Treatment of Prisoners of War, *supra* note 23, art. 4. This is only a partial listing of the provisions most relevant for determining the status of terrorists and their supporters.

status is in doubt.[73] This provision was intended to "avoid arbitrary decisions by a local commander,"[74] and in practice may be accomplished by three officers with expeditious thoroughness.[75]

The addition of an entirely new international convention in 1949, designed to create legal entitlements on behalf of the civilian population, gave rise to the dualistic view of status that persists in some quarters to this day. The International Committee of the Red Cross (ICRC) took the position in its official commentary that because there "is no intermediate status" between combatant and civilian, every person in enemy hands "must have some status under international law."[76] Though the ICRC explicitly recognized that "[m]embers of resistance movements must fulfill certain stated conditions before they can be regarded as prisoners of war,"[77] its dualist position was premised on an unstated assumption that the civilian unlawfully participating in the conflict lived in the territory occupied by another sovereign state. Modern transnational terrorist acts by definition belie this assumption, even if the ICRC premise reflected an accurate view of the law shortly after the conclusion of the Geneva Conventions in 1949.[78]

Despite overturning several centuries of legal development and judicial practice,[79] the ICRC noted that this dualism would be "satisfying to the mind"

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73. *Id.* art. 5.

74. FINAL RECORD OF THE DIPLOMATIC CONFERENCE OF GENEVA OF 1949 VOL.II-B 270 (Fed. Political Dep't, 1949).

75. DEPARTMENT OF THE ARMY, FM 27-10: DEPARTMENT OF THE ARMY FIELD MANUAL: THE LAW OF LAND WARFARE 30 (1956).

76. INTERNATIONAL COMMISION OF THE RED CROSS, COMMENTARY ON THE GENEVA CONVENTIONS OF 12 AUGUST 1949: VOLUME 4, 51 (Int'l Comm. of the Red Cross 1958) [hereinafter ICRC COMMENTARY ON GENEVA CONVENTION] ("Every person in enemy hands must have some status under international law: he is either a prisoner of war and, as such, covered by the Third Convention, a civilian covered by the Fourth Convention, or again, a member of the medical personnel of the armed forces who is covered by the First Convention. There is no intermediate status; nobody in enemy hands can be outside the law.").

77. *Id.* at 50 ("of resistance movements must fulfill certain stated conditions before they can be regarded as prisoners of war. If members of a resistance movement who have fallen into enemy hands do not fulfill those conditions, they must be considered to be protected persons within the meaning of the present Convention. That does not mean that they cannot be punished for their acts, but the trial and sentence must take place in accordance with the provisions of Article 64 and the Articles which follow it.").

78. Kristopher K. Robinson, Edward M. Crenshaw & J. Craig Jenkins, *Ideologies of Violence: The Social Origins of Islamist and Leftist Transnational Terrorism*, 84 SOC. F. 2009, 2013 (2005) ("To qualify as a *transnational* terrorist attack, the attack must involve multiple nationalities (defined in terms of country of origin) in terms of its victims, the primary actors, and/or the location of the attack relative to the actor and target. They must also be conducted by an autonomous non-state actor (i.e., a group that is not directly controlled by a sovereign state), have political goals, make use of extra-normal violence, and at least ostensibly be designed so as to induce anxiety among various targets, including the general public.").

79. *See, e.g.*, The Hostages Trial, *supra* note 66, at 57–58 ("Guerilla warfare is said to exist where, after the capitulation of the main part of the armed forces, the surrender of the government and the occupation of its territory, the remnant of the defeated army or the inhabitants themselves continue hostilities by harassing the enemy with unorganised forces ordinarily not strong enough to meet the enemy in pitched battle. They are placed much in the same position as a spy. By the law of war it is lawful to use spies. Nevertheless, a spy when captured, may be shot because the belligerent has the right, by means of an effective deterrent punishment, to defend against the grave dangers of enemy spying. The principle therein involved applied to guerrillas who are not lawful belligerents. Just as the spy may act lawfully for his country and at the same time be a war criminal to the enemy, so guerrillas may render great service to their country and, in the event of success, become heroes even, still they remain war criminals in the eyes of the enemy and may be treated as such. In no other way can an army guard and protect itself from the gadfly tactics of such armed resistance. And, on the other hand, members of such resistance forces must accept

because of its simplicity and humanitarian scope.[80] Insofar as it applied to the legal status of civilians under the occupation of a foreign power, the ICRC view accurately reflected the law. However, extrapolating this simple dualism beyond the narrow question of legal duties owed by an occupier to the citizens under its occupation reduces to obsolescence the historic practice of considering unlawful belligerents as unprotected participants in combat and therefore beyond the reach of international law. However, the dualist ICRC view did not accurately reflect the negotiating record of the 1949 Geneva Conventions, nor the practice of states in applying its provisions.

For example, the plain reading of the legal criteria ultimately accepted by delegates during the 1949 Diplomatic conference reveals that although the two conventions might appear to cover all the categories concerned, irregular belligerents were not actually protected.[81] As a matter of pure logic, extending the protection of international law to all civilians who take up arms in violation of international law would undermine the legitimacy and enforcement of such law. Granting legal protection to any civilian who takes up arms would create a perverse incentive to defy the conventions regulating conduct and deliberately conduct hostilities outside the bounds of the law all the while relying on the good will of the enemy to apply that same body of law. Some delegates pushed for a broader interpretation of the textual provisions that would have protected illegal combatants based on the understanding that the "categories named in Article 3 [the present Article 4 of the Third Geneva Convention] cannot be regarded as exhaustive, and it should not be inferred that other persons would not also have the right to be treated as prisoners of war."[82] This position was politely but firmly rejected by the delegates in favor of the view that the text itself is the exclusive source to "define what persons are to have the protection of the Convention."[83]

A number of other delegations explicitly confirmed that the text of the Geneva Conventions did not foreclose the traditional category of unlawful combatants. The Dutch delegate pointed out that a summary conclusion to the effect that combatants who did not meet the criteria for prisoner of war status "are automatically protected by other Conventions is certainly untrue."[84] The ICRC dualist view is not warranted based on the view of the delegates that negotiated the provisions that convey combatant status. The Dutch delegate further clarified, with no evidence of disagreement from any national delegation, that the Fourth Geneva Convention (the Civilians Convention) "deals only with civilians under certain circumstances; such as civilians in an occupied country or civilians who are living in a belligerent country, *but it certainly does not protect civilians who are in the battlefield, taking up arms*

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the increased risks involved in this mode of fighting. Such forces are technically not lawful belligerents and are not entitled to protection as prisoners of war when captured.").

80. ICRC COMMENTARY ON GENEVA CONVENTION, *supra* note 76, at 49; *see also supra* text in note 72.

81. Geneva Convention Relative to the Treatment of Prisoners of War, *supra* note 23, art. 4.

82. FINAL RECORD OF THE DIPLOMATIC CONFERENCE OF GENEVA OF 1949: VOL. II-B, *supra* note 74, at 268 (quoting the Danish delegate who argued that "the cases not provided for by Article 3 must be treated separately and in accordance with present-day international law").

83. *Id.*

84. *Id.* at 271.

against the adverse party."[85] Furthermore, the U.K. delegate observed that "the whole conception of the Civilians Convention was the protection of civilian victims of war and not the protection of illegitimate bearers of arms, who could not expect full protection under rules of war to which they did not conform."[86]

Rather than simply extending blanket protections to every person, the drafters established some fundamental protections that are applicable to all individuals in times of armed conflict, even as they carefully crafted definitions for the categories of persons entitled to receive specific rights and protections.[87] Thus, the position of unlawful combatants as unprotected participants in conflict remained unchanged by the 1949 Geneva Conventions, with the narrow caveat that the Fourth Geneva Convention did provide residual protection for the citizens of occupied territory *vis-á-vis* the occupying power. This state of legal development became particularly important in light of the national responses to the purported expansion of combatant status to unprivileged belligerents in the textual provisions adopted as part of Protocol I, as will shortly be demonstrated.

D. Protocol I as an Evolutionary Vehicle

The ink was hardly dry on the texts of the 1949 Geneva Conventions when the ICRC began to advocate a further expansion of the law. As noted above, the law of war continually evolves in response to the needs of states conducting conflict. While the 1949 Conventions regulate armed conflicts conducted between "two or more of the High Contracting Parties," the law applicable to non-international armed conflicts does not provide for combatant status nor does it define combatants or specify a series of obligations inherent in combatant status.[88] Under the Geneva principles, anyone operating outside the authority of a state who participates in hostile activities can expect no form of automatic legal license or protection from prosecution.[89] Indeed, introducing the concept of "combatant immunity" in the context of non-international armed conflicts would grant immunity for acts which would be perfectly permissible when conducted by combatants in an international armed conflict, such as attacks directed at military personnel or property.[90] This

85. *Id.* (emphasis added).

86. *Id.* at 621. Brigadier Page noted that illegal combatants "should no doubt be accorded certain standards of treatment, but should not be entitled to all the benefits of the convention." *Id.* The Swiss delegate expressed an almost identical view that "in regard to the legal status of those who violated the laws of war, the Convention could not of course cover criminals or saboteurs." *Id.*

87. FRANCOISE BOUCHET-SAULNIER, THE PRACTICAL GUIDE TO HUMANITARIAN LAW 302 (Laura Brav ed. & trans., 2002).

88. Geneva Convention Relative to the Treatment of Prisoners of War, *supra* note 23, art. 2.

89. *Id.*

90. In light of the current military operations in the Gaza strip at the time of this writing, it is apropos to note that Professor Bassiouni posits that:

> It is almost always the case that an attack by Israeli armed forces against Palestinian targets is presented in the public discourse as being legitimate both in purpose and in means, while a Palestinian attack upon on [sic] Israeli targets is almost invariably described in opposite terms. An attack upon military targets is permissible under IHL. Thus, if the Palestinians attack Israeli armed forces, they are legitimate targets. However, Israel always describes such attacks as terrorist attacks. For Israel to recognize the legitimacy of such attacks upon its armed forces would be a major political concession to Palestinian nationalistic claims and would add significantly to the legitimacy of their conflict against Israel as being a war of national

striking silence in the law applicable to non-international armed conflicts means that any effort to describe a "combatant engaged in a non-international armed conflict" is an oxymoron. There simply is no legal category of "combatant" in a non-international armed conflict, irrespective of the moral imperatives claimed by one party or the other to warrant hostile activities.[91] This premise remains valid even when non-state actors perpetrate violence seeking to accomplish goals similar to those of the sovereign state.[92]

These perceived inadequacies in the law of armed conflict began to surface in the context of the colonialist struggles of the 1960s. The ICRC convened a conference of government experts in 1971 to consider two draft Protocols ostensibly designed to reaffirm and develop the corpus of the laws and customs of war.[93] In the

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> liberation. Geneva Convention Protocol I would apply to such a conflict, thus giving the Palestinian combatants the status of POWs, which Israel has denied to date. The analogy in this case extends only with respect to Israeli armed forces. With respect to Israeli attacks on Palestinian targets, the target may be a civilian one, which is not authorized under IHL, or a legitimate military target, but attacked with disproportionate use of force that causes civilian casualties and destruction of private property, which would be prohibited by IHL. In both of these cases, the attack would be a violation of IHL, but is almost always presented as justified. Conversely, when the Palestinians attack a legitimate military target, it is almost always labeled an act of terrorism. Without question, if Palestinians attack a civilian target, that violates IHL.

Bassiouni, *supra* note 16, at 786 n.307 (2008).

91. In fact, a wide range of states coalesced around the effort to defeat the diplomatic draft applicable to non-international armed conflicts that was tabled in 1975 by the ICRC and supported by the United States and other Western European nations. The group of states, which included Argentina, Honduras, Brazil, Mexico, Nigeria, Pakistan, Indonesia, India, Romania, and the U.S.S.R., succeeded in raising the threshold for the application of Protocol II (designed to regulate non-international armed conflicts) precisely because of fears that extending humanitarian protections to guerillas and irregular forces might elevate the status of rebel groups during such conflicts. David P. Forsythe, *Legal Management of Internal War: The 1977 Protocol on Non-International Armed Conflicts,* 72 AM. J. INT'L L. 272, 284 (1978). *See also* ELEANOR C. MCDOWELL, 1976 DIGEST OF UNITED STATES PRACTICE IN INTERNATIONAL Law 697 (1976) (documenting the U.S. success in eliminating subjective qualifiers such as "significant" or "important" that might have permitted some states to selectively apply the provisions of Protocol II).

92. This article defines terrorism as the use or threat of use of anxiety inducing extranormal violence for political purposes by any individual or group, whether acting for or in opposition to established governmental authority, where such action is intended to influence the attitudes and behavior of a target group wider than victims. EDWARD F. MICKOLUS ET AL., INTERNATIONAL TERRORISM IN THE 1980S: VOLUME II 1984–1987 xiii (1989). For the purposes of this work:

> [T]errorist incidents are restricted to actions that purposely seek to spread terror in the population either by directly targeting noncombatants or by destroying infrastructures that may affect the life and well-being of the civilian population at large ... Insurgent, revolutionary, and right-wing terrorism are generally included under the terrorism rubric. Insurgent terrorism refers to violent acts perpetrated by identifiable groups that attack governmental or other targets for short-term goals aimed at sparking widespread discontent toward the existing government. This kind of terrorism is often grounded on a defined ideology, and it seeks to unleash a process of revolution. Revolutionary terrorism defines terrorist actions that take place during existing struggles against a determined regime and develop as a guerrilla tactic. Right-wing terrorism refers to acts perpetrated by outlawed groups that do not seek a social revolution but resort to violence as a way to express and advance their political goals, such as ultranationalism and anticommunism.

Andreas E. Feldmann and Maiju Perala, *Reassessing the Causes of Nongovernmental Terrorism in Latin America*, 46 LATIN AM. POL. AND SOC'Y 101, 104 (2004).

93. ADAM ROBERTS & RICHARD GUELFF, DOCUMENTS ON THE LAWS OF WAR 387 (3d ed. 2000).

political sphere, the United Nations General Assembly adopted language that strikingly foreshadowed the international consensus against terrorism in the wake of September 11 by declaring that the continuation of colonialism "in all its forms and manifestations ... is a crime and that colonial peoples have the inherent right to struggle by all necessary means at their disposal against colonial Powers and alien domination in exercise of their right of self-determination."[94]

By a vote of 83 to 13 with 19 abstentions, the General Assembly admonished the colonial powers that the moral basis for partisan struggles by civilians to reclaim their freedom from foreign powers warranted the application of the full array of rights under the 1949 Geneva Conventions:

> The armed conflicts involving the struggle of peoples against colonial and alien domination and racist régimes are to be regarded as international armed conflicts in the sense of the 1949 Geneva Conventions, and the legal status envisaged to apply to the combatants in the 1949 Geneva Conventions and other international instruments is to apply to the persons engaged in armed struggle against colonial and alien domination and racist régimes.
>
> The combatants struggling against colonial and alien domination and racist régimes captured as prisoners are to be accorded the status of prisoners of war and their treatment should be in accordance with the provisions of the Geneva Convention relative to the Treatment of Prisoners of War, of 12 August 1949.[95]

This position assumed a moral equivalence between private citizens fighting to free a people from colonial dominance and those who fought to restore the sovereign authority of an occupied sovereign state. The General Assembly urged the extension of the 1949 Conventions in order to achieve the protections of combatant immunity, along with the corollary status as Prisoners of War, for the local population in the context of internal armed conflicts in Southern Rhodesia, Angola and Mozambique, South Africa, and Namibia.[96] This in turn buttressed the efforts of the ICRC to gain the widest possible applicability for the principles of Geneva Law.[97] The effort to extend these political positions into binding textual provisions proved to be far more contentious and problematic during the negotiations of Protocol I.[98] The Protocols Additional to the Geneva Conventions resulted from four widely attended diplomatic conferences held from 1974 to 1977. The Protocols culminated the efforts to provide textual application of the Geneva Conventions even in the context of armed conflicts between a High Contracting

94. Basic Principles of the Legal Status of the Combatants Struggling Against Colonial and Alien Domination and Racist Regimes, G.A. Res. 3103 (XXVII), U.N. Doc. A/RES/3103 (XXVIII) (Dec. 12, 1973).

95. *Id.* paras. 3 & 4.

96. *See, e.g.*, U.K. MINISTRY OF DEFENSE, THE MANUAL OF THE LAW OF ARMED CONFLICT, para. 15.2.3 (2004) (explaining that the background to this development was the emergence of a large number of post-colonial states, many of which gained independence from their former colonial rulers after long struggles and wished to see some ongoing struggles recognized as essentially international in character).

97. BEST, WAR AND LAW, *supra* note 71, 331–43.

98. *See* MCDOWELL, *supra* note 91, at 695–96 (indicating that the issue of prisoner of war status for guerilla fighters or irregular fighters was not quickly solved at the beginning of the series of diplomatic conferences).

Party and non-state actors (guerrillas, insurgents, and so-called freedom fighters). These fundamental modifications to the well-established law of combatant immunity would have arguably been impossible without the backdrop and international division caused by the Cold War. However, as in previous efforts to shape the law of war around the reality of ongoing military and political realities, the effort to draw sharp legal distinctions between protected civilians and persons who could be lawfully targeted was the driving concern behind the modern evolution embodied in the 1977 Protocols.[99]

Protocol I was intended to be an all-encompassing source of updated rules for determining combatant status, as it was meant to govern international armed conflicts and to supplement the 1949 Geneva Conventions.[100] Protocol I combined the Hague strand of international humanitarian law (dealing with constraints on the means and methods for conducting hostilities) with the Geneva strand (primarily focused on achieving humanitarian goals). It represented the end state of the law of combatancy by attempting to reduce the combatant category to its irreducible minimum while maximizing the class of protected civilians.[101]

In perhaps its most controversial provision, the Protocol amended the concept of an international armed conflict beyond its previously clear application only to conflicts between two or more High Contracting Parties in its very first article. Article 1(4) of Protocol I purports to redefine international armed conflicts to

> include armed conflicts in which peoples are fighting against colonial domination and alien occupation and against racist regimes in the exercise of their right of self-determination, as enshrined in the Charter of the United Nations and the Declaration on Principles of International Law concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations.[102]

The effect of this language would be to internationalize the actions of non-state actors, thereby conveying combatant immunity and immunity from prosecution for crimes committed against the military and police forces of the sovereign state or

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99. BEST, WAR AND LAW, *supra* note 71, at 257.

100. Protocol I, *supra* note 1, art. 1, para. 3.

101. *See* Civilians Convention, *supra* note 23, art. 4. The legal category of protected persons is not intended to be an all-inclusive category of civilians even on the face of the Convention. Article 4 provides a definition of the legal term of art, protected persons, that limits the applicability of the protections afforded by the other provisions of the Convention as follows (using admittedly odd grammar):

> Art. 4. Persons protected by the Convention are those who, at a given moment and in any manner whatsoever, find themselves, in case of a conflict or occupation, in the hands of a Party to the conflict or Occupying Power of which they are not nationals.
>
> Nationals of a State which is not bound by the Convention are not protected by it. Nationals of a neutral State who find themselves in the territory of a belligerent State, and nationals of a co-belligerent State, shall not be regarded as protected persons while the State of which they are nationals has normal diplomatic representation in the State in whose hands they are.

Civilians Convention, *supra* note 23, art. 4.

102. Protocol I, *supra* note 1, art. 1, para 4.

colonial power. This provision in turn spawned two other controversial and key texts in order for the Protocol to maintain intellectual consistency.

On its surface, Protocol I appeared to protect previously unlawful combatants with two innovations. The era of colonial wars in no way eliminated the undercurrent of deep unease felt by states whose professional military forces require a clear articulation of the grounds for achieving combatant status, as those principles remain the backbone of military discipline and professionalism. However, the Protocol created textual uncertainty over the circumstances in which the laws of war operate to protect civilians and their property from the effects of hostilities by undermining the clarity of its application. In the first place, Article 44 eroded the traditional qualifications for achieving combatant status by accepting the notion that there may be some circumstances "owing to the nature of the hostilities" in which combatants cannot distinguish themselves from the civilian population.[103] In such circumstances, the duty to distinguish may be watered down to the point that the combatant need only carry his arms openly "[d]uring each military engagement" or when "[d]uring such time as he is visible to the adversary while he is engaged in a military deployment preceding the launching of an attack in which he is to participate."[104]

This text appears to pave the way for any person, irrespective of an organized chain of command or manifestation of state authorization, to take up arms whenever the fancy strikes. Technically, any non-state actor could claim combatant status (and accompanying immunity from criminal prosecution) based on a declaration by an "authority representing a people engaged against a High Contracting Party."[105] A literal reading of these provisions leads one to suppose that a person could engage in hostilities, put down his or her weapons, hide among the innocent civilian populace, strike at will, and yet claim combatant status for those warlike acts provided that a weapon is visible to an enemy at the precise moment it is used. This on/off combatant status, akin to the proverbial revolving door, would corrode the law of unlawful combatancy to its vanishing point.

Protocol I employed a second, somewhat more subtle, means of appearing to define away the principle of unlawful combatancy. In attempting to gain the broadest possible protections for civilians, the text implicitly eroded the 1949 notions

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103. *Id.* art. 44, para. 3. The text does contain some qualifiers by which Protocol I proponents sought to legitimize this erosion of traditional principles. For example, Article 44, para. 7 specifies that "[t]his Article is not intended to change the generally accepted practice of States with respect to the wearing of the uniform by combatants assigned to the regular, uniformed armed units of a Party to the conflict."

104. *Id.* art. 44, para. 3.

105. *Id.* art. 96, para. 3:

> The authority representing a people engaged against a High Contracting Party in an armed conflict of the type referred to in Article 1, paragraph 4, may undertake to apply the Conventions and this Protocol in relation to that conflict by means of a unilateral declaration addressed to the depositary. Such declaration shall, upon its receipt by the depositary, have in relation to that conflict the following effects:
>
> (a) The Conventions and this Protocol are brought into force for the said authority as a Party to the conflict with immediate effect;
>
> (b) The said authority assumes the same rights and obligations as those which have been assumed by a High Contracting Party to the Conventions and this Protocol; and
>
> (c) The Conventions and this Protocol are equally binding upon all Parties to the conflict.

of combatancy by virtue of an exclusive dualist definition. For the first time in international law, Protocol I attempts to define the term civilian purely in contradistinction to the opposing status of combatant. Article 50 embodied the ICRC dualist view by defining a civilian as "any person who does not belong" to one of the specified categories of combatant.[106] This provision was intentionally inclusive in contrast to the categories of protected persons defined in the Fourth Geneva Convention of 1949. Thus, a literal reading of the plain text means that a civilian is anyone who is not a combatant. An unlawful combatant would therefore be legally equated to a civilian and hence entitled to the panoply of protections accorded to that class of persons.

In theory, the ICRC dualist view enshrined in Protocol I would protect any non-state actor who elected to participate in hostilities from the effects of their misconduct. By definition, an unlawful combatant falls outside the traditional characterizations that would otherwise entitle him or her to prisoner of war status. Article 50 seems to embody a system in which there is no theoretical gap; a person is either a combatant or a civilian. This leads to the ineluctable presumption that an unlawful combatant who fails to qualify as a prisoner of war must be a civilian entitled to protection. Being legally classified as a civilian puts the military forces opposing terrorist activities into the quandary of either supinely permitting the planning and conduct of terrorist activities or violating the clear legal norm that the "civilian population as such, as well as individual civilians, shall not be the object of attack."[107]

1. The United States Response

The United States joined the consensus on the final texts and signed both Protocols on December 12, 1977, the day they were opened for signature[108] (though the U.S. delegation narrowly missed being forced to walk out of the conference in 1975).[109] With respect to Protocol I, the United States stated at the time that:

> 1. It is the understanding of the United States of America that the rules established by this protocol were not intended to have any effect on and do not regulate or prohibit the use of nuclear weapons.
>
> 2. It is the understanding of the United States of America that the phrase "military deployment preceding the launching of an attack" in Article 44, Paragraph 3, means any movement towards a place from which an attack is to be launched.[110]

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106. *Id.* art. 50, para. 1.

107. *Id.* art. 51, para. 2.

108. International Committee of the Red Cross, International Humanitarian Law—State Parties/Signatories to Protocol I, http://www.icrc.org/ihl.nsf/WebSign?ReadForm&id=470&ps=S (last visited Sept. 6, 2009).

109. *See* George Aldrich, *Prospects for United States Ratification of Additional Protocol I to the 1949 Geneva Conventions*, 85 AM. J. INT'L L. 1, 4 n.11 (1991) (explaining that Secretary of State Kissinger had ordered the U.S. delegation to leave if the National Liberation Front of South Vietnam (the Vietcong) were admitted to the conference and that their admission was defeated by a tie vote).

110. ROBERTS & GUELFF, *supra* note 93, at 512.

The second of these understandings was clearly intended, even from the outset, to demonstrate the strong U.S. view that Article 44 could provide excessive protection to terrorists that would actually facilitate their criminal acts.[111] The wave of terrorist acts that provided the context for the negotiation of the 1977 Additional Protocols was conducted by "the alphabet-soup terrorists of the past, the IRA, ETA, PLO, RAF, and others [that] were essentially political organizations with political goals."[112]

Nevertheless, apologists for Protocol I point out that the provisions of Article 44 are contingent on the actors attaining the previous status as a lawful combatant.[113] In addition, the prerequisite combatant status envisaged by Article 44 remains contingent on "being under a command responsible" to a state Party to the conflict.[114] Professor Yoram Dinstein has observed, "one cannot fight the enemy and remain a civilian."[115] Just as it is possible to lose combatant status (by becoming a prisoner of war, for example) and the immunity that goes with it (by failure to comply with the law of war), the terrorist cannot properly be termed a civilian in the same sense as those innocents who huddle in their homes while combat rages round them. By choosing to participate in hostilities, particularly in a manner that defies the very notions of human decency and compassion, modern terrorists should not be protected by a shield of combatant immunity derived from the very body of law that they deliberately flout.

Though the textual changes in Protocol I introduced new elements of ambiguity in defining the line between protected civilians and unlawful combatancy, they by no means eliminated the distinction. Even as these new provisions remain practically inapplicable in the real world of state practice, they do not vitiate the other requirements for lawful combatant status set forth in the Hague Regulations and Article 4 of the Geneva Convention on Prisoners of War 1949 (i.e., The Third Convention). Consequently, the official ICRC commentary to Protocol I specified that "anyone who participates directly in hostilities without being subordinate to an organized movement under a Party to the conflict, and enforcing compliance with these rules, *is a civilian who can be punished for the sole fact that he has taken up arms. . .*"[116] The Official ICRC Commentary further restates the long-established principle that "anyone who takes up arms without being able to claim this status [of a "lawful combatant"] will be left to be dealt with by the enemy and its military tribunals in the event that he is captured."[117]

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111. *See id.*

112. RALPH PETERS, NEW GLORY: EXPANDING AMERICA'S GLOBAL SUPREMACY 155 (2005) ("No matter how brutal their actions or unrealistic their hopes, their common intent was to . . . gain a people's independence or to force their ideology on society.").

113. Christopher Greenwood, *Terrorism and Humanitarian Law: The Debate over API*, 19 ISR. Y.B. HUM. RTS. 187, 203–04 (1989); George H. Aldrich, *New Life for the Laws of War*, 75 AM. J. INT'L L. 764 (1983).

114. Protocol I, *supra* note 1, art. 43, para. 1. This provision does contain a moderate victory for the Third World states that sought expanded legal protections through Protocol I in that the government need not be recognized by the opposing state party in order for its forces to achieve combatant status.

115. Yoram Dinstein, "*Unlawful Combatants*", 32 ISR. Y.B. HUM. RTS. 247, 248 (2002).

116. INTERNATIONAL COMMISSION OF THE RED CROSS, COMMENTARY ON THE ADDITIONAL PROTOCOLS OF 8 JUNE 1977 TO THE GENEVA CONVENTIONS OF 12 AUGUST 1949, 514 (Yves Sandoz et al. eds., 1987) (emphasis added) [hereinafter ICRC Commentary on Protocols].

117. *Id.* at 510.

Despite its apparent clarity, Protocol I preserves the principle of unlawful combatancy because it implicitly accepts the limitations inherent in civilian status. The Protocol emphasizes the limits of the traditional principle of combatant immunity by restating the traditional rule that only combatants "have the right to participate directly in hostilities."[118] In addition, the definition of combatant status incorporated the accepted categories from Article 4 of the Third Geneva Convention by reference.[119] Hence, the ICRC commentary correctly observed that the uncontroversial "provisions of Article 4 of the Third Convention are fully preserved."[120]

Finally, in one backhanded, but extremely important provision, Protocol I sustained the existing law of unlawful combatancy by specifying that civilians enjoy the protections embodied in the Protocol "unless and for such time as they take a direct part in hostilities."[121] The simplistic dualist position becomes unsustainable in light of this language because by definition a person who takes part in hostilities is not a civilian, but at the same time is not automatically entitled to prisoner of war status.[122] Accepting the reality that such persons are unlawful belligerents who may be prosecuted for their warlike acts, Protocol I describes a minimum set of due process obligations applicable to such prosecutions.[123] Article 45(3) provides that "[a]ny person who has taken part in hostilities, who is not entitled to prisoner-of-war status and who does not benefit from more favourable treatment in accordance with the Fourth Convention shall have the right at all times to the protection of Article 75 of this Protocol."[124]

Eschewing these fine-grained technical distinctions, the United States categorically refused to accept the expanded classifications of combatancy promulgated in Protocol I.[125] From the U.S. perspective, the many positive developments in Protocol I failed to outweigh its "fundamentally and irreconcilably flawed" revisions to the classic law of combatancy.[126] President Reagan concluded that Article 1(4) and Article 44(3) would actually undermine the very purposes of

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118. Protocol I, *supra* note 1, art. 43, para. 2 ("Members of the armed forces of a Party to a conflict (other than medical personnel and chaplains. . .) are combatants, that is to say, they have the right to participate directly in hostilities.").

119. *See id.* art. 44, para. 6 (discussing the status of combatants and prisoners of war) ("This Article is without prejudice to the right of any person to be a prisoner of war pursuant to Article 4 of the Third Convention.").

120. ICRC Commentary on Protocols, *supra* note 116, at 522.

121. Protocol I, *supra* note 1, art. 51, para. 3.

122. *See id.* art. 50, para. 1 (defining civilian in a way that excludes all definitions in art. 43 of Protocol I and Article 4 of the Third Convention). At the same time that an individual engaged in combat is not a civilian, however, this individual's conduct must also meet certain conditions to qualify him or her for prisoner of war status, if captured. *See id.* art. 44, para. 3 (specifying guidelines of combatant conduct which, if met, will qualify one for prisoner of war status, if captured).

123. *Id.* art. 45, para. 3.

124. *Id.*

125. Letter of Transmittal from President Ronald Reagan, PROTOCOL II ADDITIONAL TO THE 1949 GENEVA CONVENTIONS AND RELATING TO THE PROTECTION OF VICTIMS OF NONINTERNATIONAL ARMED CONFLICTS, S. TREATY DOC. NO. 2, 100th Cong., 1st Sess., III (1987), *reprinted in* 81 AM. J. INT'L L. 910, 911 (1987) [hereinafter Reagan Protocols Letter of Transmittal].

126. *Id.*; *see also* MARCO SASSOLI & ANTOINE BOUVIER, HOW DOES LAW PROTECT IN WAR? 603, 604 (Int'l Comm. of the Red Cross 1999) (discussing flaws in the Protocol, justifying it should not be forwarded to the Senate for consideration).

the Protocol and unnecessarily endanger civilians during armed conflicts.[127] The Department of State Legal Advisor declared that, regardless of the time and diplomatic energy spent negotiating a major multilateral instrument, U.S. approval "should never be taken for granted, especially when an agreement deals with national security, the conduct of military operations and the protection of victims of war."[128] The Joint Chiefs of Staff unanimously opined that Protocol I would further endanger the lives of U.S. military personnel, even as its provisions would increase the danger to innocent civilians (in whose midst terrorist combatants could hide until the opportune moment to strike).[129]

In political terms, Protocol I was achieved only because Third World states ignored the views of the United States and its European allies in order to grant combatant status (and the lawful right to claim the benefits of the Third Convention) to terrorist groups fighting for the causes subjectively deemed to represent a moral imperative.[130] The Third World political agenda caused the conference to drag on for four years rather than one and revealed the naïveté of the ICRC and the Swiss government which failed to anticipate the hijacking of the agenda.[131] The diplomatic dialogue from 1974–1977 was a "political event as well as a legal and humanitarian one" that was different from other multilateral negotiations in "the nakedness of its political pursuits and the grossness of its General Assembly-style conduct."[132] The ICRC and Swiss government faced the dilemma of whether to lock in the many positive legal developments in the text at the cost of agreeing to the more malodorous aspects. The United States, on the other hand, simply could not accept that grievous war crimes and offenses against law and order could be both justified and immunized based on the moral imperatives of self-determination marshaled by other states that advocated extending combatant status even to a non-state actor that "displays a callous and systematic disregard for the law."[133]

Because of the political climate surrounding the negotiations, it was quite plausible for the United States to conclude that the real agenda behind the Protocol was to permit a one-sided extrapolation of combatant immunity. Thus, terrorists could be expected to derive the benefits from the laws and customs of war without also assuming the concomitant obligations under that body of law. In fact, wrote the U.S. Department of State Legal Advisor (in 1987),

> The experience of the last decade confirms the hypocrisy of the regime established by Article 1(4). Having achieved a political victory by "internationalizing" their own internal conflicts, so-called liberation groups have shown little interest in following through on the obligations of the Protocol. They have not acted in accordance with the existing requirements of customary international law, nor have they even bothered

127. *See* Reagan Protocols Letter of Transmittal, *supra* note 125.

128. Abraham D. Sofaer, *The Rationale for the United States Decision*, 82 AM. J. INT'L L. 784, 787 (1988).

129. *Id.* at 785–86.

130. *Id.* at 784–86.

131. CHRISTOPHER GREENWOOD, ESSAYS ON WAR IN INTERNATIONAL LAW 206 (2006). Apart from the victories in Article 1(4) and Article 44, Third World states also secured a provision that banned the participation of mercenaries in armed conflict. Protocol I, *supra* note 1, art. 47.

132. BEST, WAR AND LAW, *supra* note 71, at 406, 415–16.

133. *Id.* at 486.

> to file declarations with the Swiss Government accepting the obligations of the Protocol (as contemplated in Article 96). They have been content to cite the Protocol (e.g., in the United Nations) for the proposition that they must be accorded the benefits of humanitarian law (e.g., prisoner-of-war status) without fulfilling the duties expected. In practice, they have continued to make indiscriminate attacks on innocent civilians.[134]

Although the head of the U.S. delegation later wrote that neither Article 1 nor Article 44 would "provide any solace or support for terrorists,"[135] President Reagan concluded that succumbing to pressure from other nations to accept Protocol I would extract "an unacceptable and thoroughly distasteful price."[136] The Commander-in-Chief accordingly declared that the United States "must not, and need not, give recognition and protection to terrorist groups as a price for progress in humanitarian law."[137] Some states, such as Argentina, attempted to ameliorate the same concerns using interpretive declarations:

> With reference to Article 44, paragraphs 2, 3 and 4, of the same Protocol, the Argentine Republic considers that these provisions cannot be interpreted:
>
> a) as conferring on persons who violate the rules of international law applicable in armed conflicts any kind of immunity exempting them from the system of sanctions which apply to each case;
>
> b) as specifically favouring anyone who violates the rules the aim of which is the distinction between combatants and the civilian population;
>
> c) as weakening respect for the fundamental principle of the international law of war which requires that a distinction be made between combatants and the civilian population, with the prime purpose of protecting the latter.[138]

President Reagan nevertheless concluded that the problems with Protocol I "are so fundamental in character that they cannot be remedied through reservations,

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134. Sofaer, *supra* note 131, at 786.

135. Aldrich, *supra* note 109, at 10:

> Finally, it should be obvious that neither the provisions of Article 1, paragraph 4, nor those of Article 44, nor those of the two in combination provide any solace or support for terrorists. Failure by combatants to distinguish themselves from the civilian population throughout their military operations is a punishable offense. Terrorist acts are all punishable crimes, including attacks on civilians, the taking of hostages, and disguised, perfidious attacks on military personnel, whether committed by combatants or by noncombatants, and whether the perpetrator is entitled to POW status or not. Assertions that ratification of Protocol I would give aid to, or enhance the status of, the PLO or of any terrorist group are totally unfounded. That such assertions should have been made by a President of the United States and those who advised him is regrettable.

136. Reagan Protocols Letter of Transmittal, *supra* note 125, at 911.

137. *Id.*

138. Protocol I, Argentina: Interpretive Declarations Made at the Time of Accession, Nov. 26, 1986, http://www.icrc.org/ihl.nsf/NORM/1F3EE768E1F92B5FC1256402003FB24B?OpenDocument (last visited Nov. 24, 2009).

and I have therefore decided not to submit the Protocol to the Senate in any form."[139] He sent Protocol II to the Senate for its advice and consent on the basis of its "expansion of the fundamental humanitarian provisions contained in the 1949 Geneva Conventions."[140]

2. The National Reservations of NATO Partners

For a period of some years following the adoption of the text in 1977, the United States deliberated internally over the relative merits of reservations, understandings or declarations in remedying the attempt to expand international protections to insurgents seeking self-determination.[141] The second sentence of Article 44(3), which has been the subject of so much debate through the decades, has been described by one of the most eminent international lawyers as a last-minute compromise that proves the truism that a treaty is "a disagreement reduced to writing."[142] As noted above, the rejection of Protocol I was based on the assessment that its expansive text could provide a pretext for terrorist acts and that the legal links of national reservations and understandings would be insufficient protection against the temptation of many states to protect terrorist acts under the rhetoric of lawful combatancy.[143] Phrased another way, the U.S. concluded that adherence to Protocol I in any form would serve to legitimize the subjective assessments of terrorists seeking public support for otherwise criminal acts.[144]

However, the articulated rationale for rejecting Protocol I provided the template for sustained U.S. engagement with other nations. U.S. diplomats met regularly with NATO members in Brussels related to the formulation of appropriate diplomatic responses to preserve the humanitarian benefits of the Protocol while minimizing its potentially corrosive effects on military equities.[145] NATO allies of the United States shared a common sense of disappointment at the disingenuous manner that Protocol I purported to protect unlawful acts committed by non-state actors, but they also sought to preserve its genuinely progressive measures.[146] Despite a common abhorrence for terrorist acts, the NATO allies ultimately disagreed with the U.S. decision to abstain from the Protocol based on a different assessment of the modalities for achieving that desired end state.[147] Pursuant to their commitment to

139. Reagan Protocols Letter of Transmittal, *supra* note 125, at 911.

140. *Id.* at 910.

141. Aldrich, *supra* note 109, at 2.

142. GREENWOOD, *supra* note 131, at 217.

143. Reagan Protocols Letter of Transmittal, *supra* note 125, at 911.

144. *Id.* at 911–12.

145. Aldrich, *supra* note 109, at 2–3:

> The only contentious issue at that time within the U.S. Government was whether we should reserve certain rights of reprisal that would otherwise be prohibited by the Protocol. When I left Washington in May 1981, the ultimate submission of Protocol I to the Senate for advice and consent to ratification seemed merely a matter of time. It also seemed entirely probable that, like the 1949 Geneva Conventions, Protocol I would eventually achieve nearly universal acceptance, with only a few exceptions.

146. *See* Theodor Meron, *The Time Has Come for the United States to Ratify Geneva Protocol I*, 88 AM. J. INT'L L. 678, 680–81 (1994) (explaining that while some NATO members shared U.S. concerns with Protocol I they felt it was not fundamentally flawed).

147. *Id.* at 680–81.

the multilateral instrument in its own right, they issued authoritative diplomatic statements that comported with the humanitarian goals of the Protocol, but would serve to limit future interpretations of its most contentious provisions should disputes arise over their meaning and normative import.[148] Rather than simple rejectionist "exceptionalism," the U.S. position vis-à-vis Protocol I framed the debate with key allies that, in turn, engaged in a second-order style of diplomacy to attempt to limit the deleterious effects of Article 44 in their own manner.[149]

At the time of this writing, 168 nations have ratified or acceded to Protocol I.[150] In the wake of extensive discussions with the United States, NATO allies Belgium, Canada, France, Germany, Ireland, Italy, the Netherlands, Spain and the United Kingdom all ratified Protocol I subject to the following reservations[151] (using the example of the United Kingdom reservation):

> It is the understanding of the United Kingdom that:
>
> The situation in the second sentence of paragraph 3 can only exist in occupied territory or in armed conflicts covered by paragraph 4 of Article 1;
>
> "Deployment" in paragraph 3(b) means any movement towards a place from which an attack is to be launched.[152]

This language sought to inhibit terrorist operations by making the duty to carry one's arms openly as broad as possible[153] (deliberately paraphrasing the U.S. definition of "deployment" from December 1977[154]). At the same time, the NATO allies sought to restrict the coverage of Article 44 to a very limited context[155] (arguably no more extensive than the levée en masse provisions previously found in Article 4 of the 1949 Geneva Convention on Prisoners of War[156]). This narrow

148. *See id.* at 681 (stating that NATO allies produced interpretive statements and reservations limiting the Protocol).

149. *See* Hans-Peter Gasser, *An Appeal for Ratification by the United States*, 81 AM. J. INT'L L. 912, 920–21 (1987) (providing a description of how various nations issued understandings to provisions of Article 44).

150. International Committee of the Red Cross, International Humanitarian Law—State Parties/Signatories, http://www.icrc.org/ihl.nsf/WebSign?ReadForm&id=470&ps=P#ratif (last visited Nov. 10, 2009). With the caveat that though the Swiss government received a letter on June 21, 1989 to the effect that the Executive Committee of the Palestine Liberation Organization had decided on May 4, 1989 "to adhere to the Four Geneva Conventions of August 12, 1949 and the two Protocols additional thereto," the Swiss Federal Council was not in a position to decide whether the letter constituted an instrument of accession, "due to the uncertainty within the international community as to the existence or non-existence of a State of Palestine." *Id.*

151. Julie Gaudreau, *The Reservations to the Protocols Additional to the Geneva Conventions for the Protection of War Victims*, 849 INT'L REV. OF THE RED CROSS 143 (2003).

152. Ratification of Protocol I by the United Kingdom of Great Britain and Northern Ireland, Jan. 29, 1998, 2020 U.N.T.S. 75, 76–77.

153. *See* Rene Kosirnik, *The 1977 Protocols: a Landmark in the Development of International Humanitarian Law*, 320 INT'L REV. OF THE RED CROSS 483 (1997), *available at* http://www.cicr.org/web/eng/siteeng0.nsf/htmlall/57jnuz?opendocument.

154. *See* Aldrich, *supra* note 109, at 2.

155. *See* ICRC Commentary on Protocols, *supra* note 116, at 530 n.43 (providing a statement by the United Kingdom and a summary of considerations by other countries).

156. *See id.* at 526 n.21 (explaining that one of the levée en masse provisions requires members of a levée en masse to act in accordance with the laws and customs of war in their operations).

construction would protect an authentic struggle for self determination to reclaim sovereignty from an occupying power that temporarily displaced sovereignty.[157] On the other hand, the subjective assessments of non-state actors who merely rebelled against the legitimate authorities of a sovereign state would be excluded from the umbrella of lawful combatancy on the basis of this interpretation.[158] The NATO allies sought to ensure that the provisions of Article 44 could not be extended by analogy to provide legal coverage that could otherwise serve to facilitate the commission of terrorist acts.[159] Other major non-NATO allies, such as Australia,[160] Japan,[161] Korea,[162] and New Zealand[163] reached substantively identical conclusions and made nearly identical statements at the time of ratification.[164] The NATO allies and the United States simply selected different pathways to manifest identical substantive concerns.

In the wake of these diplomatic demarches, the drumbeat of criticism of the U.S. position intensified.[165] The Legal Advisor to the ICRC assailed President Reagan's determination as a "political" and "partisan" position that would deprive the world community of a "common framework" and "hinder the development and acceptance of universal standards in a field where they are particularly needed."[166] This criticism ignored the explicit language of the presidential statement rejecting Protocol I, which was intended to represent

> a significant step in defense of traditional humanitarian law and in opposition to the intense efforts of terrorist organizations and their

157. *Id.* at 529–31.

158. *See id.*

159. *See* Aldrich, *supra* note 109, at 10.

160. Ratification of Protocol I by Australia, June 21, 1991, 1642 U.N.T.S. 473 ("It is the understanding of Australia that in relation to Article 44, the situation described in the second sentence of paragraph 3 can exist only in occupied territory or in armed conflicts covered by paragraph 4 of Article 1. Australia will interpret the word 'deployment' in paragraph 3(b) of the Article as meaning any movement towards a place from which an attack is to be launched. It will interpret the words 'visible to the adversary' in the same paragraph as including visible with the aid of binoculars, or by infra-red or image intensification devices.").

161. Ratification of Protocol I by Japan, Aug. 31, 2004, 2283 U.N.T.S. 265 ("The Government of Japan declares that it is its understanding that the situation described in the second sentence of paragraph 3 of Article 44 can exist only in occupied territory or in armed conflicts covered by paragraph 4 of Article 1. The Government of Japan also declares that the term 'deployment' in paragraph 3 (b) of Article 44 is interpreted as meaning any movement towards a place from which an attack is to be launched.").

162. Ratification of Protocol I by South Korea, Jan. 15, 1982, 1271 U.N.T.S. 408 ("In relation to Article 44 of Protocol I, the situation described in the second sentence of paragraph 3 of the Article can exist only in occupied territory or in armed conflicts covered by paragraph 4 of Article 1, and the Government of the Republic of Korea will interpret the word deployment in paragraph 3 (b) of the Article as meaning any movement towards a place from which an attack is to be launched.").

163. Ratification of Protocol I by New Zealand, Feb. 8, 1988, 1499 U.N.T.S. 358 ("The government of New Zealand will interpret the word 'deployment' in paragraph 3 (b) of the Article as meaning any movement towards a place from which an attack is to be launched. It will interpret the words 'visible to the adversary' in the same paragraph as including visible with the aid of any form of surveillance, electronic or otherwise, available to help keep a member of the armed forces of the adversary under observation.").

164. *Compare* Ratification of Protocol I by the United Kingdom of Great Britain and Northern Ireland, *supra* note 152, *with* Ratification of Protocol I by Australia, *supra* note 160, Ratification of Protocol I by Japan, *supra* note 161, Ratification of Protocol I by South Korea, *supra* note 162, *and* Ratification of Protocol I by New Zealand, *supra* note 163.

165. *See, e.g.*, Gasser, *supra* note 149.

166. *Id.* at 924.

> supporters to promote the legitimacy of their aims and practices. The repudiation of Protocol I is one additional step, at the ideological level so important to terrorist organizations, to deny these groups legitimacy as international actors.[167]

The message from within the ICRC hierarchy was that the U.S. position was merely a pretext for a predetermined desire to avoid commitment to a multilateral treaty.[168] The presumption seemed to be that Protocol I embodied an inherent multilateral correctness based only on the twin realities that its text had been agreed upon under the sponsorship of the ICRC and because that text later entered into force based on the ratification of a number of states.[169] In other words, the very *fact* of the multilateral treaty created a logical and legal imperative for states to consent to the entire treaty regime, irrespective of their fundamental policy goals.

Echoing this political correctness, the United Nations General Assembly became a recurring forum for a reflexive reaffirmation that the United States' refusal to ratify Protocol I served to undermine both respect for humanitarian principles and international law. In 2006, the delegate from Kenya noted that accession of states to Protocol I is of "paramount importance in ensuring the safety of civilians" and proceeded to commend the work of ICRC in its efforts to "consolidate a legal reading of the complex questions bound up with the fight against terrorism, including the development of guidelines on the detention of persons."[170] Many resolutions in the years following the Reagan decision implicitly attacked the U.S. position by calling upon "all States parties to the Geneva Conventions that have not yet done so to consider becoming parties to the Additional Protocols at the earliest possible date."[171] The Organization of American States and the European Union used slightly softer language to make the same point—opposition to Protocol I is couched internationally as a divisive point that continues to hinder international unity of purpose on the basis of common values.[172]

Despite the fact that the United States and its NATO allies shared an identical concern that terrorist acts should not be commingled within the rubric of protected combatant activities (though they may have selected differing methodologies for expressing it), there has been no substantive public engagement by states in the United Nations debates to examine the relative merits of the U.S. policy perspective with respect to Protocol I. Rather, the flood of resolutions from UN organs simply assumed that the U.S. stance against terrorism in the context of Protocol I was misplaced and based on a misapprehension of the underlying utility of Protocol I.

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167. Reagan Protocols Letter of Transmittal, *supra* note 125, at 912.

168. *See* Sofaer, *supra* note 131, at 784 (restating the ICRC's belief that the U.S. position on Protocol I was politically motivated).

169. *See* Organization of American States, Promotion and Respect for International Humanitarian Law, June 5, 2001, O.A.S.T.S. AG/RES. 1771 (stating that for international treaties like Protocol I to work, all the states involved have to consent).

170. U.N. GAOR, 61st Sess., 8th mtg., para. 67, U.N. Doc. A/C.6/61/SR.8 (Nov. 15, 2006).

171. G.A. Res. 66/1, para. 2, U.N. Doc. A/C.6/61/L.9 (Nov. 2, 2006).

172. Organization of American States, *supra* note 169; Ceta Noland, Legal Counsel, Permanent Mission of the Kingdom of the Netherlands, EU Presidency Statement: Status of Protocols Additional to the Geneva Conventions (Oct. 18, 2006), *available at* http://www.europa-eu-un.org/articles/en/article_3902_en.htm.

Protocol I became one of the litany of commonly cited examples of American exceptionalism and resistance to a multilateral world based on a commonality of values and consensus lawmaking. These arguments overlook the reality that the United States and its NATO allies were in fact engaged in sustained diplomatic efforts to achieve the precise purposes articulated in the letter of transmittal.

III. THE PRACTICE OF PRINCIPLED EXCEPTIONALISM

Alexis de Toqueville was the first observer to note the distinctiveness in the U.S. approach to the world. Writing in 1830, Toqueville referred to the United States as exceptional in a sense "that is, qualitatively different from all other countries."[173] The U.S ethos of rugged individualism in some sense originated with the rejection of European social structures and value systems and the success of colonists against the greatest military and economic power on the planet. The Revolution spawned an enduring sense that the U.S. institutions, values, and intentions are unique and thus immune from an automatic assimilation within international discourse that is based on a presumed homogeneity. George Washington, for example, warned against "the insidious wiles of foreign influence" in his farewell address to the nation on September 19, 1796.[174] U.S. political and legal debate has since been inescapably affected by this enduring sense of uniqueness and national destiny.

The debate over the reasoning and implications of what has been labeled "American exceptionalism" has spawned a vast literature.[175] A search of English-language law review articles published between 1990 and 2006 identified nearly 1,300 articles referencing American "exceptionalism" or "unilateralism," a glut of writing that compares to fewer than ten pieces identified as addressing the reluctance of European nations to accept multilateral legal instruments.[176] The predominant academic argument denounces U.S. resistance to immersion and adherence to internationalized norms and legal institutions; such "exceptionalism" is often postulated to arise from American hypocrisy.[177] The U.S. stance towards Protocol I is frequently noted in this regard, but is accompanied by a substantial list of other examples such as the refusal of the United States to join the International Criminal Court, the Kyoto Protocol on Climate Change, the Ottawa Convention on Anti-Personnel Landmines, the United Nations Convention on the Rights of the Child,

173. SEYMOUR MARTIN LIPSET, AMERICAN EXCEPTIONALISM: A DOUBLE EDGED SWORD 18 (1996); *see also* Harold Hongju Koh, *On American Exceptionalism*, 55 STAN. L. REV. 1479, 1481 n.4 (2003) (describing the historic basis of American exceptionalism).

174. George Washington, *Farewell Address*, *in* GEORGE WASHINGTON: WRITINGS 962, 974 (John Rhodehamel ed., 1997) (concluding that the primary interests of Europe would cause "frequent controversies" and that "it must be unwise in us to implicate ourselves, by artificial ties, in the ordinary vicissitudes of her politics or the ordinary combinations and collisions of her friendships or enmities").

175. *See, e.g.*, Stephen Gardbaum, *The Myth and the Reality of American Constitutional Exceptionalism*, 107 MICH. L. REV. 391 (2008); MICHAEL IGNATIEFF, THE LESSER EVIL: POLITICAL ETHICS IN AN AGE OF TERROR (2004). MICHAEL IGNATIEFF, THE LESSER EVIL: POLITICAL ETHICS IN AN AGE OF TERROR (2004); PETER HUCHTHAUSEN, AMERICA'S SPLENDID LITTLE WARS: A SHORT HISTORY OF U.S. MILITARY ENGAGEMENTS–1975–2000 (2003).

176. Sabrina Safrin, *The Un-Exceptionalism of U.S. Exceptionalism*, 41 VAND. J. TRANSNAT'L L. 1307, 1309–10 (2008).

177. *Id.* at 1310–14.

and other international human rights agreements.[178] Indeed, awareness of a global audience that carries a keenly critical predisposition has affected U.S. jurisprudence as judges address charges of "exceptionalism" in both explicit and implicit ways.[179]

Most scholarship on legal exceptionalism accepts a binary approach: Has a country acceded to a convention, or, in the alternative, has it refused to join or joined but sought to evade core treaty norms by using reservations? In the human rights context, international criticism has centered on the "number and far-reaching nature of reservations taken by the United States."[180] The Human Rights Committee, for example, expressed regret at the number of U.S reservations to the International Covenant on Civil and Political Rights and expressed its belief that "taken together, they intended to ensure that the United States has accepted only what is already the law of the United States."[181] Dean Koh described this approach as a sort of "flying buttress" mentality whereby America attempts to support the cathedral of international human rights from the outside based on incomplete adherence and adoption rather than as a strong supporting pillar fully embedded within the multilateral treaty regime.[182] From a superficial perspective, this could describe the U.S. attitude towards Protocol I whereby there was perceived to be a glib expression that humanitarian law should be expanded and enforced, although the U.S. policy was in fact intended to avoid the application of those norms to its own forces.[183]

The U.S. position towards Protocol I did presage a litany of multilateral instruments that would later be termed as "fatally flawed"[184] or "fundamentally

178. *Id.* at 1310; *see also* Michael Ignatieff, *Introduction: American Exceptionalism and Human Rights*, *in* AMERICAN EXCEPTIONALISM AND HUMAN RIGHTS 1, 4–5 (Michael Ignatieff ed., 2005); Koh, *supra* note 173, at 1485–86. As an example of the difficulties posed by the federalist structure of our Republic with regard to multilateral instruments, the much-criticized U.S. refusal to join the Convention on the Rights of the Child can be rationally explained by examination of the Convention's applicability to numerous issues usually left to the states. These include many aspects of family law and juvenile justice, such as family separation and reunification, child custody, and child abuse and neglect. Lainie Rutkow & Joshua T. Lozman, *Suffer the Children?: A Call for United States Ratification of the United Nations Convention on the Rights of the Child*, 19 HARV. HUM. RTS. J. 161, 175–77 (2006).

179. *See generally,* Margaret E. McGuinness, *Sanchez-Llamas, American Human Rights Exceptionalism and the VCCR Norm Portal*, 11 LEWIS & CLARK L. REV. 47 (2007) (explaining how "judges—implicitly and explicitly—respond to arguments for and against exceptionalism").

180. Martin Scheinin, *Reservations by States Under The International Covenant on Civil and Political Rights and its Optional Protocols, and the Practice of the Human Rights Committee*, *in* RESERVATIONS TO THE HUMAN RIGHTS TREATIES AND THE VIENNA CONVENTION REGIME: CONFLICT, HARMONY, OR RECONCILIATION 41, 46 (Ineta Ziemele ed., 2004) (noting that the United States report to the Human Rights Committee came some six months following the adoption of its General Comment 24 and was therefore "the first test for the practical application of the Committee's approach as presented in the General Comment").

181. *Report of the Human Rights Committee*, U.N. Doc. CCPR/C/79/Add.50, *reprinted in* Human Rights Committee, Annual Report of the Human Rights Committee, para. 279, U.N. Doc. A/50/40 (Oct. 3, 1995).

182. Koh, *supra* note 173, at 1484–85.

183. *Id.* at 1485–87.

184. *See, e.g.*, Jonathan Weisman, *Ex-Clinton Aides Admit Kyoto Treaty Flawed*, USA TODAY, June 11, 2001, at 7A.

flawed"[185] by a succession of U.S. presidents, from all points of the political spectrum.[186] It is also no coincidence that many of the treaties that the United States has rejected outright have been accompanied by a clause prohibiting reservations.[187] Reflexive acceptance of the proposition that U.S. resistance to multilateral instruments flows primarily from a hypocritical desire to enjoy differing standards from the rest of the world is accordingly misplaced and superficial. By way of illustration, U.S. delegates to the negotiations leading up to the 1997 Ottawa Convention on the Prohibition of the Use, Stockpiling, Production and Transfer of Anti-Personnel Mines and on Their Destruction[188] sought agreement on a regime that would preserve the U.S. obligations to deter armed conflict along the Korean demilitarized zone, while also advancing the stated purpose of preventing the loss of innocent life caused by unrecovered landmines globally.[189]

The United States refrained from joining both Protocol I and the Ottawa Convention, not because of a kneejerk exceptionalist mantra or a visceral distrust of multilateral instruments, but because delegates adopted a treaty that disregarded the legitimate equities of the United States.[190] The Ottawa Convention does not allow reservations[191] and completely ignores the special military interests of a major military power with a substantial troop presence deployed to prevent a numerically superior enemy from crossing an international border clearly marked by the high fences, guard towers, and emplaced mine fields.[192]

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185. JANET R. HUNTER & ZACHARY ALDEN SMITH, PROTECTING OUR ENVIRONMENT: LESSONS FROM THE EUROPEAN UNION 101 (2005); *see also* Reagan Protocols Letter of Transmittal, *supra note* 125 (arguing that "Protocol I is fundamentally and irreconcilably flawed").

186. On December 31, 2000, the last day that the Rome Statute was open for signature, Ambassador David Scheffer signed the Rome Statute of the International Criminal Court, but President Clinton's signing statement expressed the U.S. resistance to accession as follows:

> In signing, however, we are not abandoning our concerns about significant flaws in the treaty. In particular, we are concerned that when the court comes into existence, it will not only exercise authority over personnel of states that have ratified the treaty but also claim jurisdiction over personnel of states that have not.... Given these concerns, I will not, and do not recommend that my successor, submit the treaty to the Senate for advice and consent until our fundamental concerns are satisfied.

President Clinton, *Statement on the Rome Treaty on the International Criminal Court*, 37 WEEKLY COMP. PRES. DOC. 4 (Jan. 8, 2001), *reprinted in* SEAN D. MURPHY, UNITED STATES PRACTICE IN INTERNATIONAL LAW, VOLUME 1: 1999–2001 at 381–85 (2002).

187. *See., e.g.*, Rome Statute, *supra* note 48, art. 120 (providing that "No reservations may be made to this Statute.").

188. The meeting resulted in the Convention on the Prohibition of the Use, Stockpiling, Production and Transfer of Anti-Personnel Mines and on their Destruction, Mar. 1, 1999, 2056 U.N.T.S. 211 [hereinafter Ottawa Convention].

189. *See* Andrew C.S. Efaw, *The United States Refusal to Ban Landmines: The Intersection Between Tactics, Strategy, Policy, and International Law*, 159 MIL. L. REV. 87, 98–102 (1999) (discussing the dilemma of "balancing military needs against humanitarian consideration" and mentioning the potential benefit of U.S. landmines on the demilitarized zone of the Korean peninsula).

190. *Id.* at 149–51.

191. Ottawa Convention, *supra* note 188, art. 19.

192. Efaw, *supra* note 189, at 101; Phillip Bobbit, *American Exceptionalism: The Exception Proves the Rule*, 3 U. ST. THOMAS L.J. 328, 330 (2005) (concluding that "[n]o realistic conventional force could be protected from such a huge North Korean force without mines...."); *National Defense Authorization Act for Fiscal Year 1999: Hearing Before the H. Comm. on National Security*, 105th Cong. (1998) (statement of Gen. Henry H. Shelton, Chairman, Joint Chiefs of Staff), *available at* http://www.globalsecurity.org/military/library/congress/1998_hr/2-5-98shelton.htm (testifying that "[i]n

Commenting on the unfortunate choice required by a treaty that does not permit reservations yet undermines U.S. interests, President Clinton remarked that:

> One of the biggest disappointments I've had as President, a bitter disappointment for me, is that I could not sign in good conscience the treaty banning land mines, because we have done more since I've been President to get rid of land mines than any country in the world by far. We spend half of the money the world spends on de-mining. We have destroyed over a million of our own mines.
>
> I couldn't do it because the way the treaty was worded was unfair to the United States and to our Korean allies in meeting our responsibilities along the DMZ in South Korea, and because it outlawed our anti-tank mines while leaving every other country intact. And I thought it was unfair.
>
> But it just killed me. But all of us who are in charge of the nation's security engage our heads, as well as our hearts. [193]

Just as in the Ottawa Convention context, the United States exercised principled exceptionalism in rejecting Protocol I. Protocol I blurred the lines circumscribing lawful combatants by creating new legal rules without rigorous articulation of the rationale for why such protections should flow to "[a] category of persons who are not entitled to treatment either as peaceful civilians or as prisoners of war by reason of the fact that they have engaged in hostile conduct without meeting the qualifications."[194] As the International Court of Justice noted in the *Nuclear Weapons* case, the law of war is *lex specialis* that takes precedence over some otherwise applicable human rights provisions during an armed conflict.[195] Thus, the corpus of humanitarian law cannot be said to necessarily subsume the most important aspects of the international law related to terrorist acts.

The United States concluded that commingling of the regime criminalizing terrorist acts with the jus in bello rules of humanitarian law would be untenable and inappropriate.[196] Rather than accepting the veiled assertion repeated through the

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Korea . . . where we stand face-to-face with one of the largest hostile armies in the world, we rely upon anti-personnel landmines to protect our troops.").

193. *See* Press Release, The White House, Office of the Press Secretary, Clinton Remarks on Comprehensive Test Ban Treaty (Oct. 6, 1999), *available at* http://www.fas.org/nuke/control/ctbt/news/991006-ctbt-usia1.htm.

194. Baxter, *supra* note 60, at 328.

195. *See* Michael J. Matheson, *The Opinion of the International Court of Justice on the Threat or Use of Nuclear Weapons*, 91 AM. J. INT'L. L. 417, 422 (1997) ("the test of what is an arbitrary deprivation of life, however, falls to be determined by the applicable lex specialis, namely, the law applicable in armed conflict which is designed to regulate the conduct of hostilities"); *see also* Osman Bin Haji Mohamed Ali and Another Appellant and the Public Prosecutor, (1969) 1 Law Rep. 430 (P.C.) (appeal taken from the Fed. Ct. of Malay.), *reprinted in* MARCO SASSOLI & ANTOINE BOUVIER, HOW DOES LAW PROTECT IN WAR? 767, 771–73 (Int'l Comm. of the Red Cross 1999) (rejecting combatant status for members of the Indonesian armed forces who failed to comply with the four criteria laid out in Article 4 of the Geneva Convention).

196. *See* Matheson, *supra* note 195, at 421–22 (the United States argued that the law of armed conflict, rather than peacetime human rights law, should determine what constitutes an "'arbitrary' deprivation of life").

years in U.N. channels that the only appropriate approach to Protocol I is complete adherence to its principles,[197] the U.S. perspective was that a technical and lawyerly approach based on discrete reservations and interpretive instruments between sovereign states would be both inadvisable and ultimately impossible.[198] The very act of accepting the principles enshrined in Articles 1(4) and 44(3) would, in the U.S. view, grant terrorists a psychological and legal victory that would later be used to undermine the peace and security of innocent and peace-loving citizens.[199] In other words, even a partial acknowledgement of the propriety of terrorists' claims to combatant status presented an unnecessary risk to innocent lives and property.

American exceptionalism with regard to Protocol I was in fact a policy determination based on national self-interests that reflected the underlying community interests of states engaged in a struggle against terrorists. Governments across the globe share the duty and desire to protect innocent citizens from threats to their lives and liberty posed by terrorist acts. The NATO allies concurred completely with the substance of the U.S. desire to withhold any recognition of privileged status to terrorists or to accord their crimes any sphere of legal protection.[200] Rather than establishing an exceptionalist rejection of internationalist rhetoric, however, the U.S. position formed the benchmark for continued engagement with other nations in addressing common concerns. The U.S. rejection of Protocol I was a principled position that took political courage in the face of nearly unrelenting criticism in subsequent decades, although in fact the NATO position differed only in form and modality. U.S. leadership in shaping this normative framework became clear as states around the world hurried to ratify the most modern terrorism conventions in the aftermath of September 11.

IV. THE POST-SEPTEMBER 11 LEGAL CONTEXT

As shown above, the U.S. policy stance regarding Protocol I helped to prevent the commingling of the laws and customs of war. In the aftermath of September 11, the "exceptional" U.S. position formed the substantive benchmark around which other nations rallied in reaction to reservations designed to blur the distinctions between terrorists and privileged combatants. September 11 destroyed the naïve notion that there is a bright legal line that neatly divides a combat zone into innocent civilians (who are legally protected from deliberate hostilities) and combatants who may lawfully be targeted and killed.[201] The attacks transformed an esoteric problem that was important only to specialists in the law of armed conflict into a tactical and legal problem highly relevant to current operations. The dualistic International

197. *See* GREENWOOD, *supra* note 131, at 209 (stating that Protocol I is firmly embedded in international law).

198. *Id.* at 202.

199. *See id.* (quoting a U.S. government official calling Protocol I "law in the service of terror"); *see also* Feith, *supra* note 1 (accusing the U.N. General Assembly of issuing a "pro-terrorist treaty masquerading as humanitarian law").

200. *See* Feith, *supra* note 1 (discussing Western European representatives' opposition to the Additional Protocols during the Diplomatic Conference debate).

201. This dualistic view of the law was privately expressed by the International Committee of the Red Cross and publicly expounded by a number of commentators on the law of armed conflict. Article 48 of Protocol I, *supra* note 1, reflects this simple dualism with the basic rule that Parties to the conflict must distinguish "at all times" between civilians and protected civilian objects and "shall direct their operations only against military objectives."

Committee of the Red Cross (ICRC) view of legal status noted above simply does not square with the facts related to the war against transnational terrorist operations. Al Qaeda and its supporters acted as private citizens in declaring war on U.S. citizens and values,[202] and carried out their attacks with a purposeful intensity that rises to the level of armed conflict by any common sense definition. Moreover, the conflict against al Qaeda and its supporters is an armed conflict governed by the law of armed conflict as defined by the International Criminal Tribunal for the Former Yugoslavia.[203] Invoking the mutual defense obligations of Article 5 for the first time in NATO history, NATO accepted the legal conclusion that al Qaeda committed an armed attack on the United States.[204] Despite al Qaeda rhetoric alluding to a struggle for liberation and self-determination, no nation would ever accept the normative proposition that the private group of terrorists acted with a legally cognizable expectation of combatant immunity. Al Qaeda and its supporters forfeited the rights that would normally accrue to civilian persons caught in the midst of hostilities, chief among them the right to be free from deliberate efforts at targeting them.[205]

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202. Osama bin Laden has made more than fifty declarations of war against the United States (summary of statements on file with author). In the official fatwa signed by Bin Laden and four others on February 23, 1998, THE AL QAEDA READER 13 (Raymond Ibrahim, ed. and trans., 2007), he declared his objective:

> The ruling to kill the Americans and their allies—civilians and military—is an individual duty for every Muslim who can do it in any country in which it is possible to do it, in order to liberate the al-Aqsa Mosque and the holy mosque [Mecca] from their grip, and in order for their armies to move out of all the lands of Islam, defeated and unable to threaten any Muslim. This is in accordance with the words of Almighty God, "and fight the pagans all together as they fight you all together," and "fight them until there is no more tumult or oppression, and there prevail justice and faith in God."
>
> This is in addition to the words of Almighty God: "And why should ye not fight in the cause of God and of those who, being weak, are ill-treated (and oppressed)?—women and children, whose cry is: 'Our Lord, rescue us from this town, whose people are oppressors; and raise for us from thee one who will help!'"
>
> We—with God's help—call on every Muslim who believes in God and wishes to be rewarded to comply with God's order to kill the Americans and plunder their money wherever and whenever they find it. We also call on Muslim ulema, leaders, youths, and soldiers to launch the raid on Satan's U.S. troops and the devil's supporters allying with them, and to displace those who are behind them so that they may learn a lesson.

203. *See* Prosecutor v. Tadic, Case No. IT-94-1, Decision on the Defence Motion for Interlocutory Appeal on Jurisdiction, para. 70 (Oct. 2, 1995) ("[A]n armed conflict exists whenever there is a resort to armed force between States or protracted armed violence between governmental authorities and organized armed groups or between such groups within a State.").

204. Lord Robertson, NATO Secretary General, Statement on September 11 Attacks (Oct. 2, 2001), *available at* http://www.nato.int/docu/speech/2001/s011002a.htm (announcing NATO's determination that the September 11 attack "shall therefore be regarded as an action covered by Article 5 of the Washington Treaty, which states that an armed attack on one or more of the Allies in Europe or North America shall be considered an attack against them all").

205. The law of armed conflict provides that lawful attacks may only be directed at military objectives (which includes enemy combatants). Civilians may not be deliberately attacked unless they directly participate in hostilities. *See* Protocol I, *supra* note 1, art. 51, paras. 2–3. Celebrated in international law as the principle of distinction, the President of the ICRC opined that this principle is "crucial." Dr. Jakob Kellenberger, International Humanitarian Law at the Beginning of the 21st Century, The Two Additional Protocols to the Geneva Conventions: 25 Years Later-Challenges and Prospects, Statement at the 26th

Above all, September 11 proved that some private terrorist groups are undeterred by existing criminal law prohibitions and treaty obligations designed to apply to sovereign states in a world governed by respect for the rule of law. The United States took the view that the inherent right of self-defense permits the United States to seek "justice" using its military power.[206] The attacks provided graphic affirmation of Justice Jackson's famous truism from the Nuremberg Tribunal that "wars are started only on the theory and in the confidence that they can be won. Personal punishment . . . will probably not be a sufficient deterrent to prevent a war where the warmakers feels the chances of defeat to be negligible."[207] Transnational terrorism challenges the community of civilized nations precisely because a group of private persons linked by shared ideology is now waging war in direct defiance of international law. The classic style of terrorist sought short-term political gain through revolution, national liberation, or secession;[208] the new terrorist seeks to transform the world and is motivated by religious and ideological imperatives under the influence of a larger transcendental mythology.[209] This approach is a far cry from the anti-colonial efforts against a specific government conducted by organized gangs that provided the impetus for Protocol I.

The U.S. response to the terrorist attacks reshaped the paradigm for dealing with terrorists from an exclusive reliance on judicial mechanisms to address criminal conduct into a war-fighting model. International terrorism constitutes a national security problem as well as a law enforcement problem because it is a unique form of transnational crime in which private actors seek to unravel the fabric of civilized society and thereby undermine state, regional, and global security.[210] This new paradigm required an interface between established law of armed conflict norms and existing judicial mechanisms capable of prosecuting those perpetrators who are not eliminated or emasculated by the application of military power.[211]

In that sense the war on terrorism is more than a politically convenient concept. Without applying the law of armed conflict to transnational terrorists, it would be a non-sequitur to even consider whether they are entitled to combatant immunity for their warlike acts. Despite the widespread ratifications of Protocol I, no domestic court in the world has accepted the claims of terrorists to immunity that are unwarranted under existing international law.[212] Al Qaeda and its operatives

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Round Table in San Remo on the Current Problems of International Humanitarian Law (Sept. 5, 2002), *available at* http://www.icrc.org/Web/Eng/siteeng0.nsf/iwpList74/EFC5A1C8D8DD70B9C1256C36002EFC1E.

206. *See generally* Jack M. Beard, *America's New War on Terror: The Case for Self-Defense Under International Law*, 25 HARV. J. L. & PUB. POL'Y 559, 559–60 (2002).

207. 2 TRIAL OF THE MAJOR WAR CRIMINALS BEFORE THE INTERNATIONAL MILITARY TRIBUNAL 153–54 (1947).

208. *See* Martha Crenshaw, *The Psychology of Terrorism: An Agenda for the 21st Century*, 21 POL. PSYCHOL. 405, 411 (2000) (describing "old" terrorism as it is compared to "new" terrorism).

209. *Id.*; *see also* Michael J. Stevens, *What is Terrorism and Can Psychology Do Anything to Prevent It?*, 23 BEHAV. SCI. & L. 507, 508 (2005) (discussing the psychology of today's terrorism).

210. Stevens, *supra* note 209, at 517–18.

211. *See generally* William L. Waugh, Jr. & Richard T. Sylves, *Organizing the War on Terrorism*, 62 PUB. ADMIN. REV. 145 (2002) (discussing the United States' efforts to redefine the relationship between law enforcement and national security agencies after September 11).

212. *See, e.g.*, Her Majesty the Queen v. Mohammed Momin Khawaja, [2008] Ontario Superior Court of Justice 04-G30282; *see also* CrimA 6659/06, 1757/07, 8228/07, 3261/08, A & B v. State of Israel [2008]; Munaf v. Geren, 128 S.Ct. 2207, 553 U.S. (June 12, 2008); The Military Prosecutor v. Omar Mahmud Kassem and Others, 41 I.L.R. 470 (1971) (Israeli Military Court, Ramallah, April 13, 1969), *reprinted in* 60

scattered across the world cannot meet the Geneva Convention requirements for treatment as prisoners of war under any scenario.[213] The European Parliament accepted that reality by adopting a resolution recognizing that the terrorists "do not fall precisely within the definitions of the Geneva Convention."[214] By the accepted definition, also found in Protocol I, they became lawful targets for military action because the "destruction, capture or neutralization" of al Qaeda and its supporters "offers a definite military advantage."[215] They relinquished the protections afforded innocent civilians, who are protected from being targeted, and simultaneously forfeited the legal protections enjoyed by lawful combatants who fall into the hands of the enemy.

A. The Changing Face of Terror

Following September 11, the European Parliament opined that the law of armed conflict must "be revised to respond to the new situations created by the development of international terrorism."[216] In hindsight, Protocol I failed to bring closure to the persistent international efforts to define the boundaries of the class of "unprivileged belligerents"[217] who forfeit their protection from attack by conducting hostile activities without the privileges accruing to "combatants" under the established laws of war. If Protocol I embedded the meanings intended by its most progressive supporters, then such evolution would be unnecessary because the law would already establish an accepted legal right for al Qaeda to claim combatant status. On the other hand, the United States' reliance on the jus in bello paradigm

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HOWARD LEVIE, DOCUMENTS ON PRISONERS OF WAR, NAVAL WAR COL. INT. L. STUD. 771, 780 (1979) (rejecting the claim of combatant immunity raised by a member of the "Organization of the Popular Front for the Liberation of Palestine"); Osman Bin Haji Mohamed Ali and Another Appellant and the Public Prosecutor, *supra* note 195, at 767 (rejecting combatant status for members of the Indonesian armed forces who failed to comply with the provisions of Article 4 of the Geneva Conventions).

213. *See* George H. Aldrich, *The Taliban, Al Qaeda and the Determination of Illegal Combatants*, 96 AM. J. INT'L L. 891, 893 (Oct. 2002) ("Al Qaeda does not in any respect resemble a state, is not a subject of international law, and lacks international legal personality."). With respect to terrorists in the post-September 11 era, the Legal Advisor of the U.S. State Department mirrored the concerns voiced by previous administrations in the context of Protocol I by writing that:

> The purposes of the law of armed conflict are not advanced by granting illegitimate fighters immunity for their belligerent acts, for that would undermine the law's fundamental purpose, bring the entire body of law into disrepute, and strip it of credibility. The positive incentives of the existing normative system require that soldiers follow the rules and, most importantly, distinguish combatants from civilians. To recognize terrorists as lawful combatants would upend the entire system and cause predictably grim humanitarian consequences.

William H. Taft, *The Law of Armed Conflict After 9/11: Some Salient Features*, 28 YALE J. INT'L L. 319, 321 (2003).

214. Resolution on the Detainees in Guantanamo Bay, EUR. PARL. DOC. B5-0066 (2002) [hereinafter European Parliament Resolution].

215. Protocol I, *supra* note 1, art. 52, para. 2.

216. European Parliament Resolution, *supra* note 214.

217. Baxter, *supra* note 60, at 343 ("The correct legal formulation is, it is submitted, that armed and unarmed hostilities, wherever occurring, committed by persons other than those entitled to be treated as prisoners of war or peaceful civilians merely deprive such individuals of a protection they might otherwise enjoy under international law and place them virtually at the power of the enemy. 'Unlawful belligerency' is actually 'unprivileged belligerency.'").

necessitated discussion of combatant status as debates swirled around the proper categorization of terrorist acts and of captured terrorists.[218] Some international law scholars would argue that lawyers interpreting and applying the treaties governing the conduct of hostilities must extrapolate from the text to fashion legal advice that focuses on the "high purposes which are the raison d'être of the convention."[219] From this vantage point, Protocol I would provide the baseline from which the law would evolve in response to new forms of transnational terrorism.

In practice, September 11 provided the impetus for precisely the opposite legal development. The international community refocused on the matrix of existing terrorism conventions as the acceptable starting point for analysis when assessing the conduct and status of suspects accused of terrorist acts.[220] Only three states had become parties to the Convention for the Suppression of Terrorist Financing at the time of the attacks, in contrast to the 171 parties at the time of this writing.[221] Likewise, though the Terrorist Bombing Convention entered into force on May 23, 2001, it boasted only twenty-four participating states as opposed to 164 at the time of this writing.[222] September 11 caused a reevaluation of the multilateral framework for criminalizing terrorist acts which in turn resulted in emphatic international rejection of arguments that the legal accountability for terrorist acts can be shrouded by resort to subjective and shifting justifications or by resort to arguments based on moral equivalency.[223]

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218. *See, e.g.*, Gilbert Guillaume, *Terrorism and International Law*, 53 INT'L. COMP. L.Q. 537, 547 (2004) (discussing the same issue and focusing on the status of captured terrorists).

219. Reservations to the Convention on the Prevention and Punishment of the Crime of Genocide, Advisory Opinion, 1951 I.C.J. 23 (May 28) ("The objects of such a convention must also be considered. The Convention was manifestly adopted for a purely humanitarian and civilizing purpose. It is indeed difficult to imagine a convention that might have this dual character to a greater degree, since its object on the one hand is to safeguard the very existence of certain human groups and on the other to confirm and endorse the most elementary principles of morality.").

220. *See, e.g.*, Terrorist Financing Convention, *supra* note 6; Terrorist Bombing Convention, *supra* note 20.

221. The Convention entered into force on April 10, 2002 in accordance with Article 26 that states:

> 1. This Convention shall enter into force on the thirtieth day following the date of the deposit of the twenty-second instrument of ratification, acceptance, approval or accession with the Secretary-General of the United Nations.
>
> 2. For each State ratifying, accepting, approving or acceding to the Convention after the deposit of the twenty-second instrument of ratification, acceptance, approval or accession, the Convention shall enter into force on the thirtieth day after deposit by such State of its instrument of ratification, acceptance, approval or accession.

Terrorist Financing Convention, *supra* note 6. The Convention entered into force for the United States on July 25, 2002, in accordance with Article 26, cited above. The United States deposited its instrument of ratification on June 25, 2002; the same day President Bush signed the Convention's implementing legislation, 18 U.S.C. § 2339C, into law. *See* Terrorist Bombings Convention Implementation Act of 2002, H.R. 3275, 107th Cong. (2d Sess. 2002) ("An Act to implement . . . the International Convention of the Suppression of the Financing of Terrorism, to combat terrorism and defend the Nation against terrorist acts . . . .").

222. *See* Terrorist Bombing Convention, *supra* note 20 (requiring twenty-two states to have ratified, accepted, approved, or acceded to the Convention for the treaty to enter into force).

223. *See, e.g.*, Martha Crenshaw, *The Psychology of Terrorism: An Agenda for the 21st Century*, 21 POL. PSYCHOL. 405, 406 (2000):

> The problem of defining terrorism has hindered analysis since the inception of studies of terrorism in the early 1970s. One set of problems is due to the fact that the concept of

The U.S. position vis-à-vis Protocol I that there must be a bright line between the applicable jus in bello and the status accorded to terrorist suspects has been emphatically validated in the diplomatic dialogues accompanying state ratification of the key post-September 11 terrorism conventions.[224] International law is clear that terrorist acts will *always* be punishable under the criminal codes of one or more domestic states.[225] While the U.S. rejection of Protocol I has been portrayed as exceptionalist and hypocritical, all nations shared the underlying substantive assessment that terrorists could expect no immunity for acts that undermine the protection of human life and the goal of minimizing damage to civilian property.[226] These common concerns are the source of humanitarian law, and states have resoundingly rejected challenges to this shared conception of the international legal order.[227]

On the other hand, Protocol I provides an articulable textual basis purporting to legitimize acts of non-state actors seeking self-determination or conducting hostilities against domination by foreign sovereigns. Some states sought to extrapolate from its provisions by analogy in an attempt to redefine terrorism in the context of the Terrorist Financing Convention and the Terrorist Bombing Convention. Sovereign states overwhelmingly rejected the attempts by Egypt, Syria, and Jordan to introduce subjective elements drawn from Protocol I into the definition of terrorism. In so doing, they followed the example that the United States had provided nearly thirty years previously in the context of its rejection of Protocol I.[228] The United States was prescient in its position that the law of terrorism and the jus in bello applicable to status determinations cannot be commingled. The rejection of reservations that sought to weave the Protocol I standards into the law of terrorism marked the definitive adoption of the U.S. position.

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terrorism is deeply contested. The use of the term is often polemical and rhetorical. It can be a pejorative label, meant to condemn an opponent's cause as illegitimate rather than describe behavior. Moreover, even if the term is used objectively as an analytical tool, it is still difficult to arrive at a satisfactory definition that distinguishes terrorism from other violent phenomena. In principle, terrorism is deliberate and systematic violence performed by small numbers of people, whereas communal violence is spontaneous, sporadic and requires mass participation. The purpose of terrorism is to intimidate a watching popular audience by harming only a few, whereas genocide is the elimination of entire communities. Terrorism is meant to hurt, not to destroy. Terrorism is preeminently political and symbolic, whereas guerilla warfare is a military activity. Repressive "terror" from above is the action of those in power, whereas terrorism is a clandestine resistance to authority. Yet in practice, events cannot always be precisely categorized.

224. *See, e.g.*, International Convention for the Suppression of the Financing of Terrorism, Argentina Communication Concerning the Declaration Made by Jordan Upon Ratification, Oct. 10, 2005, C.N.1034.2005.TREATIES-35 [hereinafter Argentina Communication Concerning Jordan] (providing an example of support for a bright line declaration that all terrorist acts are criminal, regardless of motives).

225. *See, e.g.*, Terrorist Financing Convention, *supra* note 6, art. 4.

226. *See, e.g.*, Argentina Communication Concerning Jordan, *supra* note 224.

227. *See* Lea Brilmayer & Geoffrey Chepiga, *Ownership or Use? Civilian Property Interests in International Humanitarian Law*, 49 HARV. INT'L. L. J. 413, 419 (2008) (stating that the protection of the civilian person and civilian property are principles "firmly embedded in modern international humanitarian law").

228. *See* Reagan Protocols Letter of Transmittal, *supra* note 125 (describing the need to distinguish international and non-international conflicts in objective terms and avoid subjective terms that are ill-defined and threaten to politicize humanitarian law).

B. *Evolution of the Multilateral Framework Regulating Terrorism*

1. Reservations to the Terrorist Financing Convention

The essence of the Terrorist Financing Convention is its core criminal prohibition found in Article 2:

> Any person commits an offence within the meaning of this Convention if that person by any means, directly or indirectly, unlawfully and willfully, provides or collects funds with the intention that they should be used or in the knowledge that they are to be used, in full or in part, in order to carry out:
>
> (a) An act which constitutes an offence within the scope of and as defined in one of the treaties listed in the annex; or
>
> (b) Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing any act.[229]

The object and purpose of the Terrorist Financing Convention is to hinder *all* acts of terrorism by holding *all* persons[230] and legal entities liable using the broadest range of remedies available.[231] These remedies include criminal sanctions for persons, and civil, criminal, and administrative sanctions for legal entities that collect or provide funds to be used in terrorist acts defined in Article 2 of the Convention.[232] Like other multilateral terrorism conventions, the Terrorist Financing Convention specifically provides that none of the defined offenses "shall be regarded for the purposes of extradition or mutual legal assistance as a political offence or as an offence connected with a political offence or as an offence inspired by political

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229. Terrorist Financing Convention, *supra* note 6, art. 2. The Annex referenced in subpart (a) sets forth the entire universe of applicable terrorist conventions: 1. Convention for the Suppression of Unlawful Seizure of Aircraft, 2. Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation, 3. Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents, 4. International Convention against the Taking of Hostages, 5. Convention on the Physical Protection of Nuclear Material, 6. Protocol for the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation, 7. Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation, 8. Protocol for the Suppression of Unlawful Acts against the Safety of Fixed Platforms located on the Continental Shelf, 9. International Convention for the Suppression of Terrorist Bombings. *Id.* Annex.

230. The Convention adopts a broad construction of personal and subject-matter jurisdiction. Terrorist Financing Convention, *supra* note 6, art. 7, para 2.

231. *See, e.g.*, *id.* art. 5, para. 1 ("Each State Party, in accordance with its domestic legal principles, shall take the necessary measures to enable a legal entity located in its territory or organized under its laws to be held liable when a person responsible for the management or control of that legal entity has, in that capacity, committed an offence set forth in article 2. Such liability may be criminal, civil or administrative.").

232. *See, e.g.*, *id.* art. 5, para. 3 ("Each State Party shall ensure, in particular, that legal entities liable in accordance with paragraph 1 above are subject to effective, proportionate and dissuasive criminal, civil or administrative sanctions. Such sanctions may include monetary sanctions.").

motives."[233] Finally, in the clearest possible language, the Convention sweeps broadly in attempting to eliminate any room for affirmative defenses based on justification.[234] Article 6 of the Convention requires ratifying states to "adopt such measures as may be necessary, including, where appropriate, domestic legislation, to ensure that criminal acts within the scope of this Convention are under no circumstances justifiable by considerations of a political, philosophical, ideological, racial, ethnic, religious or other similar nature."[235]

Some states attempted to erode the manifest intent of the Terrorist Financing Convention through the use of reservations and declarations. A reservation is "a unilateral statement ... made by a State, when signing, ratifying, accepting, approving, or acceding to a treaty, whereby it purports to exclude or to modify the legal effect of certain provisions of the treaty in their application to that State."[236] Egypt's "explanatory declaration" is a unilateral statement made at the time of ratification of the Convention that purports to exclude or modify the legal effect of the Convention. Drawn from the substantive soil of Protocol I, article 1, paragraph 4, the "explanatory declaration" states:

> Without prejudice to the principles and norms of general international law and the relevant United Nations resolutions, the Arab Republic of Egypt does not consider acts of national resistance in all its forms, including armed resistance against foreign occupation and aggression with a view to liberation and self-determination, as terrorist acts within the meaning of article 2, [paragraph 1] subparagraph (b), of the Convention.[237]

Article 3 of the Terrorist Financing Convention limits its applicability in situations where "the offence is committed within a single State, the alleged offender is a national of that State and is present in the territory of that State and no other State has a basis under article 7, paragraph 1, or article 7, paragraph 2, to exercise jurisdiction ...."[238] Hence, if the Egyptian declaration represents a valid interpretation of the Convention, Egypt would become a sanctuary state for terrorists who sought to plan, finance, and conduct operations around the world. The declaration states that Egypt does not consider all acts of national resistance as terrorism. Such a statement can be seen as permitting funding from within Egypt with the objective of bankrolling Taliban operations in Afghanistan, the murderous Badr brigades in Iraq, Palestinian activities, or even Hezbollah activities in Lebanon and northern Israel. The "explanatory declaration" also purported to limit the definition of acts for which Egypt would have to hold accountable under Article 4 of the Convention any person who committed such acts, which may be seen as undercutting the universality of international cooperation in the fight against terrorist acts.[239] The explanatory declaration would modify Article 6 of the

233. *Id.* art. 14.

234. *Id.* art. 6.

235. *Id.*

236. Vienna Convention on the Law of Treaties art. 2, para. 1(d), May 23, 1969, 1155 U.N.T.S. 331.

237. International Convention for the Suppression of the Financing of Terrorism, Egypt: Ratification, Mar. 1, 2005, C.N.176.2005.TREATIES-3 [hereinafter Egypt Ratification].

238. Terrorist Financing Convention, *supra* note 6, art. 3.

239. *See* Egypt Ratification, *supra* 237 (limiting the definition of terrorist acts).

Convention by creating a defense of political and ideological justification derived from the subjective assessments of the terrorist for acts that would otherwise fall within the definition of Article 2 of the Convention.

Echoing the U.S. position from the Protocol I debates, at the time of this writing twenty-one states have opposed such an extrapolation into the Terrorist Financing context using virtually identical language and reasoning to state emphatic and unequivocal rejection of Egypt's position.[240] The German response is typical and follows in its entirety:

> With regard to the explanatory declaration made by Egypt upon ratification:
>
> The Government of the Federal Republic of Germany has carefully examined the declaration made by the Arab Republic of Egypt to the International Convention for the Suppression of the Financing of Terrorism upon ratification of the Convention relating to Article 2 paragraph 1 (b) thereof. It is of the opinion that this declaration amounts to a reservation, since its purpose is to unilaterally limit the scope of the Convention. The Government of the Federal Republic of Germany is furthermore of the opinion that the declaration is in contradiction to the object and purpose of the Convention, in particular the object of suppressing the financing of terrorist acts wherever and by whomever they may be committed.
>
> The declaration is further contrary to the terms of Article 6 of the Convention, according to which States Parties commit themselves to adopt such measures as may be necessary, including, where appropriate, domestic legislation, to ensure that criminal acts within the scope of this Convention are under no circumstances justifiable by considerations of a political, philosophical, ideological, racial, ethnic, religious or other similar nature.
>
> The Government of the Federal Republic of Germany recalls that, according to customary international law as codified in the Vienna Convention on the Law of Treaties, reservations that are incompatible with the object and purpose of a convention are not permissible.
>
> The Government of the Federal Republic of Germany therefore objects to the above-mentioned declaration by the Arab Republic of Egypt to the International Convention for the Suppression of the Financing of Terrorism. This objection shall not preclude the entry into force of the Convention as between the Federal Republic of Germany and the Arab Republic of Egypt.[241]

Joining the Germans, the following states objected to the declaration on the same legal basis: Austria, Belgium, Canada, the Czech Republic, Denmark, Estonia,

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240. *See* United Nations Treaty Collection, *available at* http://treaties.un.org/Pages/ViewDetails.aspx?src=UNTSONLINE&tabid=2&mtdsg_no=XVIII-11&chapter=18&lang=en (listing the objecting states).

241. International Convention for the Suppression of Financing of Terrorism, Germany: Objection With Regard to the Explanatory Declaration Made by Egypt upon Ratification, Aug. 16, 2005, C.N.677.2005.TREATIES-24; *see* United Nations Treaty Collection, *supra* note 240.

Finland, France, Hungary, Ireland, Italy, Latvia, The Netherlands, Poland, Portugal, Spain, Sweden, the United Kingdom, and of course, the United States of America.[242]

Some states added their own insights supporting their position. Argentina, for example, added with respect to the Egyptian declaration, or any future such pronouncement by any other state that "the Government of the Argentine Republic considers that all acts of terrorism are criminal, regardless of their motives, and that all States must strengthen their cooperation in their efforts to combat such acts and bring to justice those responsible for them."[243] Ireland admonished that it is "in the common interest of States that treaties to which they have chosen to become party are respected as to their object and purpose and that States are prepared to undertake any legislative changes necessary to comply with their obligations under these treaties."[244]

Against this array of diplomatic solidarity, only Syria and Jordan entered reservations that could even be remotely construed as ideologically similar.[245] The Syrian Arab Republic wrote that "acts of resistance to foreign occupation are not included under acts of terrorism."[246] Other than Argentina and Ireland, every nation that rejected the Egyptian declaration used very similar language to reject the Syrian effort, with the additions of Japan and Norway.[247] Finally, the Jordanian declaration read as follows: "The Government of the Hashemite Kingdom of Jordan does not consider acts of national armed struggle and fighting foreign occupation in the exercise of people's right to self-determination as terrorist acts within the context of paragraph 1 (b) of article 2 of the Convention."[248] Predictably, this declaration was rejected by twenty states—those listed above and the notable addition of the Russian Federation.[249]

In the context of Protocol I, all NATO allies, except the United States (for the policy reasons noted above), attempted to constrain a lawful right to internationalize an armed conflict on behalf of non-state participants to the context of occupation.[250] By rejecting the Egyptian, Syrian, and Jordanian declarations, they echoed the position that the United States had proclaimed nearly three decades prior. Hence, apart from three states, whose feeble attempts were scattered like the detritus of the World Trade Towers, international law is clear as a matter of both *opinio juris* and conventional text in that there is simply no articulable justification for the financial

242. United Nations Treaty Collection, *supra* note 240.

243. International Convention for the Suppression of the Financing of Terrorism, Argentina: Communication Concerning The Explanatory Declaration Made By Egypt Upon Ratification, Aug. 22, 2005, C.N.1034.2005.TREATIES-35.

244. International Convention for the Suppression of the Financing of Terrorism, Ireland: Objection Relating to the Explanatory Declaration Made by Egypt upon Ratification, June 23, 2006, C.N.555.2006.TREATIES-21.

245. *See* International Convention for the Suppression of the Financing of Terrorism, Syrian Arab Republic: Accession, Apr. 24, 2005, C.N.326.2005.TREATIES-6 [hereinafter Syrian Accession] (stating reservations similar to Egypt's); International Convention for the Suppression of Financing of Terrorism, Jordan: Ratification, Aug. 28, 2003, C.N.910.2003.TREATIES-32 [hereinafter Jordanian Accession] (stating reservations similar to Egypt's).

246. Syrian Accession, *supra* note 245.

247. *See* United Nations Treaty Collection, *supra* note 240.

248. Jordanian Accession, *supra* note 245.

249. *See* United Nations Treaty Collection, *supra* note 240.

250. Protocol I, *supra* note 1.

facilitation of terrorist acts. In hindsight, the world reacted to validate and reinforce the U.S. effort to prevent commingling of the jus in bello protections afforded to lawful combatants with the bright line international condemnation of terrorist acts irrespective of their context or subjective motivations.

2. Reservations to the Terrorist Bombing Convention

The International Convention for the Suppression of Terrorist Bombings presents an even more striking example of the prescience of the United States' position at the time of Protocol I. The material penal provision in Article 2 provides that

> 1. Any person commits an offence within the meaning of this Convention if that person unlawfully and intentionally delivers, places, discharges or detonates an explosive or other lethal device in, into or against a place of public use, a State or government facility, a public transportation system or an infrastructure facility:
>
> a. With the intent to cause death or serious bodily injury; or
>
> b. With the intent to cause extensive destruction of such a place, facility or system, where such destruction results in or is likely to result in major economic loss.
>
> 2. Any person also commits an offence if that person attempts to commit an offence as set forth in paragraph 1 of the present article.
>
> 3. Any person also commits an offence if that person:
>
> a. Participates as an accomplice in an offence as set forth in paragraph 1 or 2 of the present article; or
>
> b. Organizes or directs others to commit an offence as set forth in paragraph 1 or 2 of the present article; or
>
> c. In any other way contributes to the commission of one or more offences as set forth in paragraph 1 or 2 of the present article by a group of persons acting with a common purpose; such contribution shall be intentional and either be made with the aim of furthering the general criminal activity or purpose of the group or be made in the knowledge of the intention of the group to commit the offence or offences concerned.[251]

The Convention was originally intended to fill lacunae in the normative structure, but even in its Preamble it reinforces the dichotomous approach to the prevention and prosecution of terrorist acts. It specifically notes "that the activities of military forces of States are governed by rules of international law outside the framework of this Convention and that the exclusion of certain actions from the coverage of this Convention does not condone or make lawful otherwise unlawful acts, or preclude prosecution under other laws[.]"[252] The object and purpose of the

251. Terrorist Bombing Convention, *supra* note 20, art. 2.

252. *Id.* pmbl.

Terrorist Bombing Convention is to regulate terrorist bombings,[253] it does *not* aim to provide a basis for invoking a moral equivalency between terrorist acts and the conduct of operations by armed forces.

One of the most important and widely agreed-upon provisions, Article 19(2) of the Terrorist Bombing Convention, reinforces the division between the law of terrorism and the jus in bello applicable to armed conflicts:

> The activities of armed forces during an armed conflict, as those terms are understood under international humanitarian law, which are governed by that law, are not governed by this Convention, and the activities undertaken by military forces of a State in the exercise of their official duties, inasmuch as they are governed by other rules of international law, are not governed by this Convention.[254]

Recent international practice has reinforced the notion that the deliberate use of terror as a military tactic would violate international law. Both Protocol I and Protocol II prohibit acts or threats of violence, whose primary purpose is to "spread terror among the civilian population[.]"[255] The International Criminal Tribunal for the Former Yugoslavia opined that "the prohibition against terror is a specific prohibition within the general prohibition of attack on civilians," the latter of which constitutes a "peremptory norm of customary international law."[256] The ICRC Commentary notes that military operations that seek to inflict terror "are particularly reprehensible, . . . occur frequently, and inflict particularly cruel suffering on the civilian population."[257] More recently, in upholding the convictions in the AFRC Case, the Appeals Chamber of the Special Court for Sierra Leone accepted that convictions for "acts of terrorism" could lie for the three appellants who engaged in a "common plan to carry out a campaign of terrorizing and collectively punishing the civilian population of Sierra Leone . . . in order to achieve the ultimate objective of gaining and exercising political power and control over the territory of Sierra Leone."[258] As this article goes to press, Bosnian Serb leader Radovan Karadzic is being tried at The Hague, *inter alia*, on the charge of unlawfully inflicting terror upon civilians.[259]

Just as it did in the context of the Terrorist Financing Convention, Egypt attempted to blur the lines between differing legal regimes. One of its reservations stated that "[t]he Government of the Arab Republic of Egypt declares that it is bound by Article 19, paragraph 2, of the Convention insofar as the military forces of the State, in the exercise of their duties do not violate the rules and principles of

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253. *See id.*

254. *Id.* art. 19(2).

255. Protocol I, *supra* note 1, art. 51(2); Protocol II, *supra* note 69, art. 13, para. 2.

256. Prosecutor v. Galic, Case No. IT-98-29-T, Judgment and Opinion, para. 98 (Dec. 5 2003), *available at* http://www.icty.org/x/cases/galic/tjug/en/gal-tj031205e.pdf.

257. ICRC Commentary on Protocols, *supra* note 116, at 1453.

258. Prosecutor v. Alex Tamba Brima, et al., Case No. SCSL-2004-16-A, para. 70 (Feb. 22, 2008), *available at* http://www.sc-sl.org/CASES/ArmedForcesRevolutionaryCouncilAFRCComplete/AFRCJudgment/tabid/173/Default.aspx.

259. The Prosecutor v. Radovan Karadzic, Case No. IT-95-5, Amended Indictment, paras. 44–52 (Feb. 18, 2009), *available at* http://www.icty.org/x/cases/karadzic/ind/en/090218.pdf.

international law."[260] The response of the United Kingdom exemplifies the language and approach taken by other states (which included Canada, France, Germany, Italy, The Netherlands, the Russian Federation, Spain, and the United States) in opposition to the Egyptian effort.

With regard to the reservation made by Egypt upon ratification:

> The Government of the United Kingdom of Great Britain and Northern Ireland have examined the declaration, described as a reservation, relating to article 19, paragraph 2 of the International Convention for the Suppression of Terrorist Bombings made by the Government of the Arab Republic of Egypt at the time of its ratification of the Convention.
>
> The declaration appears to purport to extend the scope of application of the Convention to include the armed forces of a State to the extent that they fail to meet the test that they "do not violate the rules and principles of international law." Such activities would otherwise be excluded from the application of the Convention by virtue of article 19, paragraph 2. It is the opinion of the United Kingdom that the Government of Egypt is entitled to make such a declaration only insofar as the declaration constitutes a unilateral declaration by the Government of Egypt that Egypt will apply the terms of the Convention in circumstances going beyond those required by the Convention to their own armed forces on a unilateral basis. The United Kingdom consider this to be the effect of the declaration made by Egypt.
>
> However, in the view of the United Kingdom, Egypt cannot by a unilateral declaration extend the obligations of the United Kingdom under the Convention beyond those set out in the Convention without the express consent of the United Kingdom. For the avoidance of any doubt, the United Kingdom wish to make clear that it does not so consent. Moreover, the United Kingdom do not consider the declaration made by the Government of Egypt to have any effect in respect of the obligations of the United Kingdom under the Convention or in respect of the application of the Convention to the armed forces of the United Kingdom.
>
> The United Kingdom thus regard the Convention as entering into force between the United Kingdom and Egypt subject to a unilateral declaration made by the Government of Egypt, which applies only to the

260. International Convention for the Suppression of Terrorist Bombings, Egypt: Ratification, Aug. 9, 2005, C.N.6 34.2005 TREATIES-1 (The following articulation was made by Egypt at the time of ratification of the Terrorist Bombing Convention:

> 1. The Government of the Arab Republic of Egypt declares that it shall be bound by article 6, paragraph 5, of the Convention to the extent that the national legislation of States Parties is not incompatible with the relevant norms and principles of international law.
>
> 2. The Government of the Arab Republic of Egypt declares that it shall be bound by article 19, paragraph 2, of the Convention to the extent that the armed forces of a State, in the exercise of their duties, do not violate the norms and principles of international law.).

> obligations of Egypt under the Convention and only in respect of the armed forces of Egypt.[261]

The French added that "the effect of the reservation made by the Government of the Arab Republic of Egypt is to bring within the scope of the Convention activities undertaken by a State's armed forces which do not belong there because they are covered by other provisions of international law. As a result, the reservation substantially alters the meaning and scope of article 19, paragraph 2 of the Convention."[262]

The net effect of these consular notifications is to reinforce the bright line distinction between the relevant bodies of law. The military forces representing sovereign states are subject to the limitations of the laws and customs of war—they cannot be demeaned as terrorists because they are not operationally or legally equivalent to terrorists.[263] This principle in no way undermines the right of states to prosecute as war criminals those combatants who transgressed the boundaries of the law of war.[264] Terrorists, on the other hand, are subject to the criminal sanctions of domestic laws,[265] especially those deriving from the definitions and condemnations enshrined in the plethora of multilateral conventions that proscribe their tactics. States are absolutely united in opposing any efforts to erode the core prohibition that all acts of terrorism are—and ought to be—criminalized and that any attendant claim to combatant immunity is unfounded and ill-advised.[266]

V. CONCLUSION

In the modern vernacular, those who commit acts in contravention of the applicable conventions are termed terrorists, regardless of their ideological or religious motivations.[267] State practice since 1977 reinforces the clarity and enforceability of the agreed prohibitions against the diverse manifestations of terrorist ideology.[268] Protocol I attempted to elevate non-state actors to the status of lawful combatants, but the efficacy of those textual promises has been eroded to a

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261. International Convention for the Suppression of Terrorist Bombings, United Kingdom of Great Britain and Northern Ireland: Objection to the Reservation Made by Egypt Upon Ratification, Aug. 3, 2006, C.N.655.2006.TREATIES-11.

262. International Convention for the Suppression of Terrorist Bombings, France: Objection to the Reservation Made by Egypt Upon Ratification, Aug. 15, 2006, C.N.667.2006.TREATIES-13.

263. Geneva Convention Relative to the Treatment of Prisoners of War, *supra* note 23, art. 4.

264. *See id.* art. 85 (relating to prisoners of war who are prosecutable under the laws of the detaining authority).

265. Official Statement, International Committee of the Red Cross, The Relevance of IHL in the Context of Terrorism (July 21, 2005), *available at* http://www.icrc.org/web/eng/siteeng0.nsf/html/terrorism-ihl-210705.

266. *See, e.g.*, Terrorist Financing Convention, *supra* note 6, art. 6 (requiring acceding states to "adopt such measures as may be necessary, including, where appropriate, domestic legislation, to ensure that criminal acts within the scope of this Convention are under no circumstances justifiable by considerations of a political, philosophical, ideological, racial, ethnic, religious or other similar nature.").

267. Coady, *supra* note 11, at 47 (stating that the "ism" (in terrorism) indicates "no more than a relatively systematic nature of a method or a tactic." It is not itself an ideology.).

268. *See, e.g.*, Terrorist Bombing Convention, *supra* note 20, art. 2 (providing an example of the codification of state practice in opposition to terrorist acts post-1977).

vanishing point by states' unified and repeated opposition.[269] In the real world, the effort to decriminalize terrorists' conduct—so long as it complied with applicable jus in bello constraints in the context of wars of national liberation—has run aground on the shoals of sovereign survival. In practical terms, the Protocol I provisions mean little because they have never been applied or accepted, and their only residual value is as "agitational or rhetorical" tools.[270]

The core problem in defining and proscribing transnational terrorism is that residual uncertainty over the lawful scope of violence to achieve political ends would have the inevitable result of inducing more individuals to commit more terrorist acts. This danger becomes exponentially greater if such politicized violence were conducted with state sponsorship or umbrella authorization. Persons who employ violence amounting to the conduct of hostilities governed by the law of war do so unlawfully unless they can find affirmative legal authority for their acts under international law. Under the law of armed conflict, individuals acting with the requisite legal authority have historically been termed belligerents or combatants. Persons who have no legal right to wage war or adopt means of inflicting injury upon their enemies have been described synonymously as non-belligerents, unprivileged belligerents, unlawful combatants, or unlawful belligerents.[271] Terrorists remain in this class notwithstanding the efforts of some states to extend the protections derived from the laws and customs of war. This article has demonstrated the U.S. engagement in these essential debates began with the decision to oppose Protocol I in its entirety. In the intervening thirty years, states have overwhelmingly adhered to the substantive preference of the United States by opposing all reservations seeking to blur the line between criminal acts of terrorism and lawful acts inherent in the conduct of hostilities.

The law of armed conflict was never intended to provide a shield behind which terrorists would be free to gnaw away at the values of freedom and peace. Private efforts to wage war fall outside the structure of law that binds sovereign states together on the basis of reciprocity and shared community interests.[272] Thus, as noted above, no state in the world willingly accepts the normative proposition that international law bestows upon private citizens an affirmative right to become combatants whose warlike activities are recognized and protected. This is more than a residual appendage of sovereignty. It reflects the very essence of sovereign survival and respect for the dignity and individual worth of humans in the context of civilized society.

Words matter, particularly when they are charged with legal significance and purport to convey legal rights and obligations. Elevating to the status of combatants those non-state actors whose warlike activities indiscriminately target and terrorize innocent civilians would discredit the law of armed conflict even further in the eyes

269. *See, e.g.*, *Kasem*, 41 I.L.R. 470 (rejecting the claim of combatant immunity raised by a member of the "Organization of the Popular Front for the Liberation of Palestine"); *see generally* Aldrich, *supra* note 109.

270. BEN SAUL, DEFINING TERRORISM IN INTERNATIONAL LAW 76 (2006) (stating that "Protocol I provisions mean little as they have never been applied or accepted.").

271. *See, e.g.*, Stone, *supra* note 26, at 549.

272. II OPPENHEIM'S INTERNATIONAL LAW, *supra* note 44, at 574 ("Private individuals who take up arms and commit hostilities against the enemy do not enjoy the privileges of armed forces, and the enemy has, according to a customary rule of International Law, the right to treat such individuals as war criminals.").

of a cynical world. Though incomplete compliance with the jus in bello is the regrettable norm, knowledge of the law and an accompanying professional awareness that the law is binding remains central to the professional ethos of military forces around our planet.[273] For example, entitlement to prisoner of war status was limited to persons "captured by the enemy" under the 1929 Geneva Conventions.[274] Based on the text of the convention, the thousands of Germans who surrendered during World War II were categorized as "Surrendered Enemy Persons" not automatically entitled to the rights and privileges accorded to prisoners of war.[275]

Unless the world is prepared to accept terrorist acts justified wholly on the subjective, political, or religious motivations of the perpetrator, there must be a strict bulwark between the laws and customs of war regulating the authorization to conduct military operations and the legal framework regulating terrorism. The semantic label applied to captured Germans made little difference in their treatment or their attitudes. In the context of transnational terrorism, even a partial acknowledgement of the propriety of terrorist claims to combatant status presents an unnecessary and ill-advised risk to innocent lives and property. The legal regime governing terrorist conduct should remain fixed in its clarity of purpose and principle rather than being reduced to a subjective and indeterminate mass of text and pretext. U.S. exceptionalism in the context of Protocol I represented an act of leadership based on national self-interest that in reality reflected the underlying community interests of states engaged in the larger struggle for the international rule of law. The United States concluded that the commingling of the regime criminalizing terrorist acts with the jus in bello rules of humanitarian law would be untenable and inappropriate. Though no state has formally acknowledged the wisdom of the U.S. rejection of the most politicized provisions of Protocol I, states' actions in demonstrating a cohesive legal front to deflect efforts to protect terrorists from prosecution provide implicit acceptance and accolade. By rejecting the principles embodied in Articles 1(4) and 44(3), the United States led the world and thereby denied terrorists a psychological and legal victory that was reinforced by the international cohesiveness against efforts to undermine the multilateral terrorism conventions.

273. *See* W. Michael Reisman, *supra* note 38, at 5–6 (stating that military codes and manuals across the planet communicate the "gravity and importance" of such behavioral norms).

274. Geneva Convention Relative to the Treatment of Prisoners of War, *supra* note 23, art. 1.

275. JAGK-CM 302791 (1946), *reprinted in* 8 BULL. OF THE JUDGE ADVOCATE GEN. OF THE ARMY 262 (Sept.–Oct. 1946).

Change, Dependency, and Regime Plasticity in Offshore Financial Intermediation: The Saga of the Netherlands Antilles

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Abstract

The legal regimes of offshore jurisdictions have historically differed in significant ways from those applicable in onshore jurisdictions. Inevitably, legal and financial professionals have seized upon these differences to develop strategies for reducing transactions costs. A prominent example of such cross-border arbitrage was the routing of Eurodollar loans through a small group of former Dutch island colonies in the Caribbean, a practice which peaked in the mid-1980s, when virtually every major U.S. corporation made interest payments to a Netherlands Antilles finance subsidiary. The "Antilles sandwich" strategy exploited the difference between high U.S. withholding tax rates that applied to interest payments made to most foreign lenders, and the zero rate of tax that applied to U.S. interest payments made to residents of the Antilles under the United States-Netherlands Antilles double taxation treaty. Both jurisdictions reaped significant benefits from the strategy until the United States unilaterally terminated the tax treaty in 1987, virtually wiping out the Antilles offshore financial sector overnight. Unfortunately, because of rigidity in its governance structure, the Antilles failed to develop alternative financial intermediation strategies to replace the Antilles sandwich structure before its demise.

The rise and fall of the Antilles' offshore financial sector provides insight into the current debate over the role of offshore financial centers like the Antilles within the global economy. Concerned about tax evasion by their residents, onshore jurisdictions

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including France, Germany, and the United States are pressing for major changes in offshore jurisdictions' legal and regulatory regimes that may eliminate legitimate opportunities for international arbitrage. In such an environment, offshore financial centers may find it difficult to survive. In this article, we distill from the Antilles experience a theory of "regime plasticity" and examine the role that it plays in allowing offshore financial centers to adapt to changes in the legal and political environments within which they operate. How offshore financial centers react and whether they have learned the lessons of the Antilles' experience will play a major role in determining the future of the global offshore financial sector.

SUMMARY

I. INTRODUCTION

In the immediate aftermath of World War II, world markets were littered with protective measures, exchange control regimes, tariffs, and endless quantitative trade restrictions.[1] As the decades following the war passed, barriers to trade in goods gradually fell and, as trade grew, global capital markets also began to open.[2] The pace of that opening varied considerably across jurisdictions around the globe, however, leading to significant differences among the legal regimes within those jurisdictions. It was virtually inevitable that legal and financial professionals would seize upon these differences to develop strategies for reducing transaction costs (including taxes and regulatory expenditures) through international arbitrage. One of the most prominent examples of this was the use of Netherlands Antilles international finance subsidiaries by U.S. companies to tap into the Eurodollar markets.[3] This practice peaked in the mid-1980s, when virtually every major U.S. corporation had at least one Antilles finance subsidiary.[4]

The "Antilles sandwich" financing strategy was not a result of competitive or opportunistic lawmaking by an offshore financial center. Rather, it exploited the then-existing difference between high withholding tax rates that applied to interest

1. KEETIE E. SLUYTERMAN, DUTCH ENTERPRISE IN THE TWENTIETH CENTURY: BUSINESS STRATEGIES IN A SMALL OPEN ECONOMY 166 (2005).

2. *See* JOOST JONKER & KEETIE SLUYTERMAN, AT HOME ON THE WORLD MARKETS: DUTCH INTERNATIONAL TRADING COMPANIES FROM THE 16TH CENTURY UNTIL THE PRESENT 271 (2000) (noting that "from the end of the Second World War until 1960, the growth of world exports in US dollars averaged 6% a year" due in large measure to removal of tariffs through the General Agreement on Tariffs and Trade).

3. Eurodollars are "originally deposited in US banks that are acquired by persons resident outside the United States and held abroad, mainly in Europe. Eurodollars are used by foreign banks as a method of financing loans to other local or foreign banks or to commercial borrowers." Organisation for Economic Co-operation and Development, Glossary of Tax Terms, http://www.oecd.org/document/29/0,3343,en_2649_34897_33933853_1_1_1_1,00.html#E; *see also* Richard C. Marston, *American Monetary Policy and the Structure of the Eurodollar* Market, 34 PRINCETON STUD. INT'L FIN. 3, 3 (1974) ("The Eurodollar deposit has been the preferred medium for much short-term investment. The Eurodollar market has attracted funds previously committed only to domestic markets by offering yields that were at times far in excess of those available domestically.").

4. A Treasury official described the typical structure as involving: (1) a Netherlands Antilles subsidiary of a U.S. parent corporation; (2) an American parent that contributes 33–50% of the amount of debt to be issued as capital; (3) the subsidiary that borrows funds from foreign lenders, with the loans guaranteed by the U.S. parent and the interest payments to be net of U.S. and Antilles taxes; (4) the money is then lent back to the U.S. parent on similar terms and conditions at a slightly higher interest rate; and (5) with the bonds sold by the subsidiary not listed with the S.E.C., sold only to foreign buyers, and in bearer form. *Tax Evasion Through the Netherlands Antilles and Other Tax Haven Countries: Before the Subcomm. of Commerce, Consumer, and Monetary Affairs of the Comm. on Government Operations H.R.*, 98th Cong. 275–76 (1983) [hereinafter *1983 Tax Evasion Hearings*] (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Department of Treasury). There would be: no U.S. or Antilles tax on the sale, redemption, or other disposition of the bonds and no estate tax in either jurisdiction if the bonds were owned by a non-resident of the Antilles. The parent would receive a foreign tax credit for the tax paid on the profit from the spread between the interest rates, and the parent would receive the foreign source income on the profit from the spread which could be used to make use of otherwise excess foreign tax credits. *Id.* at 277. Some accounts attribute the structure to Anton Smeets. *See id.* at 787 (in the 1960s Smeets found an opportunity "to get back into his old specialty" doing finance subsidiaries in the Antilles).

payments made by U.S. borrowers to foreign persons,[5] and the low rates of tax or outright tax exemption that applied to interest payments made by U.S. borrowers to residents of the Netherlands Antilles.[6] As we discuss in greater detail below, interest payments made by a U.S. firm on a Eurodollar loan to, say, a Venezuelan investor in the 1970s, would have been subject to a thirty percent U.S. withholding tax. Under the terms of the tax treaty between the United States and the Netherlands Antilles in force between 1955 and 1987, however, no such tax would have applied to those interest payments if they were made to an investor resident in the Antilles. Since under U.S. law, corporations are legally resident where they are incorporated, the

5. As a practical matter, once income leaves the United States it is virtually impossible for the United States to collect tax on the income. To effectively tax such income, the United States requires payors of such income to withhold tax from any payments made to foreign persons and remit it to the U.S. Treasury. *See* I.R.C. § 1441 (mandating that "all persons ... having the control, receipt, custody, disposal, or payment of any ... income ... of any nonresident alien individual or of any foreign partnership shall ... deduct and withhold from such items a tax equal to 30 percent thereof"). However, as a practical matter, the amount of tax, and therefore the amount of deduction, is dependent on specific provisions of bilateral treaties between the United States and many other countries. *See, e.g.*, Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, U.S.-Neth., art. 10, Sept. 18, 1992, 32 I.L.M. 457 (providing for a maximum 15% tax on dividends paid to nonresident aliens); *see also* U.S. DEP'T OF TREASURY, INTERNAL REVENUE SERV., PUBLICATION NO. 519, U.S. TAX GUIDE FOR ALIENS 43–54 (2007), *available at* http://www.irs.gov/pub/irs-pdf/p519.pdf (instructing nonresident aliens on common exceptions granted in tax treaties; and providing references to individual treaties and resources, and instructing nonresident aliens to file form W-8BEN with a withholding agent to correct a payor withholding an amount greater than that provided by treaty).

6. The island of Curaçao has been a part of a number of jurisdictional groupings as the Netherlands has attempted to find an appropriate organizational structure for its Caribbean possessions. These groupings have included Curaçao, the other five islands, and Suriname, as well as just Curaçao and the other five islands. On Jan. 1, 1986, Aruba left the Antilles and established a separate, direct relationship with the Kingdom government. GERT OOSTINDIE & INGE KLINKERS, DECOLONISING THE CARIBBEAN: DUTCH POLICIES IN A COMPARATIVE PERSPECTIVE 128 (2003). At a date yet to be determined (originally scheduled for Dec. 15, 2008), the Netherlands Antilles will cease to be an entity; Curaçao and Sint Maarten will become separate countries within the Kingdom, and Bonaire, Sint Eustatius, and Saba will become special status municipalities of the Netherlands. *See* Press Release, Government of the Netherlands, Agreement on Division of Netherlands Antilles (Feb. 13, 2007) [hereinafter Government of the Netherlands, Netherlands Antilles], *available at* http://www.government.nl/News/Press_releases_and_news_items/2007/February/Agreement_on_division_of_Netherlands_Antilles; Press Release, Government of the Netherlands, Curaçao and St. Maarten to have Country Status (Mar. 11, 2006) [hereinafter Government of the Netherlands, Curaçao], *available at* http://www.government.nl/News/Press_releases_and_news_items/2006/November/Cura_ao_and_St_Maarten_to_have_country_status; Gino Bernadina, *Consensus, But no Date Set for New Status*, THE DAILY HERALD (St. Maarten), May 23, 2008, *available at* http://www.thedailyherald.com/news/daily/k006/steer006.html; *Dutch Make Available Over 1 Billion Guilders,* THE DAILY HERALD (St. Maarten), Feb. 13, 2007, *available at* http://www.thedailyherald.com/news/daily/j226/accor226.html ("St. Maarten will become a country and the three "smaller" islands Bonaire, Saba and St. Eustatius overseas municipalities."); Stephanie van den Berg, *Curaçao Votes for More Autonomy*, CARIBBEAN NET NEWS, Apr. 11, 2005, *available at* http://www.caribbeannetnews.com/2005/04/11/autonomy.shtml (describing vote for "Status Aparte" in Curaçao); Economist Intelligence Unit, *Netherlands Antilles*, VIEWSWIRE (2009), *available at* http://viewswire.eiu.com/index.asp?layout=VWcountryVW3&country_id=1330000333&rf=0 (noting new date of Jan. 1, 2010 had been agreed for dissolution of Antilles, but now is likely to be pushed back a year). The six islands have had multiple names with both the island of Curaçao and the entire group known as Curaçao until 1949, and then as the Netherlands Antilles (including Aruba until that island withdrew). In the interest of clarity, we will use "Curaçao" to refer to the island of Curaçao and "Netherlands Antilles" or "Antilles" to refer to the larger entity of islands within the Kingdom of the Netherlands to which Curaçao belongs, even when it may not be historically accurate to use the term "Netherlands Antilles."

Venezuelan investor could form an Antilles N.V.[7] that would, as an Antilles resident, qualify for treaty benefits. The Antilles N.V. could then deduct the money it paid to the Venezuelan investor, leaving little to be taxed in the Antilles. This difference in legal rules prompted the formation of Antillean companies to function as conduit "recipients" of U.S. interest payments in what was referred to as an "Antilles sandwich" structure. This strategy made lending money to U.S. corporate borrowers economically appealing to foreign investors[8] and, as such lending—generally known as the "Eurobond" market[9]—grew, helped relieve the U.S. balance of payments problems. With strong initial encouragement from the U.S. Treasury, the structure flourished into the mid-1980s[10] and provided a tremendous boon to the Antilles economy.

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7. F.J.W. Löwensteyn, *Legal Persons*, *in* INTRODUCTION TO DUTCH LAW FOR FOREIGN LAWYERS 125, 131–32 (Jeroen Chorus et al. eds., 2d ed. 1993) (explaining that "N.V." is the abbreviation for "naamloze vennootschap," literally "anonymous partnership," the Dutch term for a public limited liability corporation).

8. *1983 Tax Evasion Hearings*, *supra* note 4, at 168 (statement of Robert Butcher, Vice President, Citicorp) ("The existence of the 30 percent U.S. withholding tax on interest payments to foreign investors effectively eliminates direct access of U.S. corporate borrowers to these foreign markets and necessitates indirect access through the Netherlands Antilles finance subsidiaries.").

9. A Eurobond is an "international bond issued by a company in a market other than its domestic market. Eurobonds may take the form of loans, debentures or convertible debentures, and may be designated in any currency." Organisation for Economic Co-operation and Development: Centre for Tax Policy and Administration, Glossary of Tax Terms, *available at* http://www.oecd.org/document/29/0,3343,en_2649_34897_33933853_1_1_1_1,00.html#E. Eurobonds were not exactly the same as bonds sold in the U.S. market:

> Eurobond buyers want bearer bonds, annual coupons, front-end discounts, maturities bunched in the 5- to 7-year range, tighter call provisions, better credits. They are historically more interested in floating rate notes and warrants than U.S. investors. In addition, they require that any interest paid must be "grossed up" by the borrower in the event of the imposition of a Netherlands Antilles or U.S. withholding tax on the interest payments.

1983 Tax Evasion Hearings, *supra* note 4, at 169 (statement of Robert Butcher, Vice President, Citicorp). *See also 1983 Tax Evasion Hearings*, *supra* note 4, at 203 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen) (defining Eurobond market as international bond market traditionally free of taxes where borrower must pay any tax imposed on interest payments). Paying the withholding tax would dramatically increase the effective interest rate for U.S. borrowers. For example, if the bond market called for 10% interest and the 30% withholding tax applied, the U.S. borrower would need to pay an effective interest rate of 14.3% to provide the foreign lender with a net 10% rate since the additional payment of the tax would itself be a taxable amount. *Id.* The Netherlands Antilles allowed bearer bonds, a feature not available in the United States. Bearer bonds and shares are owned by whoever holds them, as contrasted with securities that have registered owners. This makes such instruments similar to cash in terms of owner anonymity. *See* BLACK'S LAW DICTIONARY 190 (8th ed. 1999) (defining bearer bonds); MARSHALL J. LANGER, HOW TO USE FOREIGN TAX HAVENS 101–02 (Practising Law Institute, 1975) (defining bearer shares).

10. By 1979, new issues in the Eurobond market reached $17.2 billion (with $10.4 billion denominated in dollars), a considerable sum compared to the U.S. corporate bond market that had $24 billion in new issues in that year. By 1982, the Eurobond market had reached $48.9 billion (with $39.1 billion in dollars) relative to a U.S. corporate bond market of $33.5 billion. *1983 Tax Evasion Hearings*, *supra* note 4, at 175 (statement by Butcher, Vice President, Citigroup). A study estimated the current market value of U.S. finance subsidiaries' Eurobond offerings through the Netherlands Antilles at $20–25 billion in 1981. *1983 Tax Evasion Hearings*, *supra* note 4, at 585 (excerpts from a report by Taxecon Associates). One estimate put Eurobond volume at 40–50% of all U.S. corporate bonds in the early 1980s. *A Treaty That May Sink Havens*, BUS. WK., Feb. 14, 1983.

Concern grew within the United States about use of the U.S.-Netherlands Antilles treaty by non-Antilles residents because such use impacted the United States' ability to negotiate tax information agreements with third countries and resulted in lost tax revenues. This concern, combined with a desire to make direct access to the Eurobond market available, ultimately led the United States to eliminate the withholding tax on interest payments made to foreign lenders, which rendered the interest withholding provision of the U.S.–Netherlands Antilles tax treaty unnecessary. Shortly thereafter, the United States terminated the tax treaty itself, leaving nothing in its stead but a grandfathering period for certain outstanding bond issues. When the difference in the U.S. legal regime toward Antilles lenders went away, the bulk of the Antilles financial intermediation sector was wiped out. Because of rigidities in the Antilles' governance structure, the jurisdiction failed to adapt in time to the changes in U.S. attitudes and did not develop substitute financial intermediation and regulatory arbitrage products to replace the Antilles sandwich structures before its demise. The Antilles had had such opportunities, having served as the legal residence of hedge funds[11] beginning in the 1960s and experimenting with captive insurance prior to the tax treaty's cancelation.

The rise and fall of the Antillean financial intermediation business provides insight into the current struggles between onshore and offshore governments over the role of offshore financial centers like Barbados, Bermuda, the Cayman Islands, the Channel Islands, Hong Kong, the Isle of Man, Liechtenstein, Mauritius, Singapore, and Switzerland in the global economy. With France, Germany, and the United States pressing for major changes in offshore jurisdictions' legal and regulatory regimes,[12] one likely avenue by which these governments may seek to pressure offshore governments is by moving to eliminate opportunities for such arbitrage. How offshore financial centers react, and whether they have learned the lessons of the Antillean experience, will play a major role in determining the shape of the offshore financial sector and which jurisdictions will be successful.

The fate of the Antilles suggests four critical propositions for the offshore financial sector at large that we explore in depth in this article. First, there will always be differences among legal regimes, and those differences often may be arbitraged to make business transactions more cost-efficient. This arbitrage may be financially beneficial to the parties to the transactions and to the jurisdictions in which the transactions take place. The immediate fiscal benefits of the form of financial intermediation involved in the Antilles sandwich flowed primarily to the Antilles, which derived a considerable portion of its government revenue from the offshore financial sector.[13] The United States, however, also benefited because U.S.-

11. A hedge fund is a largely unregulated investment fund geared toward sophisticated individual and institutional investors that actively trades a range of financial instruments and typically compensates its management with both a fixed management fee and a percentage of profits. *See* Houman B. Shadab, *The Law and Economics of Hedge Funds: Financial Innovation and Investor Protection*, BERKELEY BUS. L.J. (forthcoming 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1066808 ("A hedge fund is a private investment pool not subject to the full range of restrictions on investment activities and disclosure obligations imposed by the federal securities laws, that compensates management in part with an annual performance fee, and typically engages in the active trading of financial instruments.").

12. *See* ORG. FOR ECON. CO-OPERATION AND DEV. [OECD], TOWARDS GLOBAL TAX CO-OPERATION: PROGRESS IN IDENTIFYING AND ELIMINATING HARMFUL TAX PRACTICES 7 (2000) (discussing how interested parties and entities like OECD are working toward improving legal and regulatory norms for offshore jurisdictions).

13. *1983 Tax Evasion Hearings*, *supra* note 4, at 64 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) (reporting that the Antilles Central Bank

based companies operating abroad gained access to cheaper foreign capital and thus, became increasingly competitive.

A second proposition is that while differences in general among legal regimes are persistent, any particular difference is fluid, which makes the revenue flows realized by jurisdictions engaged in financial intermediation particularly vulnerable to elimination through changes in both business conditions and in the legal regimes that produce intermediation opportunities. Even large jurisdictions are vulnerable to the effects of changes in other jurisdictions' laws, though those effects may not be as damaging. This is as true for the United States in its role as an offshore financial center as it is for the Antilles and other jurisdictions more typically thought of as offshore financial centers. To the extent that the United States serves an offshore role for Latin American or Asian investors, it, too, is susceptible to changes in those countries' tax and regulatory laws.[14]

Third, the vulnerability of offshore jurisdictions to the elimination of revenue flows from financial intermediation activity places a premium on a jurisdiction's legislative agility. To survive in a world of perpetual change, an offshore jurisdiction must develop the ability to adapt quickly. Fourth, whether an offshore jurisdiction can adapt to variations in business conditions and alteration in the onshore legal regimes depends greatly on its own laws and its own political arrangements.

In this Article, we examine the history of the Netherlands Antilles' offshore financial sector and use that jurisdiction's experience as a lens through which to examine the way that changes in onshore jurisdiction law and the international regulatory climate may affect other international financial centers, both onshore and offshore. In Part I, we provide the first comprehensive account of the Antilles' early economic history, an important contribution given the historic role played by the island's financial sector in the overall development of offshore finance. Part II describes the arc of the Antilles reign as an offshore financial intermediation powerhouse, which finally ended with the repeal of the U.S.–Netherlands Antilles tax treaty. In Part III, we develop our theory of "regime plasticity"[15] and the role that it plays in allowing offshore financial centers to adapt to changes in the legal and political environments where they operate. We also evaluate the response of the Antilles' to the collapse of its financial sector in light of this theory. Part IV concludes the article by offering an assessment of the future roles of offshore

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calculated that taxes from offshore activities in 1981 accounted for 16% of total tax receipts); *see* Interview with Gregory Elias, United Trust Co., Curaçao, Netherlands Antilles (May 22, 2008) [hereinafter Interview, Elias, United Trust Co.] (stating that 60% of government revenue derived from offshore sector in the mid-1980s).

14. *See* Craig M. Boise, *Regulating Tax Competition in Offshore Financial Centers, in* REGULATORY COMPETITION AND OFFSHORE FINANCIAL CENTERS (Andrew P. Morriss ed., forthcoming 2010) (explaining that for smaller jurisdictions, the relative magnitude of the impact of changes by onshore jurisdictions is much greater than it is for large diversified economies like that of the United States).

15. The term "plasticity" generally refers to the capability of an object to be molded and retain its shape after change. Merriam-Webster Online Dictionary, at http://www.merriam-webster.com/dictionary/plasticity ("[T]he ability to retain a shape attained by pressure deformation."). Interestingly, the meaning of plasticity in the context of brain function is particularly apt for our purposes in delineating the ability of offshore jurisdictions to respond to change. *See id.* at http://www2.merriam-webster.com/cgi-bin/mwmednlm?book=Medical&va=plasticity ("[T]he capacity for *continuous alteration* of the neural pathways and synapses of the living brain and nervous system *in response to experience of injury that involves the formation of new pathways and synapses and the elimination or modification of existing ones*.") (emphasis added).

financial intermediation jurisdictions, onshore jurisdictions, and multilateral institutions within the global economy, particularly in light of recent negative attention to offshore financial centers around the globe.

II. ECONOMIC UNDERPINNINGS

Europeans Alonso de Ojeda and Amerigo Vespucci first visited Curaçao, one of the Caribbean islands that comprise the Netherlands Antilles, in 1499.[16] It was not until 1527, however, that the Spanish finally settled the island,[17] making it part of the Spanish Empire for more than a hundred years until it was ceded to the Dutch in 1634.[18] Except for a brief period of British rule during the Napoleonic wars, the island has since remained a part of the Kingdom of the Netherlands, albeit under a surprisingly diverse series of constitutional arrangements and as part of a shifting cast of other Caribbean islands and territories colonized by the Dutch.[19] In this section we describe the rise of Curaçao's financial sector, beginning with its early economic activities and continuing through the hey-day of the island's financial intermediation activity in the late 1970s. This early history explains why the factors necessary for the development of offshore financial activity appeared in Curaçao and sheds light on the reasons why Curaçao was among the first jurisdictions to develop a substantial offshore sector.

A. *"A Lonely Island"*[20]

The Dutch arrived in the Caribbean not for religious or ideological reasons, but with "the hope of making their fortunes and to establish themselves as a prominent nation."[21] Yet the islands they colonized were not obvious choices to advance either goal. Indeed, the six islands that became first Curaçao and later the Netherlands Antilles were not highly sought after by European powers.[22] The Spanish called them *islas inútiles,* or "useless islands,"[23] and surrendered them without serious resistance to the Dutch in 1634.[24] Living up to its Spanish nickname, colonial Curaçao provided the Dutch with little in the way of agricultural or natural resources.[25] The one local industry that did develop was salt production, which

16. *See Curaçao, in* COLUMBIA ENCYCLOPEDIA 727 (6th ed. 2007).

17. *See id.*

18. *See id.*

19. *Id. See also Netherlands Antilles, in* COLUMBIA ENCYCLOPEDIA 1988; *see generally* J. HARTOG, CURAÇAO: FROM COLONIAL DEPENDENCY TO AUTONOMY (1968) (providing an overview of the history of Curaçao and the influence of the Dutch on the island).

20. Herdman F. Cleland, *Curaçao, a Losing Colonial Venture,* 41(3) BULL. OF THE AM. GEOGRAPHICAL SOC'Y 129, 138 (1909).

21. GERT OOSTINDIE, PARADISE OVERSEAS, THE DUTCH CARIBBEAN: COLONIALISM AND ITS TRANSATLANTIC LEGACIES 4 (2005).

22. *Id.* at 2.

23. *Id.* at 5.

24. Philip Hanson Hiss, *Dutch West Indies: Curaçao and Surinam, in* THE NETHERLANDS 392, 392, 396 (Bartholomew Landheer, ed. 1943).

25. OOSTINDIE, *supra* note 21, at 8 ("The Leeward Islands were simply too dry for large-scale cultivation of tropical export crops; crop production and goat breeding never really developed beyond local supply."); PHILIP HANSON HISS, NETHERLANDS AMERICA: THE DUTCH TERRITORIES IN THE WEST 119 (1943) ("Agriculture on Curaçao was limited to the cultivation of aloes, divi-divi pods for tanning, and a small number of oranges which were used in the manufacture of the well-known Curaçao

helped the Dutch break Spain's monopoly on that commodity.[26] This turned out to be too little to make the colony prosper, however, and after only ten years the Dutch gave serious consideration to abandoning their new possessions.[27] An early Dutch observer concluded that

> [o]ne cannot describe the island of Curaçao as a treasure trove of the most valuable products of nature: its entrails are not pregnant with gold, silver or gems, and its fertile plains, between rocks and stony ground, produce little that is exceptional; all that grows and waxes is usually for personal use or to feed the Negro slaves. This island can therefore be regarded as a warehouse, or supply shed, for products that are shipped from the mainland or the Netherlands, or any land out of whose lap Europe enjoys notable benefits.[28]

Even today, a visitor is likely to be struck by the contrast between other, more lush Caribbean islands and the arid terrain filled with cacti and other desert plants that characterizes the bulk of Curaçao's topography.[29]

Lacking natural resources, the island's economy was almost entirely dependent on trade and its importance lay in its harbor and its proximity to major trade routes.[30] The growth of trade, together with religious toleration, brought to Curaçao a large colony of Sephardic Jews almost from the beginning of Dutch colonization, who founded merchant houses that eventually came to be known as the "Little Rothschilds" of the Caribbean, and helped establish the island as an early financial hub.[31] Indeed, the Dutch willingness to disregard religious and political differences in

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liqueur."); FUAT M. ANDIC & SUPHAN ANDIC, GOVERNMENT FINANCE AND PLANNED DEVELOPMENT: FISCAL SURVEYS OF SURINAME AND THE NETHERLANDS ANTILLES 175 (1968) ("*Agriculture* has never been important in the Netherlands Antilles.").

26. KENNETH GORDON DAVIES, THE NORTH ATLANTIC WORLD IN THE SEVENTEENTH CENTURY 44 (1974) ("In 1634 [the Dutch] took Curaçao from Spain, wanting it for its salt. . . .").

27. PIETER EMMER, THE DUTCH IN THE ATLANTIC ECONOMY, 1580–1880: TRADE, SLAVERY AND EMANCIPATION 101 (1998).

28. J.H. HERING, BESCHRIJVING VAN HET EILAND CURAÇAO, EN DAAR ONDER HOORENDE EILANDEN BON-AIRE, OROBA, EN KLEIN CURAÇAO 57 (1779) *quoted and translated in* OOSTINDIE, *supra* note 21, at 5–6.

29. A *Wall Street Journal* report on the offshore sector in the late 1980s termed the island "a harsh landscape of rock" with wind "so fierce and unremitting that the best-known piece of nature may be the divi-divi tree, which looks like an upside-down L; its branches grow straight out to one side, saving the wind the trouble of having to blow them that way." Charles F. McCoy, *Netherlands Antilles Minus a U.S. Treaty is Tax-Paradise Lost–Faced with Cancellation, Locals Seek Alternatives*, WALL ST. J., July 28, 1987, § 1. The island also played a minor role in Rachel Carson's *Silent Spring*, featured as the location of a successful screwworm eradication program using sterilized male screwworms. The island was selected for the program because of its isolation. *See* RACHEL CARSON, SILENT SPRING 280–82 (1962).

30. Cleland, *supra* note 20, at 130 (stating the harbor is "a remarkable one" and that a 1909 observer noted the bay "is said to be large and deep enough to shelter the largest navy in the world."); HISS, *supra* note 25, at 50–51 (noting the prosperity of Curaçao was based on trade although there was some agriculture); OOSTINDIE & KLINKERS, *supra* note 6, at 58 (remarking that Curaçao "fulfilled a vital function as points of connection for trade—both legal and illegal—within the Caribbean region."). OOSTINDIE, *supra* note 21, at 2 (noting the Dutch West Indies did break the Spanish monopoly on salt and provide Holland with a vital source of salt, critical to the herring industry in the Netherlands).

31. CORNELIS CHRISTIAAN GOSLINGA, CURAÇAO AND GÚZMAN BLANCO: A CASE STUDY OF SMALL POWER POLITICS IN THE CARIBBEAN 12 (1975). See also HISS, *supra* note 25, at 401 (discussing role of Portuguese Jewish community).

trade gave them a great advantage over their European competitors. As a colonial governor of the British colony of Jamaica noted, perhaps enviously, the Dutch believed that "Jesus Christ was good, but trade was better."[32]

During the 1700s, Dutch slave traders made a substantial contribution to Curaçao's wealth by bringing slaves to Curaçao and then selling them in South America and the Caribbean.[33] Moreover, Curaçao proved an important conduit through which flowed: Dutch capital to fund the Caribbean sugar industry's growth; Dutch shipping to carry refined sugar; Dutch technical assistance to improve sugar production quality; and Dutch merchants to provide the luxury goods the newly rich planters in other European nations' Caribbean colonies could now afford.[34] Apart from the slave trade, Curaçao's location close to modern day Venezuela and Colombia offered opportunities for circumventing the Spanish (and later Venezuelan and Colombian) restrictions on trade with outsiders, and for avoiding customs duties.[35] In what might be viewed as an early example of offshore financial activity, Dutch privateers based on Curaçao harassed Spanish treasure fleets throughout this period.[36] Recognizing the importance of trade, the Dutch abandoned the mercantilist trade regime by 1675 and declared Curaçao a free port.[37] In sum, Curaçao's colonial legacy was that of a trading center facilitating metropolitan involvement in the New

32. EMMER, *supra* note 27, at 101.

33. CORNELIS CHRISTIAAN GOSLINGA, A SHORT HISTORY OF THE NETHERLANDS ANTILLES AND SURINAM 35 (1979), 110–11; EMMER, *supra* note 27, at 27, 55 ("Illegal but tolerated" imports of slaves via Curaçao were an important source of labor for Spanish America after 1640. As the height of the slave trade, slaves made up half the population of the colony.); HISS, *supra* note 25, at 401 ("[T]he wealth of Curaçao [in the eighteenth century] . . . lay in its commerce in goods and slaves."); PAUL BLANSHARD, DEMOCRACY AND EMPIRE IN THE CARIBBEAN: A CONTEMPORARY REVIEW 276 (1947) ("It paid Curaçao to be a middleman in the slave trade. . . ."); GOSLINGA, *supra* note 31, at 4 (noting the island "served as a slave market and warehouse, providing the Spanish colony [of Veneuzela] with a much-needed black labor force and many commodities which Spain was unable to provide."). *See* HARTOG, *supra* note 19, at 163 (noting the Dutch were successful as slave suppliers to Spanish territories in part because they had access to the necessary capital, while the Spanish did not; another example of an early "offshore" role for the island).

34. MELVIN H. JACKSON, SALT SUGAR, AND SLAVES: THE DUTCH IN THE CARIBBEAN, 14–15 (1965) ("Behind the scenes of this revolution [introduction of sugar cane], the Curaçaoans were ubiquitous. Backed by Amsterdam capital, they arranged for the credits needed to set up in the new industry: vats, boilers and caldrons were offered at attractive financing. Dutch technicians, trained in Brazil, were available for consultation to provide the necessary instruction to ensure a fine product. Omnipresent Dutch shipping was at hand to carry off the product, relieving planters of marketing worries . . . . The warehouses at Willemstad expanded their stores of European staples and luxuries for the increasingly prosperous and fastidious planter class . . . .").

35. GOSLINGA, *supra* note 33, at 35; BLANSHARD, *supra* note 33, at 276 ("[I]t has always paid the more daring merchants of the island to smuggle goods into South America."); OOSTINDIE, *supra* note 21, at 9 ("Curaçao and Saint Eustatius . . . were especially important to trade within the Caribbean and between the Caribbean and the mainland. This trade was mainly smuggling, as hazardous as it was potentially profitable for merchants and the opportunistic colonial power."); GOSLINGA, *supra* note 31, at 4 ("[T]rade relations [with Venezuela], although largely illicit, . . . were the source of its prosperity in the seventeenth and eighteenth centuries."); HISS, *supra* note 25, at 51 ("[T]he vast majority of European goods and American produce was carried in Dutch bottoms . . . for the colonists [in the entire West Indies] rightly refused to abide by the ordinances of governments in Europe that were interested in the West Indies colonies only for the money they could get out of them. . . .").

36. GOSLINGA, *supra* note 33, at 21; OOSTINDIE, *supra* note 19, at 2 (noting that "[t]he distinction between war and piracy at that time was a vague one"); HISS, *supra* note 25, at 53–54 (discussing privateering at Curaçao); JONKER & SLUYTERMAN, *supra* note 2, at 50 (stating privateering was "the most profitable" activity in Dutch West Indies in early 17th century).

37. EMMER, *supra* note 27, at 77.

World.[38] In this role, Curaçao prospered from the late seventeenth century through the end of the eighteenth century.[39]

However, Curaçao's affluence faded in the nineteenth century. A local history describes the period from 1816 through 1916 as "years of bitter poverty" with "very few exceptions."[40] Moreover, as the nineteenth century progressed, technological advances in shipping made Curaçao less necessary as a provisioning stop for trans-Atlantic shipping.[41] By the close of the nineteenth century, the capital of Willemstad "on dry, barren Curaçao, was a desolate 'entrepot for traders'"[42] and the entire colony was viewed as "a liability to the Dutch government."[43] Once again, consideration was given to selling or simply abandoning the island.[44] Overshadowed within the Caribbean region by the Dutch mainland colony of Suriname and globally by the vastly larger Dutch colony of Indonesia, the Dutch Caribbean islands became little more than an afterthought for the Kingdom of the Netherlands.[45] As a result, in

38. In addition to its role as a trading center, the island has served as a political refuge for Venezuelan revolutionaries at various times. Cleland, *supra* note 20, at 138 (noting that "Bolivar, Paez, Miranda, Sublet, Guzman Blanco, Riero and other Venezuelan 'revolutionists' have spent their leisure time [in Curaçao] making plans for future action").

39. ALBERT L. GASTMANN, THE POLITICS OF SURINAM AND THE NETHERLANDS ANTILLES 10 (1968) (describing how the island had "vast economic importance and richness in the eighteenth century" while the slave trade flourished).

40. HARTOG, *supra* note 19, at 267; BERNARD L. POOLE, THE CARIBBEAN COMMISSION: BACKGROUND OF COOPERATION IN THE WEST INDIES 131 (1951) (noting that the end of the slave trade in 1863 was thought to have ruined the prosperity of the islands); GOSLINGA, *supra* note 31, at 85 (stating that the way emancipation proceeded in the Dutch West Indies illustrates the Dutch lack of concern with their West Indian colonies). HISS, *supra* note 25, at 107 (noting that the Dutch emancipated their slaves only on July 1, 1863). As Oostindie and Klinkers note:

> It was not until the beginning of the 1850s that the Crown, the Ministry of Colonial Affairs and the Dutch parliament came to recognize that the institution of slavery could not be upheld much longer—if only because it made the Netherlands look increasingly backward. Even though this was the first occasion that the Dutch government had become seriously concerned with its West Indian colonies, it would take another ten years before slavery was finally abolished in 1863—long after England (1834) and France (1848) had taken this step. This was mainly due to the thorny problem of the compensation to be paid—to the slave owners, that is, not to the slaves.

OOSTINDIE & KLINKERS, *supra* note 6, at 59.

41. HISS, *supra* note 25, at 119.

42. An "entrepot" is "a building or place where goods from abroad may be deposited and from which those goods may then be exported to another country without paying a duty." BLACK'S LAW DICTIONARY 574 (8th ed. 2004).

43. GASTMANN, *supra* note 39, at 9–10 ("Economically, politically and strategically these islands had ... lost their importance by the nineteenth century."); GOSLINGA, *supra* note 31, at 85 ("The island's economy never really recovered from British occupation during most of the Napoleonic Wars.").

44. GOSLINGA, *supra* note 31, at 85–88, 93–94; OOSTINDIE & KLINKERS, *supra* note 6, at 59.

45. BLANSHARD, *supra* note 33, at 274 ("To Hollanders the Dutch investment in the Caribbean is trivial compared to the two billions invested in the East Indies."); GOSLINGA, *supra* note 31, at 9 (noting that by the nineteenth century, "[t]he West Indian colonies formed by a tiny part of the Dutch colonial empire, which contributed no profits to the Dutch treasury, and required subsidies"); Hiss, *supra* note 24, at 393 ("The recent tendency ... has been to discount the importance of the West Indies and to stress the wealth and glamor of the East Indies."); OOSTINDIE, *supra* note 21, at 6–7 (noting that "the Dutch West Indies rarely emerged from the shadow of the Dutch East Indies"); OOSTINDIE & KLINKERS, *supra* note 6, at 62 (explaining that the Antilles and Suriname were "small and problematic possessions very far away geographically and culturally" and were "completely overshadowed by the Dutch-East Indies relationship" during decolonization).

the words of the preeminent historians of Dutch colonial policy, the Dutch policies in the Caribbean were "rather uninspired and fairly inactive" and the Dutch Caribbean colonies never rose above "the status of 'poor cousin' to the Dutch East Indies."[46]

In addition to the end of the slave trade and technological advances in shipping, a third major reason for Curaçao's nineteenth century decline was its difficult relationship with Venezuela, "on which it was largely [economically] dependent."[47] "Curaçao's role as a commercial intermediary between Venezuela and the outside world was almost completely eliminated" in the early nineteenth century by the combination of the Dutch government's retreat from free trade and reliance on tariffs, "long after all the other Caribbean powers had opened their ports to free trade,"[48] and Venezuela's counter-tariffs.[49] Even after the Dutch ended their tariffs in 1828,[50] Curaçao traders suffered greatly when, in an effort to punish the Dutch colony for failing to control or expel its political exiles living there, Venezuela adopted a higher tariff on goods shipped to its ports from Curaçao than from elsewhere.[51]

By 1909, Curaçao's decline had advanced to the point that an article describing the island could credibly be entitled "Curaçao, a Losing Colonial Venture," and conclude that "Curaçao will in time be obliged to yield to the inevitable and take the place that her geographic position and climatic conditions have ordained—a lonely island, with little political or commercial importance, and a small and poor population."[52] What little remained of the island's earlier economic prosperity came from sales to Venezuelans who visited Curaçao's free port "to trade and take their chances on being able to smuggle their purchases through the Venezuelan custom houses."[53] The depths of Curaçao's economic troubles during this period are evidenced by the fact that the only notable local industrial activities were production of women's straw hats (for which even the thatch was imported) and fishing.[54] The advent of World War I failed to revive Curaçao's flagging economic fortunes,[55] and, in fact, the war brought further stagnation of trade despite the Netherlands' neutrality.[56] Shipping at Willemstad fell from 1,500 ships and 2,800,000 tons in 1913

46. OOSTINDIE & KLINKERS, *supra* note 6, at 57.

47. HARTOG, *supra* note 19, at 278–79.

48. GOSLINGA, *supra* note 31, at 4.

49. HARTOG, *supra* note 19, at 278–79 (referring to Venezuelan duties and tariffs).

50. HISS, *supra* note 25, at 118; HARTOG, *supra* note 19, at 247–48. The various port duties were abolished first in 1826 but the governor had "set his mind against the abolition of the port-dues" and undercut the policy by instituting a "safety tax" that equaled the abolished taxes in amount. *Id.* The new tax was not abolished until the end of 1827. *Id.*

51. GOSLINGA, GÚZMAN BLANCO, *supra* note 32, at 97–99 (describing deliberate Venezuelan use of differential tariff to harm Curaçao); *id.* at 103 (describing impact of duties, reducing Curaçao's imports from over 5.5 million guilders in 1880 to just over 3.1 million in 1883, leading to an exodus by merchants).

52. Cleland, *supra* note 20, at 138.

53. *Id.* at 134, 138 (relating how Dutch subsidies of $150,000–$200,000 per year were necessary in the early 20th century); GOSLINGA, *supra* note 31, at 85 (noting that subsidies in 1868 alone were 200,000 guilders and the total between 1867 and 1881 was over 2,200,000 guilders); *see also* GOSLINGA, *supra* note 33, at 127–30 (describing importance of legitimate trade with Venezuela in 19th century and conflicts with Venezuela); *id.* at 137 (describing how a 30% tariff introduced by Venezuela in the 1880s on goods from the island but not elsewhere "hurt Curaçao bitterly and would have even more, if smuggling had not risen to the task and taken over much of the regular trade before long").

54. GOSLINGA, *supra* note 33, at 132.

55. *See id.* at 144 (discussing the war's impact on trade and creation of supply shortages).

56. *Id.*

to 248 ships and just over 680,000 tons in 1918.[57] As a result, subsidies from the Netherlands to Curaçao became increasingly necessary and reached a million guilders in 1919[58] (roughly US$6.7 million today).[59] Not surprisingly, Dutch colonial policies were soon primarily focused on "reducing financial loss."[60]

Curaçao and the other Dutch Caribbean islands likely would have "remained forgotten"[61] but for the 1914 discovery of oil at Venezuela's Lake Maracaibo.[62] This discovery alone would have had little impact on Curaçao were it not for the need for a facility to refine the Venezuelan oil and the island's possession of two characteristics that made it an appealing location for such a facility. First, Curaçao offered one of the best-protected and most strategically situated harbors in the Caribbean, only forty miles off the coast of Venezuela.[63] Second, Curaçao's Dutch administration provided a level of political stability that was lacking in Venezuela, which was a crucial concern for an oil company contemplating where to place an enormously expensive fixed asset.[64] These factors persuaded Royal Dutch/Shell, the Anglo-Dutch oil company, to begin constructing on Curaçao what was at the time one of the world's largest oil refineries.[65] Begun in 1915, completed in 1918, and brought to full capacity in 1922,[66] the refinery brought to Curaçao "a period of prosperity unparalleled even in the eighteenth century."[67] It created an employment

57. *Id.*

58. *Id.* at 144–45.

59. *See, e.g.*, NationMaster.com, Netherlands Antilles Gulden, http://www.nationmaster.com/encyclopedia/Netherlands-Antillean-gulden (last visited Nov. 13, 2009) (explaining that the Caribbean islands used a currency based on the Dutch guilder until World War II); International Institute of Social History, Value of the Guilder/Euro, http://www.iisg.nl/hpw/calculate.php (last visited Nov. 13, 2009) (calculating that one Netherlands guilder in 1919 would have been worth €5.16 in 2006); OANDA.com, FXHistory®: Historical Currency Exchange Rates, http://www.oanda.com/convert/fxhistory (last visited Oct. 11, 2009) (calculating that 1 in 2006 was worth roughly US$1.28 as of October 11, 2008).

60. OOSTINDIE & KLINKERS, *supra* note 6, at 59.

61. GASTMANN, *supra* note 39, at 9.

62. HISS, *supra* note 25, at 123; POOLE, *supra* note 40, at 133.

63. *See* Cleland, *supra* note 20 (noting the shape of the harbor and its importance in the island's development); GASTMANN, *supra* note 39, at 10 (noting that Curacao has one of the best natural harbors in the Caribbean); GOSLINGA, *supra* note 33, at 141 (noting that Venezuela "did not seem to be suitable [for a refinery] . . . due to the poor facilities characterizing all Venezuelan ports . . ."). In addition to Curaçao's other advantages, its location close to Venezuela was crucial because a sand bar at the entrance to Lake Maracaibo prevented large tankers from entering the lake. BLANSHARD, *supra* note 33, at 278. Curaçao's location also gave it an advantage in shipping refined products to the U.S. and British markets, as the island was 200 miles closer to New York and 800 miles closer to Liverpool than was Houston, Texas, a rival refining center. HARTOG, *supra* note 19, at 308.

64. BLANSHARD, *supra* note 33, at 278 ("The great European capital interests which rushed to Venezuela in the early stages of its oil boom did not trust the political rulers of that country. They feared revolution or the exaction of undue tributes. . . ."); GASTMANN, *supra* note 39, at 10; GOSLINGA, *supra* note 33 at 141 (noting that Venezuela "did not seem to be suitable [for a refinery], mainly because of its internal turmoil . . ."); Hiss, *supra* note 24, at 405 ("There was only a small market for petroleum products in Venezuela . . . the country was politically unstable . . . . Curaçao, only a short distance away, suffered none of these defects."); HISS, *supra* note 25, at 123 (describing problems in Venezuela); OOSTINDIE & KLINKERS, *supra* note 6, at 60 ("[T]he islands counted as stable and secure investment areas, unlike the notoriously unstable republic of Venezuela.").

65. For a time in the 1930s, the Curaçao refinery was the world's largest. BLANSHARD, *supra* note 33, at 279.

66. HISS, *supra* note 25, at 124.

67. GOSLINGA, *supra* note 33, at 142. *See also* Hiss, *supra* note 24, at 406 (describing oil-driven prosperity).

boom[68] and, beginning in the mid-1920s, enabled the colony to balance its budget.[69] By 1929, government revenue was "120 percent more than it had been five years before, nearly 187 percent more than it had been ten years before, and almost 540 percent more than it had been fifteen years earlier."[70] Importantly, the refinery's need for employees with financial expertise, in addition to technically skilled laborers, brought managers and accountants to Curaçao[71] and thus gave the island a nascent professional services sector. The sector expanded further when Royal Dutch/Shell relocated the headquarters of its Curaçao Oil Industry Company subsidiary to Willemstad in the 1920s.[72]

Curaçao's refinery boom stalled with the onset of the Depression in the late 1920s. Half of the plant's employees lost their jobs between 1929 and 1931, and unemployment in general reached 1,300 notwithstanding the departure of some 5,000 people from the island and its workforce.[73] By 1934, however, good times had returned,[74] and in 1941 the island had the highest level of imports per capita in the Caribbean. Just before World War II, the future of the island seemed firmly tied to the oil industry;[75] almost ninety percent of the value of Curaçao's exports in 1937 came from the refinery.[76] The refinery-driven prosperity brought immigrants from the other Dutch islands and from other Caribbean islands as well, and between 1910 and 1941 the population doubled.[77]

In summary, the first three hundred years of Dutch rule in Curaçao found the island playing a variety of roles: a financial center of sorts, a facilitator of trade, and a stable investment climate in a sea of unstable, post-colonial Latin American regimes. The Netherlands largely ignored Curaçao and the other Dutch Caribbean possessions, particularly in contrast to the much larger and more lucrative Dutch colony of Indonesia, except when the refinery returned prosperity to the island. However, Curaçao's stability, its European and Latin American connections, and its

68. HISS, *supra* note 25, at 127 ("[T]here is scarcely a family on either [Curaçao or Aruba] which is not connected either directly or indirectly with the refineries.").

69. GASTMANN, *supra* note 39, at 16 (stating that the Dutch parliament's approval was needed for deficit budgets, and so the balanced budget decreased Dutch control over Curaçao's affairs); GOSLINGA, *supra* note 33, at 144–45 (explaining that for the first time since 1816, there was no subsidy in 1924 and the years thereafter, except for 1929 when a Venezuelan rebel group assaulted Fort Amsterdam to get weapons to invade Venezuela).

70. Amry Vandenbosch, *Dutch Problems in the West Indies*, 9 FOREIGN AFFAIRS 350, 350 (1931). Some complained that the "government is run by the oil companies." HISS, *supra* note 25, at 128 (claiming it was common to hear this asserted).

71. I. Wagenmaker, *Black Gold: The Oil Industries of Aruba and Curaçao, in* HOLLAND CARRIES ON: THE NETHERLANDS WEST INDIES 40, 41 (1943) ("The majority of the executives and technicians of the Curaçao refinery are Europeans . . ."); Interview with Shulaika Paassen-Delsol, Managing Director, Paassen Delsol, in Curaçao, Neth. Antilles [hereinafter Interview, Paassen-Delsol, Paassen Delsol] (May 21, 2008).

72. GOSLINGA, *supra* note 33, at 142.

73. *Id.* at 147, 151 (describing how bad economic conditions led to a lot of outmigration of men—seasonal workers in Cuba and Puerto Rico, work in salt pans in St. Kitts, phosphate mines in French Guiana.).

74. *See* HARTOG, *supra* note 19, at 353 (stating that in 1934, trade was no longer in decline and the oil industry resumed activities).

75. HISS, *supra* note 25, at 131.

76. Calculated from HISS, *supra* note 25, app XIV, at 202 (showing that "Petroleum Products" accounted for 266,666,763 Guilders out of a total of 269,943,953 Guilders).

77. HISS, *supra* note 25, at 130.

low transaction costs helped to establish quite firmly the "financial DNA" that would lead to its later success as a jurisdiction engaged in financial intermediation.

As both others and we argue elsewhere, it is no accident that small island jurisdictions (or "virtual" islands on the mainland such as Liechtenstein and Luxembourg) have found a modern role as offshore financial centers.[78] The limited resources available to small jurisdictions create a need for economic opportunities such as those offered by financial centers. By the same token, the openness to trade that permits small jurisdictions to survive makes them well suited to exploit those economic opportunities.[79] It certainly was not inevitable that Curaçao would become an offshore financial center, for such development generally depends on factors beyond any single jurisdiction's control.[80] But it would have been surprising, given its history, if Curaçao had not at least pursued such economic opportunities.

B. The Impact of the Second World War

World War II played a critical role in establishing Curaçao as an offshore financial center and in the birth of the offshore world generally.[81] The first consequence of the war was that it brought to the attention of multinational firms the jurisdictional mechanism by which Curaçao would later profit enormously. When the Netherlands was invaded by German forces on May 10, 1940, the Dutch government fled to London and established a government-in-exile.[82] The German occupation of the Netherlands presented Dutch companies having interests outside of Europe with a two-pronged dilemma. First, some Dutch companies owned assets located in neutral countries, such as the United States at the beginning of hostilities in Europe.[83] These neutral countries may have frozen or impounded those assets.[84]

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78. Dhammika Dharmapala & James R. Hines Jr., Which Countries Become Tax Havens? 1 (May 2009) *available at* http://ssrn.com/abstract=952721 (noting that "tax havens are small countries, commonly below one million population").

79. *See* Boise, *supra* note 14.

80. *Id.*

81. *1983 Tax Evasion Hearings*, *supra* note 4, at 800 (statement of Harold Henriquez, Minister for the Netherlands Antilles Affairs, Government of the Netherlands Antilles) (explaining that "[t]he international financial sector began just prior to World War II when European companies formed Western hemisphere holding companies to prevent their non-European holdings from falling into enemy hands").

82. James H. Huizinga, *Holland in the War, in* THE NETHERLANDS (Bartholomew Landheer ed., University of California Press 1943) 411, 412–16 (describing invasion and flight). Following the invasion of the Netherlands, the Dutch Caribbean colonies declared martial law and German shipping and Germans in the colonies were seized. HISS, *supra* note 25, at 164.

83. The United States did not enter the war until December of 1941, some nineteen months after the German occupation of the Netherlands. OOSTINDIE & KLINKERS, *supra* note 6, at 44.

84. Within German-occupied territory, Dutch multinational assets were still subject to control by German-dominated entities in the occupied Netherlands. For example, after Royal Dutch relocated its statutory seat to Curaçao:

> *Reichskommisar* A. Seyss-Inquart, the highest civil authority in the Netherlands during the German occupation, picked on a technicality to declare it [the relocation] null and void. Consequently the *Verwalter* appointed to manage Royal Dutch and Bataafsche [a shipping subsidiary] had full powers to act on behalf of the concern in occupied Europe and in the countries allied to Germany, such as Romania. The *Verwalter* lost no time in appointing a new general manager, more amenable to the German demands, at Astra Romana, the Group's operating company there and that country's biggest oil producer.

Second, some Dutch companies' assets were located in Allied belligerent countries such as Britain. These governments certainly would have taken steps to seize control of those assets if there were no mechanism to legally separate the assets from entities in occupied Holland.[85] Such measures in either circumstance would have hampered Dutch companies when the war ended, since they would have been required to undertake onerous legal measures to regain control of their assets, even as non-Dutch competitors were busy rebuilding. On the other hand, the Dutch did not want merely to relocate their remaining assets to other Allied jurisdictions, since they did not want Dutch assets made subject to non-Dutch law during the turmoil of the war.[86] These twin problems were resolved in part by a Dutch statute that allowed corporations to shift their statutory seats[87] within the Kingdom of the Netherlands in the event of war, natural disaster, social upheaval and certain other calamitous events.[88] All that the statute required was that appropriate paperwork be filed in the new jurisdiction.[89]

Moreover, the idea of regulatory arbitrage to gain advantage through use of subsidiaries domiciled in useful jurisdictions was beginning to take hold in the 1930s. Esso relocated its Baltic tanker fleet from the Free City of Danzig to Panama in the 1930s to gain tax and regulatory advantages.[90] Similarly, a Norwegian-English

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2 STEPHEN HOWARTH & JOOST JONKER, A HISTORY OF ROYAL DUTCH SHELL 31 (2007). *See* William Harvey Reeves, *Displaced Corporations in Wartime—Switzerland's Answer*, 14 BUS. LAW. 205, 212–13 (1958) (discussing problems of "refugee" corporations). The Germans "by hook or by crook" soon obtained "a majority of share capital" in Dutch businesses. L. DE JONG & JOSEPH W.F. STOPPELMAN, THE LION RAMPANT: THE STORY OF HOLLAND'S RESISTANCE TO THE NAZIS 56 (1943). LOUIS DE JONG, THE NETHERLANDS AND NAZI GERMANY 36 (1990).

85. SLUYTERMAN, *supra* note 1, at 113. The Dutch government-in-exile also took such steps as forbidding the transfer of Netherlands securities without government permission and forbidding the companies that relocated to pay dividends to those who could not prove ownership of shares prior to May 1940 or could not prove permission to acquire them after that date. Wagenmaker, *supra* note 71, at 9.

86. HOWARTH & JONKER, *supra* note 84, at 31. Royal Dutch chose Curaçao in part because of a desire to keep the company's assets from being controlled by the British. Using a trust legally resident in Britain would have subjected assets to British law, while moving the statutory seat meant that "the assets remained subject to Dutch law . . . . and managers did not have to contend with outsiders who might have a different opinion about the interests of shareholders." *Id.*

87. *See* Christian Kirchner, Richard Painter & Wulf Kaal, *Regulatory Competition in EU Corporate Law after Inspire Art: Unbundling Delaware's Product for Europe,* Univ. of Illinois Law & Econ. Research Paper No. LE04–001 (2004), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=617681 (explaining that "[u]ntil very recently, many countries in the EU applied the 'seat theory' under which a corporation is governed under the corporate law of its principal place of business or 'seat'"). European law is moving toward permitting competition for corporate charters more analogous to that allowed under U.S. law. *See* ERIN A. O'HARA & LARRY E. RIBSTEIN, THE LAW MARKET 116–17 (2009).

88. Wet van 26 April 1940 STAATSBLAD VAN HET KONINKRIJK DER DEDERLANDEN [STB.] 1940 nr. 200; HOWARTH & JONKER, *supra* note 84, at 27 (noting "special legislation enacted on 8 May 1940 to transfer the legal seat of companies to the overseas territories of the Kingdom of the Netherlands in case of an emergency"). The government-in-exile took other steps to secure Dutch assets outside of occupied territories in cooperation with Allied governments. *See* Anderson v. N.V. Transandine Handelmaatschappij, 43 N.E.2d 502, 504, 507 (N.Y. Ct. App. 1942) (demonstrating the New York court's and State Department's recognition of Dutch decrees preventing transfer of ownership of assets outside occupied territories).

89. Interview, Elias, United Trust Co., *supra* note 13; Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71; Interview with Eric Andersen, Eclipse Consulting, LLC, Curaçao, Netherlands Antilles (May 19, 2008) [hereinafter Interview, Andersen, Eclipse Consulting, LLC].

90. RODNEY CARLISLE, SOVEREIGNTY FOR SALE: THE ORIGINS AND EVOLUTION OF THE PANAMANIAN AND LIBERIAN FLAGS OF CONVENIENCE 48–52 (1981). A later company history also claimed the relocation was in anticipation of Nazi expansion, although this seems likely to be primarily a revisionist claim. *Id.* at 49–50.

whaling company moved its headquarters to France and its fleet to Panama's registry to avoid double taxation and labor regulations.[91]

As war began to appear increasingly likely in the late 1930s, Dutch companies made some preparations "to ensure the continuation of their international activities" in the event of war, preparing to move their statutory seats, executives, and managers, and to establish trusts and management companies.[92] For example, "[a]s early as May 1939, the ... board [of Dutch multinational Ceteco] had issued a warrant entrusting the Curaçao managers with the overall control of the company's overseas business if and when the Netherlands should come to fall under enemy occupation."[93] Following the invasion of the Netherlands, the government-in-exile took steps to validate the legal formalities related to these moves and to appoint new executives and directors where existing ones were trapped in occupied Holland.[94] Keeping Dutch companies' international operations out of the hands of German-dominated entities back in the Netherlands also helped address the government-in-exile's pressing financial problems, by making available important revenue sources.[95] Although some of the early corporate moves were to Indonesia,[96] the directors of the giant Dutch oil company Royal Dutch/Shell chose Curaçao because of the company's refinery operations there, moving both the statutory seat and a number of other international companies that formed part of the Royal Dutch/Shell group to the Antilles.[97]

The convergence of war-related problems faced by Dutch multinationals and the Dutch law permitting the relocation of corporate statutory seats within the Kingdom presented an unprecedented opportunity that was quickly recognized and seized upon by a Dutch notary Anton Smeets.[98] He persuaded a number of other Dutch multinationals to follow the lead of Royal Dutch/Shell and relocate their statutory seats to Curaçao.[99] Smeets viewed Curaçao as the ideal site for relocated

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91. *Id.* at 60.

92. HOWARTH & JONKER, *supra* note 84, at 29 (describing how Philips and Unilever set up overseas trusts by the summer of 1939, and noting that "[m]anagers of the big Dutch multinationals held regular meetings to discuss joint political, legal, and financial problems and such an important subject as the legal preparations for war will have figured at those meetings."). Unfortunately, "[t]he history of Dutch business outside the Netherlands during the Second World War" remains "largely unexplored territory." SLUYTERMAN, *supra* note 1, at 122.

93. JONKER & SLUYTERMAN, *supra* note 2, at 253.

94. SLUYTERMAN, *supra* note 1, at 114; JONKER & SLUYTERMAN, *supra* note 2, at 253.

95. *See* SLUYTERMAN, *supra* note 1, at 114.

96. Shell, History of Shell in Indonesia, http://www.shell.com/home/content2/id-en/about_shell/who_we_are/history_of_shell_indonesia_0905.html (last visited Nov. 19, 2009).

97. HOWARTH & JONKER, *supra* note 84, at 29.

98. A notary is a Dutch independent legal professional appointed by the Crown for life who records legal agreements, either because the law requires it or at the parties' request. All notaries are law graduates and are experts in family law, succession law, corporate law and property law. The formal document drawn up by a notary, known as a notarial instrument, constitutes definite proof that the date and the parties' signatures to the relevant legal documents are correct. The notary retains the original notarial instrument and issues certified copies to each party. A specially endorsed copy, known as the execution copy, provides the same conclusive evidence of title as a court judgment. *See* DeNotaris, Royal Dutch Notarial Society (KNB) *available at* http://www.notaris.nl/page.asp?id=355 (last visited June 24, 2008). Lawyers have played roles similar to Smeets' in legal competition within the United States. *See* O'HARA & RIBSTEIN, *supra* note 87, at 68–71 (an overview of the choice-of-court ability in the American legal system).

99. James O'Shea, *Wall Street Helped Open 'Antilles Window'*, CHICAGO TRIB., Nov. 21, 1982, at S5.

statutory seats because the island was relatively secure and an extremely important strategic asset for the Allies. The United States would not allow Curaçao's refinery, which turned Veneuzelan heavy crude into fuels critical for the war effort, to fall into Axis hands.[100] By contrast, the location of the other major Dutch colony—Indonesia—put it squarely at risk of a Japanese invasion.[101] A significant number of Dutch companies Smeets approached agreed to transfer their statutory seats to Curaçao.[102] Since these multinationals had directors outside of the Netherlands, they were able to authorize Smeets to act for them in Curaçao and the relocations were quickly accomplished, thus keeping their overseas assets outside of occupied territory and safe from German control.[103]

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100. Interview, Elias, United Trust Co., *supra* note 13; BLANSHARD, *supra* note 33, at 273 (describing defense arrangements during war with United States troops stationed on Curaçao within a month of Pearl Harbor); POOLE, *supra* note 40, at 128 (describing defense arrangements during war, with United States troops stationed on Curaçao within a month of Pearl Harbor); HISS, *supra* note 25, at 174 ("The rise of air power has doubled the significance of the West Indian islands not only as defenses for the Panama Canal but also as stepping stones to the South American continent, an importance which cannot be overemphasized."); E. Elias, *The Hub of the Caribbean, in* HOLLAND CARRIES ON: THE NETHERLANDS WEST INDIES 38, 38 (1943) (quoting Dutch Minister for the Navy in 1942 that "Curaçao is of vital importance for keeping intact the communications across the Caribbean; it is highly important for defensive as well as offensive operations."). The Dutch Antilles generally were seen as "an essential link in the American defense periphery" after the U.S. entered the war in 1941:

> The gold reserves of the Bank of Curaçao, about eight and a half million guilders, were shipped to the United States for safe-keeping. The Americans modernized the airports and made them feasible for bombers. Blackouts became mandatory and iron nets were lowered in St. Ann Bay and others to prevent the German U-boats, which seemed to be everywhere, from entering. Although there was never any overt danger of German occupation, many tankers sailing to and from the islands were torpedoed and sunk by the enemy. In February 1942, a refinery was even bombed. For some time in 1941 and 1942, these attacks came close to paralyzing the transport of oil. Oil, of course, was too important to allied warfare for any chances to be taken. . . . The refineries on both islands increased production, with the SHELL reaching 30,000 tons daily. Curaçao and Aruba provided the allied forces with 80 per cent of their high-octane fuel needs. It is no exaggeration to say that the gasoline refined on Curaçao and Aruba fed the war.

GOSLINGA, *supra* note 33, at 149. BLANSHARD, *supra* note 33, at 273 (noting U-boat attacks on Curaçao and terming submarine warfare in the Caribbean "very serious business."); HISS, *supra* note 25, at 169 (describing the torpedoing of tankers and submarine attempts to shell the refinery at Curaçao). *See also* OOSTINDIE, *supra* note 21, at 88–89 ("The Curaçaoan and Aruban oil refineries produced a significant amount of the fuel that was so vital for Allied forces . . . .").

101. Indonesia fell to the Japanese in early 1942 and was occupied through the end of the war. DE JONG, *supra* note 84, at 66. *See also* Huizinga, *supra* note 82, at 422–23; DE JONG & STOPPELMAN, *supra* note 84, at 321 (noting that the Dutch anticipated a Japanese attack); SLUYTERMAN, *supra* note 1, at 123 (business activities in Indonesia "came to an abrupt halt with Japan's lightning advance through Asia starting in December 1941."); DE JONG, *supra* note 84, at 59 (explaining that the Dutch cabinet had wanted to move the seat of government to Indonesia but Queen Wilhelmina refused to agree).

102. *1983 Tax Evasion Hearings*, *supra* note 4, at 800 (statement of Harold Henriquez, Minister for the Netherlands Antilles Affairs, Government of the Netherlands Antilles).

103. HARTOG, *supra* note 19, at 317 (relocation of Shell). The Germans took steps to gain control of the Dutch economy, requiring all shares in foreign businesses to be registered: dollars, Swiss francs, and Swedish crowns had to be surrendered; interest and dividends due to Dutch holders of German shares were payable only through a special clearing house; loans to German borrowers had their interest rates lowered to 4%; and other measures. DE JONG & STOPPELMAN, *supra* note 84, at 54; Interview, Elias, United Trust Co., *supra* note 13; Interview with Hermann Behr, HBM Group, in Curaçao, Netherlands Antilles (May 19, 2008) [hereinafter Interview, Behr, HBM Group]; Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71; Interview, Andersen, Eclipse Consulting, *supra* note 89 (some companies relocated to Sint Maarten as well); *see also* Hiss, *supra* note 24, at 408 ("many large Netherlands corporations have

Smeets's idea had important consequences for the Antilles. One longtime Curaçao attorney termed Smeets "a visionary" for conceiving of Curaçao as an offshore center at a time when there was relatively little corporate infrastructure on the island.[104] The transfer of the statutory seats of Dutch multinationals produced demand in Curaçao for corporate services and the small existing professional and legal infrastructure of accountants, lawyers, managers, and notaries began to develop to support the relocated companies.[105] Smeets created CITCO, now one of the leading international offshore management companies, to provide such services in Curaçao.[106] In short, an emergency wartime legal maneuver set the stage for the development of the offshore sector in the post-war years by creating the human capital in Curaçao necessary to conduct business affairs and demonstrating to businesses worldwide that location of entities in Curaçao was both feasible and potentially beneficial.

A second important development during World War II was that the Antilles guilder became linked to the U.S. dollar.[107] As a result, trade became increasingly oriented toward the United States rather than to the Netherlands. Even before the war, just under half of non-petroleum imports had come from the United States and only a fifth from the Netherlands.[108] This increased flow of goods and services between the United States and the Antilles would help facilitate transactions between the two countries following the war.[109]

A final war-era development was a growing demand for autonomy in Curaçao, as well as in the other Dutch colonies.[110] Recognizing this demand, the government-in-exile in London announced plans for a post-war conference aimed at, as the Queen put it in a major address, "a commonwealth in which The Netherlands, Indonesia, Suriname, and Curaçao will participate, with complete self-reliance and freedom of contract for each part regarding its internal affairs but with the readiness to render mutual assistance."[111] What form this new post-war governance structure would take was unclear, but the Queen's speech suggested that considerable sovereignty would be shifted from the Netherlands to the non-European territories,

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moved their offices to the West Indies").

104. Interview, Elias, United Trust Co., *supra* note 13.

105. Interview, Behr, HBM Group, *supra* note 103; Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71.

106. Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71.

107. Prior to the war, notes denominated in Dutch guilders were issued by Curaçaoan banks. *See* NationMaster.com *Netherlands Antilles Gulden*, http://www.nationmaster.com/encyclopedia/Netherlands-Antillean-gulden (last visited Oct. 11, 2009). After the war these were replaced by Antillean gulden which were not linked to the Dutch currency. *Id.*

108. Calculated from figures in HISS, *supra* note 25, app. XI, at 198.

109. OOSTINDIE, *supra* note 21, at 89; HARTOG, *supra* note 19, at 361.

110. GASTMANN, *supra* note 39, at 22–23, 35–36 (discussing growth in demand for autonomy as a result of war); GOSLINGA, *supra* note 33, at 149 (discussing growth in demand for autonomy as a result of war); ANK KLOMP, POLITICS ON BONAIRE: AN ANTHROPOLOGICAL STUDY 68 (1986) ("The war years brought increased political awareness to the Antilles. The economic prosperity of that period, the necessarily increased autonomy of the region during the time when the Netherlands were occupied by Germany, and the universally heard cry for independence all fanned the desire for self-government on the islands.").

111. GASTMANN, *supra* note 39, at 25 (quoting Queen's Speech of Dec. 7, 1942); *see also* GOSLINGA, *supra* note 33, at 169 (discussing reaction to Queen's Speech); DE JONG, *supra* note 84, at 66–67 (noting that the Queen felt the speech "went too far"); OOSTINDIE & KLINKERS, *supra* note 6, at 67 (discussing the debate between the Queen and her cabinet over content of speech).

an idea that quickly took hold among island leaders.[112] The important features of the constitutional framework that eventually emerged following the war remain essentially intact today.[113] This framework figured importantly in both the development and limitation of Curaçao's offshore financial capabilities as discussed in the next section.

C. *Jurisdictional Foundations*

Although the Queen's 1942 speech called for a new constitutional framework for the Kingdom, it left the exact structure of that framework for later negotiations. Those negotiations took place within a narrower range than did contemporaneous discussions elsewhere in the Caribbean. On the one hand, there was broad agreement within the Dutch Caribbean territories that independence was not a serious option.[114] Local leaders in the Dutch Caribbean believed that "the political assistance of Holland in obtaining financial aid and loans" would be crucial to post-war development and that "the economic stability of their homeland would be easier to preserve within the framework of a large nation than in a feeble federation of miniscule islands."[115] On the other hand, there also was agreement that the French solution of incorporating the Caribbean territories directly into the European nation was unacceptable.[116] Thus both Dutch and Caribbean negotiators sought a middle ground between independence and incorporation.

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112. OOSTINDIE & KLINKERS, *supra* note 6, at 74 (stating that "autonomy was the ultimate goal" for Antillean politicians). Curaçao's leading politician, M. F. da Costa Gomez, argued that the Dutch needed to emulate the more flexible British approach to sovereignty, allowing it to be divided with the colonies, instead of maintaining their rigid approach. GASTMANN, *supra* note 39, at 35–36.

113. OOSTINDIE, *supra* note 21, at 90. Suriname became independent on November 25, 1975. Aruba formed a direct relationship with the Kingdom, as its separate colony, on January 1, 1986 with the understanding (later rescinded) that the island would achieve independence in 1996. *See* Armando Lampe, *The Recolonisation of Aruba*, *in* ISLANDS AT THE CROSSROADS: POLITICS IN THE NON-INDEPENDENT CARIBBEAN 106, 107–08 (Aaron Gamaliel Ramos & Angel Israel Rivera eds., 2001) (discussing Aruba's status). The remaining five islands are in the midst of a transition that will ultimately eliminate the Antillean level of government, but the overall structure for the relationship between Aruba, Curaçao, Sint Maarten, and the Netherlands remains intact. Press Release, Government of the Netherlands, Curaçao and St Maarten to Have Country Status (Nov. 3, 2006), *available at* http://www.government.nl/News/Press_releases_and_news_items/2006/November/Cura_ao_and_St_Maarten_to_have_country_status.

114. The Dutch also left independence of the overseas territories off the table, with a government wartime pamphlet stating that the "all important principle" of constitutional development was "the principle of unity, the indivisibility of the Kingdom of the Netherlands, by which is not meant the Territory in Europe—what is generally called Holland—or any of the Overseas lands, but all these Territories together." J. H. Boas, *Constitutional Development in* HOLLAND CARRIES ON: THE NETHERLANDS WEST INDIES 47, 47 (1943).

115. GASTMANN, *supra* note 39, at 104; *see also id.* at 2–3 (noting that the Caribbean territories accepted the Kingdom structure rather than demanding complete independence, because in the early 1950s their leaders believed "that their countries were too weak to stand alone" and because "the most important politically articulate groups in that period were not anti-Dutch" and included many of Dutch ancestry). Antillean Prime Minister Efrain Jonckheer told the United Nations in November 1955 that the Antilles preferred remaining in the Kingdom to independence "because this would . . . not serve the interest, the advantage and security of the small conglomeration (of islands) in the situation in which the world at present finds itself . . . ." *Id.* at 102. Curaçao's representative in the government in exile in London during the war, and an important local political leader, Dr. M. F. da Costa Gomez was quoted in a wartime pamphlet as saying that "Curaçao is not a separate dominion (staatsdeel); it is the Netherlands in the tropics, waiting for Dutch initiative in favor of closer organic cooperation, in order to extend and broaden our unique community of nations." J.H. Boas, *supra* note 114, at 47.

116. OOSTINDIE & KLINKERS, *supra* note 6, at 80–81; *see generally* Boise, *supra* note 14 (describing

The constitutional structure ultimately proposed by the Dutch as a basis for association with its former colonies was developed with the objective of keeping Indonesia within the Kingdom, not with the well-being of the Caribbean territories in mind.[117] Nonetheless, the Antilles could insist on being treated in the same way as Indonesia, which ultimately worked to Curaçao's advantage, as it led to the Antilles having formal equality with the Netherlands within the Kingdom. Given that the Netherlands had over seventy times the Antilles' combined population in the 1940s, while Indonesia's population was more than seven times larger than the Netherlands',[118] this was a significant benefit for Curaçao. Thus, the Dutch focus on Indonesia resulted in a greater degree of autonomy for the Caribbean territories than they might otherwise have had.

Eventually, in 1949, the Netherlands was forced to accept Indonesia's complete independence.[119] Thereafter, the Dutch government became intensely focused on restructuring the relationship between the Netherlands and the Caribbean territories, both the Antilles and Suriname.[120] Although there were some difficulties over creating a tie-breaking mechanism for the Kingdom government, as well as over recognition of the right to secede (the Surinamese delegates wanted to explicitly recognize the right, while the Dutch preferred to leave it implicit in the document),[121] the overall formal process of negotiations "went relatively smoothly."[122] The six Dutch Caribbean islands were to be united into a single political unit called the Netherlands Antilles rather than Curaçao (as the islands collectively had been known

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pursuit of that status by three of the islands currently in the Antilles).

117. OOSTINDIE, *supra* note 21, at 91; OOSTINDIE & KLINKERS, *supra* note 6, at 62 (observing that Antilles were able to benefit "from the far-reaching concessions made in vain to the East Indies . . ."); *id.* at 217 (stating that Charter "had in actual fact been designed during World War II with the specific purpose of winning over nationalist opposition in the major Dutch colony of Indonesia."). After a rocky start in 1948 that saw telegrams being sent by some of the Antillean delegates to the United Nations and Pan American Union appealing for "aid in their struggle to rid themselves of colonial oppression," the Caribbean and Dutch delegates agreed on a framework for discussions that would give each country the autonomy to create its own constitution and an overall Kingdom government. The Kingdom government would consist of the monarchy, a Kingdom cabinet in which Suriname and the Antilles would be represented with at least one member, a supreme court of the Kingdom to decide constitutional issues, a bicameral legislature combining the local legislatures, and a representative of the monarchy in the Caribbean countries with "the power of supervision." GASTMANN, *supra* note 39, at 66–67; *see also* OOSTINDIE & KLINKERS, *supra* note 6, at 76–88 (discussing conferences). Because the Dutch did not want to create a permanent structure for the Kingdom until they had resolved the situation in Indonesia, the Dutch government issued interim orders to amend the Staatsregelingen (constitutions) of the Caribbean territories to provide increased autonomy on an interim basis in early 1949. GASTMANN, *supra* note 39, at 69; GOSLINGA, *supra* note 33, at 170–71. These interim orders provided for local review of Dutch Parliamentary acts affecting the territories, limited Kingdom powers over internal matters, and created an independent judiciary. GASTMANN, *supra* note 39, at 70. They also dramatically democratized the islands' governments. The number of qualified voters rose from 5,000 to 65,000 with the introduction of universal suffrage in 1948–49. POOLE, *supra* note 40, at 177; *see* OOSTINDIE, *supra* note 21, at 88 (discussing universal suffrage in the Antilles and Suriname in 1948).

118. HISS, *supra* note 25, at 182.

119. ADRIAN VICKERS, A HISTORY OF MODERN INDONESIA 112 (2005).

120. OOSTINDIE, *supra* note 21, at 89–90.

121. GASTMANN, *supra* note 39, at 88–89. Allowing revisions to the Charter to be accomplished easily and shifting the issue into the section dealing with amendments from the preamble resolved the secession issue. *Id.* at 91–92.

122. OOSTINDIE, *supra* note 21, at 90.

previously). This unit would be one of three constituent parts of the larger Kingdom, along with Suriname and the Netherlands.[123]

This decision gave rise to what would become the most important issue for the Antilles; namely, how to structure a new pan-island government.[124] The smaller islands feared that Curaçao would dominate the joint Dutch-Caribbean institutions because of its greater size.[125] For example, Aruba insisted that the price for its participation in a six-island political unit be equal representation with Curaçao in joint institutions.[126] Resolving this issue played a role in determining the overall structure of the Kingdom government, since creating separate federal structures would have presented significant challenges for both the Kingdom and the Antilles. The former would have been required to subsidize the expense of three separate layers of government, while the latter would have been required to produce from their populations enough qualified people to fill them.[127]

The dilemma was resolved by relying on Dutch institutions augmented with Caribbean members to serve as the Kingdom-level parliament and cabinet, thus limiting the number of new Kingdom institutions. The result was a Kingdom that was "a federative structure with confederative traits."[128] The "principal Kingdom institutions" were to be the monarchy (represented by a governor in Caribbean territories), the Council of State, the Council of Ministers (the Cabinet), the States General (Parliament), and the High Court of Justice of the Netherlands.[129] Although the Kingdom would be treated as one nation under international law, it would allow

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123. GASTMANN, *supra* note 39, at 66–68.

124. *Id.* at 73–74. *See also* GOSLINGA, *supra* note 33, at 174 ("[T]he political problematic is decided by island individualism. There are island interests and an insular mentality.").

125. GASTMANN, *supra* note 39, at 104 ("In the Antilles the smaller islands wanted countervailing power to prevent Curaçao from dominating them both politically and economically.").

126. *Id.* at 57. An example of the disputes was the police controversy over whether new policemen for Aruba would be recruited in Holland or Curaçao when there were no local applicants. *Id.* at 56–57.

> The central concept of the Island regulations, adopted by the Dutch Government in 1951 after the proposals of the Staten had been carefully studied, was that each of the four island areas created by the regulation, namely, Curaçao, Aruba, Bonaire, and the Windwards [Sint Maarten, Sint Eustatius, and Saba], should have complete freedom to govern themselves and make their own laws. Only a limited number of matters explicitly stated in the island regulations was left to the authority of the Central Government in Willemstad [on Curaçao]. These matters concerned immigration, justice, currency, post and telegraph, and control over the police force of the Antilles.

Id. at 74. The result was "an advantage" for the other islands over Curaçao despite Curaçao's larger size. GOSLINGA, *supra* note 33, at 172.

127. The manpower issue was a serious one. One local Curaçao newspaper opined that:

> For the introduction of the new constitutional structure . . . already the former Governor had calculated that forty persons were needed to occupy the key positions and the maximum number of people who are available are not even five . . . .

GASTMANN, *supra* note 39, at 59 (quoting *Vrome Wensen voor de Nederlandse Antillen*, AMIGOE (Curaçao), June 21, 1949). Although in the initial 1948 draft of the Kingdom Charter there had been a separate Kingdom government, the 1952 draft instead "let Dutch institutions function as Kingdom institutions," augmented with representatives of Suriname and the Antilles. Both Dutch and Caribbean delegates accepted this compromise because the expense of a new level of government seemed unnecessary in light of the Kingdom's limited responsibilities. *Id.* at 87.

128. GASTMANN, *supra* note 39, at 4.

129. *Id.* at 109.

each of its constituent parts virtually complete autonomy over all but a few matters.[130] Crucially, each jurisdiction within the Kingdom had almost complete legal autonomy on fiscal matters,[131] which allowed the Antilles government to later create its innovative offshore tax regime.

The "mixture of moral and largely pragmatic considerations" in designing the Kingdom, however, left a "democratic deficit" regarding the Caribbean territories as the Kingdom ministerial council was not responsible to any Kingdom legislative body and so was dominated by the Dutch.[132] The Kingdom ministerial council made the government more responsive to Dutch politics than to the non-European polities' needs.[133] While the overall constitutional result was what one analyst has termed "a remarkable document," it was one with a "far from watertight construction" since it rested on a "remarkable fiction, namely the fiction of the complete equality of the *de facto* unequal partners in the Kingdom."[134] Crucially, while the Caribbean jurisdictions gained the autonomy they sought, they did not get "too much" autonomy, which likely would have been problematic for the growth of the offshore sector. Investors would need assurance that their investments were safe, and Antilles' maintenance of close ties to the Dutch provided that assurance.[135] But this reassurance came at a price: foreign affairs, defense, Dutch nationality, and "the guarantee of fundamental human rights and freedoms, the rule of law and good governance" were specifically made Kingdom responsibilities.[136]

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130. *See id.* at 2.

131. As one historian noted:

> The countries are completely autonomous in formulating their internal economic policy and as far as their own finances are concerned the Caribbean States are quite independent of the Netherlands. They issue their own currency and determine its value, without interference from The Hague. There is no Kingdom Treasury .... [T]he lack of a common treasury and the fact that the Caribbean countries regulate their own currency give them a financial independence which is rare in federal states of today.

Id. at 115; ANDIC & ANDIC, *supra* note 25, at 171 ("Politically, the Netherlands Antilles have enjoyed ... virtual autonomy in domestic affairs since 7 February 1951 ...."). The result satisfied the United Nations, which exempted the Netherlands from further reporting on the process of decolonization after December 1955. Rita Giacalone, *The Political Status of Curaçao at the End of the Twentieth Century*, *in* ISLANDS AT THE CROSSROADS: POLITICS IN THE NON-INDEPENDENT CARIBBEAN 95 (Aaron Gamaliel Ramos & Angel Israel Rivera eds., 2001).

132. OOSTINDIE & KLINKERS, *supra* note 6, at 85–86.

133. *Id.* ("Care had been taken to ensure that almost complete power over the affairs of the Kingdom remained on the European side of the Kingdom ....").

134. OOSTINDIE, *supra* note 21, at 90–91. The Charter was well received in the Western European and American press. The *New York Times* called the new Charter "one of the most interesting developments in the whole story of the modification of former 'colonial' structures." *Id.* (quoting Editorial, *New Caribbean Autonomy*, N.Y. TIMES, Dec. 16, 1954, at 36).

135. One area that investors are particularly concerned about with respect to offshore jurisdictions is the stability of the court system that will adjudicate their disputes. In the Netherlands Antilles, judges were appointed by the Queen and had life tenure (albeit with retirement at age 60). This gave the judges a substantial degree of independence from local politics. GOV'T. INFO. SERV. (Neth. Antilles), THE NETHERLANDS ANTILLES 30 (1961). In 1961, the Antilles adopted a statute making the Netherlands High Court the "court of cassation" for Antillean courts under Article 23 of the Charter. GASTMANN, *supra* note 39, at 114 (noting that in civil law jurisdictions, this is the court of final appeal). This remains an important selling point for the Antilles offshore sector.

136. OOSTINDIE, *supra* note 21, at 90 (quoting Charter art. 43, citing art. 3).

The Dutch cabinet, augmented by Caribbean ministers, served as the Kingdom Cabinet while the Dutch Parliament, augmented by Caribbean members, served as the Kingdom Parliament.[137] Of particular significance for the future of the Netherlands Antilles' offshore financial center aspirations was the power the Dutch retained over foreign affairs.[138] This would contribute to an overall lack of flexibility in responding to developments in the offshore world because Curaçao was left dependent on the Dutch-dominated Kingdom government for approval of tax treaties. The tax treaties were a subject where Dutch and Antillean interests did not always coincide. Moreover, the Dutch retained other important measures of control, continuing, for example, to appoint Dutch rather than Antillean governors of the Antilles for years.[139] As one assessment concluded, the Dutch maintained considerable control because "The Hague stuck to a policy of pulling the strings."[140]

Why did the Netherlands agree to *de jure* equality with the Antilles (and Suriname) within the Kingdom? There were no major economic benefits for the Netherlands in maintaining a relationship with the Antilles,[141] although some particular Dutch interests did benefit from continuing ties with the islands.[142] The scholarly consensus is that the Dutch agreed to the Charter based on both economic and charitable motivations.[143] The cost to the Netherlands of *de jure* equality was minimal given *de facto* Dutch control of the Kingdom institutions. Further reducing the cost to the Dutch was their expectation that the Charter structure would not prove long-lived and would eventually be followed by "a looser union."[144] Nonetheless, the compromise was successful in addressing the most pressing needs of its constituents—"three countries that had rather little to do with each other"[145]—as the "Charter worked more or less smoothly" throughout the 1950s and 1960s.[146]

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137. GASTMANN, *supra* note 39, at 66–67.

138. *See id.* at 114 (citing Charter art. 3) (discussing the requirement of Kingdom involvement in treaties).

139. OOSTINDIE & KLINKERS, *supra* note 6, at 73 ("For example, no consideration was given to questions such as the appointment of a native . . . Antillean Governor.").

140. *Id.*; *see also* Giacalone, *supra* note 131, at 101 (observing that the Dutch channeling of aid through Antilles government "expanded the Dutch influence within the island system").

141. GASTMANN, *supra* note 39, at 4; OOSTINDIE & KLINKERS, *supra* note 6, at 10 (noting that the Antilles "had little economic significance to the metropolis, and this would remain the case"); OOSTINDIE, *supra* note 21, at 21 ("The balance sheet of Dutch colonialism in 'the West' is utterly delusional. A world that was created to make profits generated mainly ever-growing losses.").

142. GASTMANN, *supra* note 39, at 3–4.

143. *Id.* ("[T]here existed in Holland a feeling, expressed by church groups and humanitarian movements that the well-being of the people [in the colonies] should be the primary concern of the colonial administration. Many of the civil servants had always considered that their primary duty was towards the colonial people. These men had more influence in shaping policy than [those who argued it was all due to economic interests] realized."); OOSTINDIE & KLINKERS, *supra* note 6, at 74 (arguing that "[e]conomic interest is no credible explanation" for Dutch willingness to continue association with the Caribbean territories but not finding any other strong explanation beyond "a feeling that a mission needed to be accomplished" and that the territories needed to be protected from territorial claims by Venezuela and Brazil).

144. GASTMANN, *supra* note 39, at 4. These doubts continue with the discussion of the Charter in Professor Oostindie's recent history of the Dutch Caribbean entitled "Pit Stop or Finish?". *See* OOSTINDIE, *supra* note 21, at 91 (questioning whether the Charter will survive).

145. OOSTINDIE & KLINKERS, *supra* note 6, at 218.

146. OOSTINDIE, *supra* note 21, at 92. There was some effort by the Caribbean territories to increase their role in Kingdom affairs, but the Dutch "would not make any real concessions" at a 1961 roundtable on the issue, with The Hague insisting that it retain control of Kingdom foreign affairs. OOSTINDIE & KLINKERS, *supra* note 6, at 90.

Importantly, its concept of formal equality created jurisdictional space for the development of an offshore financial sector in the Netherlands Antilles.

II. THE ARC OF ANTILLEAN FINANCIAL INTERMEDIATION

We now turn to how this new autonomy, the wartime experience with the relocated multinationals, and the island's history combined to create the opportunity for the development of an offshore financial center.

A. The Economic Need to Create an Offshore Sector

At the close of the war, Curaçao had what was likely the highest standard of living among Caribbean colonies, due to the refinery's provision of regular, well-paid employment for large numbers of Curaçaoans.[147] This refinery-based prosperity continued for a decade after the war, but after 1958 the refinery proved to be an unstable foundation for economic prosperity. The islands faced "great economic difficulties" as Venezuela began to insist on greater investment in its own refining capacity in exchange for access to its oil.[148] By limiting oil imports under the Mandatory Oil Import Program (MOIP), the United States caused the refineries in the Antilles to begin to face demand constraints.[149] Far from the prosperity of the immediate post-war period, a visiting Dutch Parliamentary commission in 1959 found "great social, economic, and political neglect" in the Antilles.[150] Despite these problems, however, GDP per capita in the Antilles was US$11,495 in 1960, the second highest in the Caribbean.[151]

The Antilles' economic problems worsened during the 1960s. Unemployment in the islands rose from fourteen percent of the labor force in 1961 to twenty-four to twenty-seven percent of the labor force in 1966,[152] remaining above twenty percent

147. BLANSHARD, *supra* note 33, at 277. *See also* POOLE, *supra* note 40, at 179 (1951 book concluding that "[i]n the final analysis . . . the future economic prosperity of the islands depends almost entirely upon the petroleum industry").

148. OOSTINDIE & KLINKERS, *supra* note 6, at 89–90.

> After the fall of [Venezuelan president] Marcos Pérez Jiménez in [1958], the Venezuelan government embarked on an extensive program of refining its own oil, although scrupulously observing existing contracts with SHELL and LAGO. Yet, a tacit understanding was reached with these companies not to expand their refineries on the islands. Concomitantly, both SHELL on Curaçao and LAGO on Aruba initiated a process of automation which, for the first time since the Great Depression of the early thirties, caused a downward trend in the labor force.

GOSLINGA, *supra* note 33, at 175. *See also* GASTMANN, *supra* note 39, at 140 (describing how the mechanization of oil industry caused economic dislocations); HOWARTH & JONKER, *supra* note 84, at 41 (noting agreement by Royal Dutch/Shell to "limit the processing capacity of Curaçao to 200,000 b/d or 10.4 million tons a year" in response to Venezuelan demands to increase refining domestically).

149. ANDIC & ANDIC, *supra* note 25, at 177. *See* Andrew P. Morriss & Nathaniel Stewart, *Market Fragmenting Regulation: Why Gasoline Costs So Much (and Why It's Going to Cost Even More)*, 72 BROOK. L. REV. 939, 991–1001 (2007) (discussing the history of the MOIP).

150. GOSLINGA, *supra* note 33, at 152.

151. OOSTINDIE & KLINKERS, *supra* note 6, at 154.

152. ANDIC & ANDIC, *supra* note 25, at 173.

for the balance of the decade.[153] Per capita GDP fell fifteen percent in real terms between 1957 and 1965.[154] Exacerbating the economic problems, just as the refinery workforce was falling dramatically from 13,000 laborers in 1952 to less than 4,000 in 1967, the island's population was rapidly increasing, growing by almost thirty-five percent in the same period.[155] Moreover, the close relationship between the rest of the industrial economy and the refining sector meant that as the latter declined so did the former.[156] This combination pressured the Antilles government to find economic development projects and, in response, it "made a serious attempt to create a favorable climate for investment," focusing on tourism,[157] the creation of temporary monopolies to be offered as a lure for investment, and appeals to The Hague for development aid.[158] Despite some limited successes, a review in 1975 by the central bank concluded that 1969–74 had been a period of falling prosperity, largely due to declining employment at the refinery.[159]

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153. GOSLINGA, *supra* note 33, at 177 (noting that unemployment was substantial in the 1960s, ranging from 18 percent of the labor force of 55,000 in 1964 to 20 to 25 percent of the labor force of 73,000 in 1970).

154. ANDIC & ANDIC, *supra* note 25, at 174.

155. GOSLINGA, *supra* note 33, at 175. Although the refinery workforce on Curaçao was in decline, the Royal Dutch-Shell Group remained at the time "the second largest oil organization in the free world, operating in more than ninety countries through 500 associated companies." *Profit Is Raised for Royal Dutch*, N.Y. TIMES, March 3, 1962, at 25.

156. ANDIC & ANDIC, *supra* note 25, at 177.

157. GOSLINGA, *supra* note 33, at 175. Initial post-war assessments suggested that Curaçao's appeal to tourists was limited, with one concluding that while "Curaçao is a beautiful sight in the sun with its clean tinted buildings . . . few tourists would care to spend more than a day there." BLANSHARD, *supra* note 33, at 71. But in the early 1960s, Curaçao experienced a small boom in tourism as cruise ships drawn by the available cheap fuel arrived in increasing numbers, a luxury hotel was built, and a growing number of U.S. tourists visited. Early cruises stopped at Curaçao for the cheap fuel available at the refinery. HARTOG, *supra* note 19, at 325. The scale was still small enough that construction of a 124-room hotel merited significant attention in a government brochure on the economy in 1961. GOV'T. INFO. SERV. (Neth. Antilles), *supra* note 135, at 39.

158. GOSLINGA, *supra* note 33, at 175. The incentives for new industry were not particularly successful, in part because the domestic market was too small to support additional industry and in part because of "lack of coordination between the levels of government." ANDIC & ANDIC, *supra* note 25, at 179. The appeals for aid were successful in attracting funds from Europe, particularly once the Antilles' participation in the European Common Market (beginning in 1964) made the island eligible for additional development aid. GOSLINGA, *supra* note 33, at 176–77. The Antilles' associate membership was two years behind Suriname's, largely because of disputes over oil exports from Curaçao's refinery, which were settled by an agreement to allow the E.E.C. to impose a tariff on the oil products "in case of market disturbances." ANDIC & ANDIC, *supra* note 25, at 172. The Kingdom adopted a 114 million guilder (US$275.2 million) "Urgency Plan" for Curaçao and Aruba in the 1960s to support construction of roads, airport improvements, water plants, and other infrastructure, and the Netherlands picked up the tab for two thirds of the development projects. GOSLINGA, *supra* note 33, at 177; ANDIC & ANDIC, *supra* note 25, at 172. Unfortunately, while the aid did improve living standards in the Caribbean territories, it did not "[lead] to noticeable developments in terms of economic viability and self-sufficiency. . . ." OOSTINDIE, *supra* note 21, at 94. Efforts to promote foreign investment suffered a blow when the 1964 revision of the tax treaty between the Netherlands and the United States "eliminated most of the incentives offered to the investor." GOSLINGA, *supra* note 33, at 176; *see infra* note 265 and accompanying text. Nonetheless, overall capital investment continued to increase, although not by enough to provide a sufficient substitute for the decline in the refinery's labor force.

For the currency conversions, we converted a Dutch guilder in 1965 to 2.15 guilders in 2006 and then converted it to U.S. dollars as of Oct. 11, 2008 (calculated by the currency calculator of the International Institute of Social History, http://www.iisg.nl/hpw/calculate.php (last visited Nov. 13, 2009)). In 2006 1 guilder was worth roughly US$1.28. *See* OANDA.com, *supra* note 59.

159. BANK VAN DE NEDERLANDSE ANTILLEN, REPORT ON THE PERIOD 1969/1974 5–8 (1975); GOSLINGA, *supra* note 33, at 175. Similarly, a 1968 analysis of the Antilles' economy concluded that "the

The island's economic problems played a major role in riots in the capital city of Willemstad on May 30, 1969. The city "burst into flames" and the intervention of Dutch troops was required to restore order.[160] The riots damaged the Netherlands' international reputation, as they became "[f]ront-page news in the international press ... with photographs of military patrols on the streets of Willemstad," publicity which significantly "undermined the progressive image the Netherlands liked to present of itself."[161] The May riots led to the Dutch government "quite suddenly mov[ing] to the active pursuit of independence for its Caribbean territories."[162] The Minister for Surinamese and Antillean Affairs made clear that the Dutch viewed the two countries as an economic liability, speaking of the "millions of guilders" the Netherlands put into them annually.[163] Indeed, the Dutch spent 900 million guilders (more than US$2 billion[164]) on aid to the Antilles between 1960 and 1975.[165] The Dutch viewed the mix of their responsibility to maintain order and their concomitant lack of ability to affect the quality of government in the Caribbean as problematic.[166] As a result the Dutch began to take a more active role in the islands' governance and replacing the governor (who had been nominated by the island government) with their own choice. In 1971 they announced that a substantial majority in the Dutch parliament favored transfer of sovereignty, roiling island politics.[167] Political instability increased after 1969, with no Antillean government lasting more than two years. Antillean politics was then based on coalitions of insular parties rather than multi-island support for a party.[168] The Dutch at least temporarily abandoned their efforts to encourage Antillean independence as Suriname's problematic post-

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levels of consumption and investment achieved by the Netherlands Antilles in the past have been made possible only because of external assistance mainly from Holland and private sector investments from the United States, and that, given the prevailing unemployment and other circumstances of the economy, they will continue to be possible with continued external assistance ...." ANDIC & ANDIC, *supra* note 25, at 211–12.

160. *See* OOSTINDIE, *supra* note 21, at 93.

161. *Id.* at 95. As Oostindie and Klinkers summarize the impact of on the Dutch image:

> Images of Dutch Marines patrolling the smouldering ruins of Willemstad, machine guns at the ready, had been transmitted worldwide. With little understanding of the Kingdom relations and the nature of the Charter, the world inevitably witnessed colonial intervention. In hindsight this concern needs to be understood above all as a typical Dutch overestimation of the interest existing abroad for the way the Netherlands acted within its own sphere of influence. Yet this concern would be instrumental in the new Dutch approach to the Kingdom relations.

OOSTINDIE & KLINKERS, *supra* note 6, at 99.

162. OOSTINDIE & KLINKERS, *supra* note 6, at 90–91; *see also* Giacalone, *supra* note 131, at 96 ("[A]s a consequence of the political disturbances on May 30, 1969, the question of political status became a crucial theme of discussion ....").

163. OOSTINDIE & KLINKERS, *supra* note 6, at 116.

164. Calculated using the 1968 mid-point values. International Institute of Social History, *supra* note 59 (for conversion of 900 million 1968 guilders into present value); Coinmill.com—The Currency Converter, http://coinmill.com/ANG_USD.html#ANG (last visited Nov. 13, 2009) (for conversion into U.S. dollars).

165. OOSTINDIE & KLINKERS, *supra* note 6, at 159.

166. *Id.* at 98.

167. *Id.* at 100–01; *see also id.* at 102 (recalling that the Dutch government that took office in 1973 announced a policy of opening talks on a time table for independence for the Caribbean territories).

168. Giacalone, *supra* note 131, at 100–01.

independence experience diminished Dutch enthusiasm for shedding its remaining overseas territories.[169]

A second impact of the riots was a large increase in social spending in the early 1970s.[170] Some of this spending was financed by aid from the Netherlands, but the growth in revenue from the growing offshore sector also was a significant source of funds.[171] On the islands, the riots were a harsh reminder "of the broad divide separating the elite and working classes, a gulf that was as much socio-economic as it was racial and cultural."[172] Today, May 1969 is "routinely interpreted as the watershed in post-Charter Curaçao," marking the moment when politics shifted from "a small, predominantly non-black local elite" to an arena dominated by "local black leaders."[173] It does not appear to have produced a parallel change "in the economy and in private relations—in this respect too, the Curaçao experience parallels the unfinished emancipation elsewhere in the Caribbean."[174] And notably, it did not affect the growing offshore financial sector, a testament to the credibility of the Dutch guarantee of the rule of law and stability.[175]

In short, a gradual but significant reduction in employment at the Curaçao refinery coupled with a growing population produced an overall decline in economic conditions in the Antilles in the two decades following World War II. The islands needed an industry that could provide government revenue, create jobs, and usher in greater opportunity for residents. Although tourism initially appeared to be a promising option, it ultimately failed to achieve the scale necessary to generate economic prosperity for Curaçao, growing most rapidly elsewhere in the Antilles. Thus, conditions were ripe for the development and growth of the offshore financial services sector, the early stages of which are discussed in the following section.

B. The Beginnings of Offshore Activity

Following World War II, many of the companies that had relocated their statutory seats to Curaçao as a result of the German occupation moved them back to the Netherlands.[176] Without the German occupation of Holland, the island needed another reason for companies to maintain their formal connection to Curaçao. With few resources, Anton Smeets, the notary who pioneered the World War II statutory seat relocations, embarked on a campaign to both persuade the Antilles government to create a climate that could draw business and to promote Curaçao to the international business community.[177] At this same time, multinationals—particularly

169. KLOMP, *supra* note 110, at 75; *see also* Giacalone, *supra* note 131, at 97 (describing course of discussions over status through the 1970s and early 1980s).

170. BANK VAN DE NEDERLANDSE ANTILLEN, *supra* note 159, at 6.

171. GOSLINGA, *supra* note 33, at 175–76; BANK VAN DE NEDERLANDSE ANTILLEN, *supra* note 159, at 6 (the "rapid increase in the number off-shore companies which had a favourable effect on the tax proceeds"); *id.* at 8–9 (describing how, in 1973–74, "continued growth of tax income from off-shore companies" and more aid made it possible for improvements in government budget, despite economic troubles and worsening employment statistics).

172. OOSTINDIE, *supra* note 21, at 93.

173. *Id.* at 126–27.

174. *Id.*

175. LANGER, *supra* note 9, at 188 (noting that the riots "had relatively little effect on the use of the Netherlands Antilles as a base for offshore operations").

176. Interview, Elias, United Trust Co., *supra* note 13.

177. *Id.*

oil companies—began actively seeking opportunities to arbitrage among legal regimes with respect to mobile assets, creating potential demand.[178]

Smeets's greatest accomplishment during the decade following the war was convincing the Antilles to adopt a tax regime that was particularly favorable to businesses having their statutory seats in the islands but doing business elsewhere.[179] Thus, the Antilles became the first jurisdiction to set up such a regime—now known as a "ring-fenced tax regime"—in 1954.[180] Under this regime, a Netherlands Antilles company earning only passive income and having neither its beneficial ownership nor any business activity within the Antilles would be exempt from Netherlands Antilles taxation on all but ten percent of its profits.[181] Such an entity could secure an effective tax rate of between 2.4 and three percent.[182] Moreover, at a time when exchange controls were common, the Antilles did not impose significant barriers to the transfer of currency by offshore companies.[183]

The early results of the Antilles' new tax regime were largely positive, as over 300 holding and investment companies were incorporated in the Netherlands Antilles between 1953 and 1960.[184] Taxable profits from companies participating in the Antilles' ring-fenced tax regime were estimated at between NAf 67 and NAf 121 million in the mid-1950s (US$35.6 million to US$64.1 million[185]), making the regime a valuable, although fluctuating, resource.[186] By the end of the 1960s, the offshore sector was firmly established as an important part of the Antilles' economy.

Notwithstanding the initial success of the Antilles offshore sector, there were some bumps in the road. At that time, Curaçao had a fairly primitive physical infrastructure that one long-time Curaçao attorney characterized as "three donkeys and six dinosaurs."[187] Nonetheless, as a result of the events surrounding World War II, the island possessed a sufficient professional services infrastructure composed of

178. See CARLISLE, supra note 90, at 110 ("The war had exposed hundreds of business and government leaders to the system of business convenience under Panamanian registry, which had been tried out on a small scale in the 1930s. In the period from 1946 to 1948 that alternative appealed widely as American tanker owners utilized the flag to build a competitive position in the market.").

179. GOV'T. INFO. SERV. (Neth. Antilles), *supra* note 135, at 49.

180. Interview, Behr, HBM Group, *supra* note 103.

181. *Id.* The company also could expect to receive some leniency in tax rulings that would further reduce its tax liabilities. *Id.* The ten-percent rule was a substitute for a foreign tax credit. *1983 Tax Evasion Hearings*, *supra* note 4, at 802 (statement of Harold Henriquez, Minister for the Netherlands Antilles Affairs, Government of the Netherlands Antilles).

182. The applicable tax rate was 2.4 percent on the first one million of a company's income, and 3 percent on the balance. Interview, Elias, United Trust Co., *supra* note 13; Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71. *See also* LANGER, *supra* note 9, at 193 (describing reduced tax rates available for selected types of companies). Similarly, banks were taxed at an effective rate of 3 percent by taxing only 10 percent of their income at the nominal rate of 30 percent. Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71.

183. BANK VAN DE NEDERLANDSE ANTILLEN, *supra* note 159, at 43.

184. GOV'T. INFO. SERV. (Neth. Antilles), *supra* note 135, at 49. *See also* Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71.

185. In nominal dollars. The Antillean guilder was pegged to the U.S. dollar at a rate of 1.88585 to the dollar until 1971, when it was adjusted to 1.79:1. *See* Int'l. Monetary Fund [IMF], *Kingdom of the Netherlands—Netherlands Antilles: 2003 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion*, app. I, IMF Country Report No. 03/160, June (2003) Appendix I, at 32, *available at* http://www.imf.org/external/pubs/ft/scr/2003/cr03160.pdf.

186. ANDIC & ANDIC, *supra* note 25, at 189.

187. Interview, Elias, United Trust Co., *supra* note 13.

accountants, lawyers, notaries, and other professionals that was now prepared to assist foreign companies in taking advantage of the new tax regime. Evidence of the growing interest in financial structures utilizing the Antilles' tax regime can be seen in period literature. For example, a 1960 translation of the Netherlands' corporation law included notations of differences between Antillean and Dutch law, and its introduction observed that the translation was undertaken in response to "requests for information about Netherlands Antilles corporation law from several American interested parties."[188] And a government brochure promised potential investors in Antilles companies that

> The Netherlands Antillean Government . . . accords the greatest possible freedom to business and industry, shuns any oppressive controls and recognizes the vital importance of free enterprise to the country's prosperity. Thoughts about nationalization or any other alienation of property rights are unknown in the Netherlands Antilles.[189]

However, the handicap of doing business as a civil law jurisdiction using Dutch as its official language when dealing with a common law, English-speaking economy like the United States is apparent in this literature. For example, a pamphlet on Dutch corporation law translated into English highlighted the problem, noting that it used "American legal expressions" where possible, and attempted to explain "principles of which a few are typically different from common law conceptions" to "those not well versed in Roman law."[190] With at least three English translations in use, which "differ somewhat from one another," a 1975 survey concluded that it was "wise" to compare all three translations "in order to frame meaningful questions to local counsel and to comprehend his replies."[191] Moreover, articles of incorporation had to be filed in Dutch,[192] an additional expense and barrier to client comfort. But by being among the first of the offshore jurisdictions (only the Bahamas was offering real competition in the Caribbean in the 1960s and early 1970s[193]), Curaçao was able to overcome these handicaps.

C. *"Like Finding Gold"*[194]

The 1950s and 1960s were a period of radical transition in the world economy. The post-war Bretton Woods currency system was breaking down in the late 1960s, and ultimately collapsed in 1972.[195] As a result, exchange controls and other barriers

188. DUTCH CORPORATION LAW 3 (S.W. Van Der Meer trans., 1960).

189. GOV'T INFO. SERV. (Neth. Antilles), *supra* note 135, at 48.

190. DUTCH CORPORATION LAW, *supra* note 188, at 3.

191. LANGER, *supra* note 9, at 125–26 (noting that two of the three were "literal" translations while the third was "less literal" and "makes substantial use of footnotes to explain how the law works" although it was out of date and "probably out of print"). In addition, the text of the tax treaty itself was difficult to find into the 1970s, with Langer noting that the treaty "does not appear as a separate treaty in any of the U.S. tax treaty services." *Id.* at 122.

192. *Id.* at 190.

193. Andrew P. Morriss & Craig M. Boise, Creating Cayman: The Making of an Offshore Financial Center 22–25 (unpublished manuscript, on file with author) (describing the great successes of the offshore banking industry in the Bahamas).

194. Interview, Elias, United Trust Co., *supra* note 13.

195. BARRY EICHENGREEN, GLOBALIZING CAPITAL: A HISTORY OF THE INTERNATIONAL MONETARY SYSTEM 123–34 (1996).

to the movement of capital slowly eroded and capital markets became more accessible.[196] In the late 1960s, as banks around the world began to accept deposits denominated in foreign currencies, the so-called "Eurocurrency" market was born. The Eurodollar market grew substantially as the dollars that paid for the increasing volume of U.S. imports came to rest outside the United States.[197] The soaring price of oil in the early 1970s, in particular, created massive pools of "petrodollars" in oil-exporting countries that could be tapped for investment.[198]

As the Eurodollar market grew, U.S. firms sought to access it to fund domestic investment.[199] They were aided in their pursuit by persistent U.S. balance of payments deficits in the 1960s that ultimately led the government to enact a series of measures designed to encourage U.S. multinationals to borrow outside the United States.[200] Even after the balance of payments issues of the 1960s disappeared, the Eurodollar market remained attractive to U.S. businesses. For a variety of reasons—including costly U.S. banking regulations—Eurodollars could be borrowed at interest rates that were lower than domestic U.S. interest rates.[201] In addition, U.S. banks

196. *Id.* at 191 ("[A]s international transactions were liberalized, it became impossible to keep domestic markets tightly regulated. Once financial markets joined the list of those undergoing decontrol, new channels were opened through which capital might flow, and the feasibility of controlling international capital movements diminished accordingly.").

197. *See* Oscar L. Altman, *Euro-Dollars, in* READINGS IN THE EURO-DOLLAR 1, 2 (Eric B. Chalmers ed., 1969) ("[T]he Euro-dollar market is now one of the world's largest markets for short-term funds—mostly dollars. It is an international market, and it is one of the freest, most competitive, and most flexible capital markets that exists anywhere."); *The Eurocurrency Market Control Act of 1979: Hearings Before the Subcomm. on Domestic Monetary Policy and the Subcomm. on International Trade, Investment and Monetary Policy of the Comm. on Banking, Finance and Urban Affairs*, 96th Cong., 1st Sess. (1979) (discussing how the Eurodollar market grew from $110 billion to $695 billion between 1970 and 1977).

198. *See* FREDERICK G. FISHER III, THE EURODOLLAR BOND MARKET 17–19 (Euromoney Publications Ltd. 1979) (describing the role of "recycling" petrodollars back into the U.S. economy from oil states).

199. *1983 Tax Evasion Hearings*, *supra* note 4, at 168 (statement of Robert Butcher, Vice President, Citicorp) ("No large borrower of funds in the world today can ignore the Eurobond market, for it is a sizeable source of funds, and it is growing more rapidly than the U.S. corporate bond market."); *1983 Tax Evasion Hearings*, *supra* note 4, at 587 (Taxecon Associates, *Consequences of Imposing the U.S. 30 Percent Withholding Tax on Interest Paid to or by Netherlands Antilles Finance Subsidiaries of U.S. Corporations*, July 1982) (estimating savings at 2–3%, although cautioning that this might overestimate savings because users of finance subsidiaries were those with higher credit ratings).

200. Interest Equalization Tax, Pub. L. No. 88-563, 78 Stat. 809 (1964); *1983 Tax Evasion Hearings*, *supra* note 4, at 800 (statement of Harold Henriquez, Minister for the Netherlands Antilles Affairs, Government of the Netherlands Antilles) ("This sector further developed in the mid nineteen sixties, when foreign borrowing was encouraged (and required) by the various U.S. balance of payments programs."); *see generally* Robert L. Maines, *The Interest Equalization Tax*, 17 STAN. L. REV. 710 (1965) (describing various measures employed by the U.S. to address the balance of payments problem, including the Interest Equalization Tax, the purpose of which was to curtail U.S. investment in foreign securities thus reducing the outflow of portfolio capital).

201. *1983 Tax Evasion Hearings*, *supra* note 4, at 585 (Taxecon Associates, *Consequences of Imposing the U.S. 30 Percent Withholding Tax on Interest Paid to or by Netherlands Antilles Finance Subsidiaries of U.S. Corporations*, July 1982) (estimating savings at 2–3%, although cautioning that this might overestimate savings because users of finance subsidiaries were those with higher credit ratings); *1983 Tax Evasion Hearings*, *supra* note 4, at 168 (statement of Robert Butcher, Vice President, Citicorp) ("No large borrower of funds in the world today can ignore the Eurobond market, for it is a sizeable source of funds, and it is growing more rapidly than the U.S. corporate bond market."). This was not true in the 1960s, when Eurodollar rates exceeded U.S. interest rates on some occasions due to restrictions on U.S. banks' holdings abroad. Marston, *supra* note 3, at 6.

used the Eurodollar market to diversify their sources of funds.[202] From the perspective of foreign investors, the size and stability of the American economy made it a desirable location for the deployment of investment capital.[203] There was thus both demand for Eurodollars within the United States and an abundant supply of those dollars available for investment into the United States.[204]

Unfortunately for all parties, a U.S. withholding tax on interest payments made by U.S. borrowers to foreign lenders initially made the Eurodollar market prohibitively expensive for U.S. corporate borrowers.[205] The solution to this problem, like many others in the global capital markets, involved an offshore financial center. Specifically, the Netherlands Antilles and its tax treaty with the United States formed the core of an innovative strategy for avoiding the U.S. tax and providing access to the Eurobond market for U.S. corporate borrowers. To appreciate the Antilles' role in this strategy, however, it is necessary to first understand a bit about international income taxation and the function of tax treaties.

There are two normative bases for income taxation that are recognized in international law: source and residence.[206] Source-based taxation derives from a state's sovereignty over its territory and the activities taking place within that territory, while residence-based taxation is rooted in a state's sovereignty over its residents.[207] When a company established in one country earns income in another, the income is potentially subject to taxation by both the company's home (residence) country and the (source) country in which the income is earned. Thus, for example, in the absence of a tax treaty addressing the issue, a Dutch resident earning interest from a debt instrument issued in the United States by a U.S. entity would likely be subject to both residence-based Dutch income tax and source-based U.S. tax. Double taxation of the same income in this manner would quickly bring international cross-border investment to a halt were it not for two mitigating mechanisms employed by many jurisdictions: the "foreign tax credit" and bilateral, double taxation treaties.[208] The United States and the Netherlands entered into such a treaty

202. *1983 Tax Evasion Hearings*, *supra* note 4, at 175 (statement of Robert Butcher, Vice President, Citicorp).

203. *See generally* CHARLES R. GEISST, ENTREPOT CAPITALISM: FOREIGN INVESTMENT AND THE AMERICAN DREAM IN THE TWENTIETH CENTURY (1992) (describing historical attractiveness of U.S. for foreign investors).

204. The Eurodollar market quickly came to play a key role in the international economy. "Trading firms and corporations with multinational interests have found in the market the flexibility necessary for international operations ... [and it] considerably increased the efficiency of international financing and investment." Marston, *supra* note 3, at 30. One estimate of U.S. corporate borrowing in the Eurodollar market in 1968–1970 (and so before the large influx into the market of petrodollars produced by the soaring oil prices in the early 1970s) was $4 billion. *Id.* at 12.

205. In the words of John Chapoton, an Assistant Secretary in the Treasury Department in the 1980s, a withholding tax is "not a tax; it is a barrier to access to foreign debt markets." *1983 Tax Evasion Hearings*, *supra* note 4, at 267 (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Department of Treasury).

206. Nancy H. Kaufman, *Fairness and the Taxation of International Income*, 29 LAW & POL'Y INT'L BUS. 145, 148 (1998).

207. In most countries, residence is based on an individual's physical presence within the jurisdiction for roughly half of the taxable year. *See, e.g.*, I.R.C. § 7701(b)(3). The United States also asserts the right to tax the income of its *citizens* even if they do not reside within the country during the taxable year. *See, e.g.*, I.R.C. § 7701(a)(30)(A) (defining a "United States person" as a citizen *or* resident of the United States).

208. *See* REUVEN S. AVI-YONAH ET AL., U.S. INTERNATIONAL TAXATION 2–4 (2005) (describing double taxation and the two mitigating mechanisms).

in 1948, one of the provisions of which eliminated the thirty percent withholding tax that would otherwise apply to U.S.-source interest payments made to Dutch residents.[209]

Although no one at the time fully anticipated its implications,[210] the most crucial development in the creation of the Netherlands Antilles' offshore financial sector was the extension of the U.S.-Netherlands tax treaty (and its withholding tax exemption) to the Antilles in 1955.[211] The extension was almost an afterthought, accomplished in an atmosphere of postwar goodwill pursuant to a provision of the treaty that permitted its terms to be replicated in new treaties with the overseas territories of either country.[212] Under the treaty, a U.S. corporate borrower could set up a Netherlands Antilles finance subsidiary (usually a public limited liability company, or "N.V.").[213] The finance subsidiary would issue Eurobonds to foreign investors and on-lend the proceeds of the bond offering to the U.S. corporate borrower. The U.S. borrower then made interest payments to the finance subsidiary, which would in turn make interest payments to the Eurobond holders. In this manner, U.S. corporate borrowers gained access to the Eurodollar market while the interest payments they made to foreign investors were subject only to residence taxation in their own countries, plus the minimal Antilles tax applicable to the interest-rate spread (profits) retained by the finance subsidiary.[214]

Creation of new Antilles finance subsidiaries sparked an economic boom.[215] In its review of the years 1969 through 1974, the Antilles' central bank estimated that "billions" of guilders in international capital flowed through the islands, and that by the end of that period—a time when the international finance business had slowed due to changes in U.S. law—the offshore financial sector had paid NAf 35 million

209. Further, the extension of the tax treaty cut the withholding tax on income from U.S. securities to 10% from 30%. GOV'T. INFO. SERV. (Neth. Antilles), *supra* note 135, at 49.

210. As one prominent tax lawyer noted later, when the treaty was extended to the Antilles, "nobody knew what an international finance subsidiary was." *1983 Tax Evasion Hearings*, *supra* note 4, at 205 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen).

211. LANGER, *supra* note 9, at 194 (noting the 1955 protocol extending the treaty to the Antilles and stating that the "one major reason for using a Netherlands Antilles company to invest in the United States. . . . is to take advantage of favorable provisions contained in the U.S.-Netherlands Antilles income tax treaty.").

212. *1983 Tax Evasion Hearings*, *supra* note 4, at 192 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen). The treaty was extended, at least in part, in acknowledgement of the Antilles' post-colonial status as a constituent part of the Kingdom of the Netherlands. *1983 Tax Evasion Hearings*, *supra* note 4, at 51 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) ("Most U.S. tax treaties with tax haven countries are in effect because previous U.S. treaties with developed nations were extended to present and former colonies of those nations).

213. *See* Löwensteyn, *supra* note 7, 131–32 (explaining that "N.V." is the abbreviation for "naamloze vennootschap," literally "anonymous partnership," the Dutch term for a public limited liability corporation).

214. *See supra* note 205 and accompanying text; *1983 Tax Evasion Hearings*, *supra* note 4, at 193 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen) ("The combination of favorable tax treaty provisions and a special low rate of tax made the Antilles very attractive as a base for foreign investment in the United States.").

215. H.C. BEERS, THE FINANCIAL SECTOR OF THE NETHERLANDS ANTILLES 33 (1979) ("The emergence of the Netherlands Antilles as a centre of international financial activity basically started with a growth in the number of the so-called finance subsidiaries . . . . In only a few years, billions of U.S. dollars were channeled from Europe to the United States, through the intermediary of Curaçao finance subsidiaries.").

(approximately US$19.6 million) in taxes to the Antilles government.[216] The success of the offshore sector is also evident in a 1968 study of the Antillean economy that concluded that "[t]he balance of payments would be in continuous deficit, were it not for the remittances by investment companies and by oil companies on account of wages and other payments to be effected in the Netherlands Antilles."[217]

D. Expanding the Franchise

The Antilles' finance subsidiary business helped to mature a financial services sector in Curaçao that had begun with accountants and other professionals employed by the refinery and then expanded with the introduction of the Antilles ring-fenced tax scheme.[218] The increasing sophistication of Curaçao's legal and financial professionals, in turn, led to the development of ever more creative uses for the Antilles N.V., the most popular of the country's business entities.[219]

One of the most important uses was to acquire U.S. real estate and make other investments in the United States,[220] because an Antilles N.V. offered a number of features that were particularly attractive to foreign investors in U.S. real property and other assets.[221]

First, there were tax advantages when U.S. property was owned through a foreign corporate entity. A foreign investor who sold U.S. real property owned through an Antilles N.V would not be taxed by the United States on gains from the sale of the property, and the N.V. would pay at most the low two and four-tenths percent to three percent Antilles tax applicable to corporate profits on the gain.[222]

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216. BANK VAN DE NEDERLANDSE ANTILLEN, *supra* note 159, at 43. *See* International Institute of Social History, Value of the Guilder/Euro, *supra* note 59 (providing conversion rates and calculations).

217. ANDIC & ANDIC, *supra* note 25, at 181.

218. As a central bank review noted in 1979:

> The infrastructure of the islands, mainly Curaçao and to a lesser extent Aruba and Sint Maarten, is fairly developed. Professional services of bankers, lawyers and accountants are available, as are services of trust companies that undertake the incorporation maintenance and operation of entities.

BEERS, *supra* note 215, at 33.

219. *Id.*

220. *1983 Tax Evasion Hearings*, *supra* note 4, at 59–60 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) (discussing use for stock and bond investments); LANGER, *supra* note 9, at 187 ("Many sophisticated foreigners investing in U.S. real estate do so through Netherlands Antilles companies."); Interview, Elias, United Trust Co., *supra* note 13; Interview, Behr, HBM Group, *supra* note 103; Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71; John J. Fialka, *Closing the Loophole: Corporate Tax Haven in Netherland Antilles is Bracing for Disaster*, WALL ST. J., Oct. 11. 1982, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 787–88 (reporting that the CIA believed Arab investors using Antilles structures for privacy and higher interest and that privacy loving Arab investors liked Antilles vehicles).

221. Charles R. Irish, *Tax Havens*, 15 VAND. J. TRANSNAT'L L. 449, 472–73 (1982) (describing benefits of Antilles company as vehicle for U.S. real estate holdings).

222. *1983 Tax Evasion Hearings*, *supra* note 4, at 194 (Statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen). At the time, the U.S. considered such gain foreign-source income because the selling corporation was not a U.S. resident. This changed in 1980, when the Foreign Investment in Real Property Tax Act (FIRPTA) made the use of N.V. vehicles "somewhat less attractive." *1983 Tax Evasion Hearings*, *supra* note 4, at 59 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) (discussing the avoidance of U.S. tax). For text of FIRPTA, see I.R.C. § 897 (2009). *See also* Irish, *supra* note 221, at 473 ("[T]he sale may be structured so the gain is taxed in neither

Alternatively, the owners of the N.V. might sell the company (and thus, the real property), and avoid even the Antilles corporate tax, since the sale of the N.V. would not be considered a taxable transaction in the Antilles[223] and there would be no change of ownership of the U.S. real estate recorded in the U.S. to trigger application of any U.S. tax. By contrast, if a foreign investor owned U.S. real property through a U.S. corporation, the selling corporation would be a U.S. resident and the U.S. capital gains tax would be imposed on any gain from the sale.[224] In addition, a foreign person owning either U.S. real property or shares of a U.S. corporation that owned real property would, at death, be subject to U.S. estate tax on the real property or the shares of the corporation.[225] However, U.S. estate taxes did not apply if the foreign investor owned U.S. real property through a foreign corporation, like an Antilles N.V., and left the shares to his heirs.[226]

Similar tax benefits applied to other U.S. investments made through Antilles N.V.s. For example, an investor from a country not having a tax treaty with the United States who bought a portfolio of U.S. stocks would pay the thirty percent U.S. withholding tax on the dividends she received.[227] Moreover, if the investor resided in a country that imposed territorial taxation (as was the case with many Latin American countries), she would not receive a credit against domestic taxes for the U.S. withholding tax paid.[228] If, on the other hand, the investor purchased the same portfolio of U.S. shares through an Antilles N.V., the entity would pay only the fifteen percent withholding rate applicable under the U.S.-Netherlands Antilles treaty.[229] U.S. companies also used Antilles' subsidiary companies to hold income-

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the United States nor the Netherlands Antilles.").

223. Interview, Elias, United Trust Co., *supra* note 13.

224. *See* I.R.C. § 61(a)(3) (2009).

225. I.R.C. § 2101(a) (2002) ("Except as provided in section 2107, a tax is hereby imposed on the transfer of the taxable estate (determined as provided in section 2106) of every decedent nonresident not a citizen of the United States.").

226. *1983 Tax Evasion Hearings*, *supra* note 4, at 179 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen); Irish, *supra* note 221, at 473. So great was the popularity of N.V.s for foreign investment in U.S. real estate investments that with perhaps only slight overstatement, one Curaçao attorney stated that in the 1970s there was "not a building in New York City not owned by an [Netherlands Antilles] company at one time." Interview, Behr, HBM Group, *supra* note 103. Florida real estate was also often held in Antillean structures. *1983 Tax Evasion Hearings*, *supra* note 4, at 119–20 (statement of Charles Kimball) (estimating that 42% of foreign acquisitions of real estate in Florida are via anonymous corporations and a majority of those are through Antilles vehicles); *id.* at 132 (noting 1979 survey found that almost half of foreign investment in South Florida real estate in 1979 was made through foreign corporations, with a majority of those done via the Netherlands Antilles).

227. *1983 Tax Evasion Hearings*, *supra* note 4, at 194 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen).

228. *Id.*

229. *Id.* Until the treaty was renegotiated in 1963, the less than 3% tax in the Netherlands Antilles would have provided a total effective tax rate of under 18%. *1983 Tax Evasion Hearings*, *supra* note 4, at 194 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen). *See also* LANGER, *supra* note 9, at 194. After the 1963 change, the N.V. would pay 15% tax to the Antilles on its net income. But because of the difference between the application of the U.S. withholding tax to "gross payments" and the Netherlands Antilles tax to "net income," it was comparatively easy to reduce the overall effective tax rate on the investment from 30% to between 20 to 25%. *1983 Tax Evasion Hearings*, *supra* note 4, at 195 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen). *See also* LANGER, *supra* note 9, at 197 ("[Effective rates are] invariably less than the U.S. statutory withholding rate of 30 percent."); *id.* at 199 (explaining how effective rate was reduced to around 24% in most cases); *1983 Tax Evasion Hearings*, *supra* note 4, at 263 (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Department of Treasury). The U.S. parent could claim a tax credit for any tax paid in the Netherlands Antilles as well.

generating intellectual property and to obtain comparable tax benefits.[230] Deductible royalty payments made by U.S. companies to Antilles' subsidiaries could flow into the ring-fenced tax regime of the Antilles free of U.S. withholding tax.[231]

In addition to tax advantages, the N.V. offered anonymity to foreign investors. That is, the identity of the beneficial owners of an N.V. would not appear in public records such as deed registries in the United States, nor would the N.V.'s shareholder list be a public record in the Antilles.[232] This protected the beneficial ownership of foreign investors in N.V.s from casual scrutiny.[233] Indeed, an N.V. could issue both bonds and shares of stock in "bearer form"[234] and effectively shield from disclosure the identity of owners of both debt and equity investments.[235] This was a particularly important benefit for investors worried about a U.S. backlash against foreign ownership of U.S. assets, like the one against Middle Eastern investors that occurred in the latter part of the 1970s.[236] Of course, anonymity was also appealing to those having less savory motives, and it became a source of frustration for U.S. law enforcement authorities who were convinced that the Antilles harbored significant money laundering activities.[237]

Id. After the protocol, interest income net of expenses had to be taxed in the Antilles at the 24 to 30% rate to be exempt from withholding. *1983 Tax Evasion Hearings*, *supra* note 4, app. 30 at 800 (statement of Harold Henriquez, Minister for the Netherlands Antilles Affairs, Government of the Netherlands Antilles).

230. *See 1983 Tax Evasion Hearings*, *supra* note 4, at 195 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen).

231. *See* BEERS, *supra* note 215, at 33 ("[Q]uite a large number of offshore investment, holding, royalty, copyright and patent holding companies have been established in the Netherlands Antilles."); LANGER, *supra* note 9, at 200.

232. THE NETHERLANDS ANTILLES—UNITED STATES INCOME TAX TREATY (Marshall J. Langer ed., 1973), *in 1983 Tax Evasion Hearings*, *supra* note 4, at 563 (noting that information is exchanged only to prevent fraud, and is always treated as "secret" and beyond disclosure); *see 1983 Tax Evasion Hearings*, *supra* note 4, at 574–77 (Memorandum from the Internal Revenue Service Branch Chief, S. Branch to Assistant Chief, Criminal Investigation Div. Jacksonville Dist. Office (Nov. 23, 1982)) (discussing the treaty stipulation, and Antillen practice, of not sharing information).

233. Note that the Antilles did not have a specific bank, or other, secrecy law but instead relied on general provisions in the criminal code. For example, divulging confidential financial information was punishable by payment of a 60 guilder fine or imprisonment for up to six months under Articles 285 and 286 of the Netherlands Antilles Criminal Code. *See 1983 Tax Evasion Hearings*, *supra* note 4, app. 29 at 794–96; *see also 1983 Tax Evasion Hearings*, *supra* note 4, at 570 (Memorandum from Peter S. Barash and Dean T. Scott to Chairman and Members of the Subcommittee (Apr. 5, 1983)) (providing example of Florida Real Estate transaction where parties remained anonymous).

234. See the definitions of bearer bonds and shares *supra* note 9, (describing how bearer bonds and shares are owned by whoever holds them, making them amenable to owner anonymity).

235. *1983 Tax Evasion Hearings*, *supra* note 4, app. 14 at 569 ("The Antilles 'bearer share' concept is unique even among tax treaty countries and enables U.S. and foreign persons to establish companies or financial accounts in the Antilles without disclosing their identities. As a result, I.R.S. agents cannot determine whether an Antillean company or financial account receiving U.S. source income at zero percent withholding is entitled to a tax exemption.").

236. Interview, Elias, United Trust Co., *supra* note 13; Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71.

237. *See 1983 Tax Evasion Hearings*, *supra* note 4, app. 14 at 571 (Staff Memorandum, Apr. 5, 1983) ("Eurobonds are tax-free only to foreign persons, but some Eurobonds end up in U.S. taxpayers' hands. Since the bonds are bearer bonds, interest paid to U.S. holders is virtually untraceable. U.S. corporation issued Eurobonds presently total over $40 BILLION, with estimated yearly interest payments of nearly $4 billion. It is a virtual certainty that U.S. owners of Eurobonds fail to pay taxes on the interest earned. This is a logical surmise because Eurobonds pay 2 to 3 percent less interest than identical bonds issued in the U.S. Only a tax evasion purpose would justify a bond purchase at this lower rate of interest.").

Finally, the Antilles provided extremely fast service. In the mid-1970s, a previously created shell company could be purchased and put to use in a single business day[238] at a cost of US$1,400 to $2,000 (plus $1,000 in annual maintenance costs).[239] With each Antilles N.V. generating approximately US$1,000 for the government plus legal and other fees to Antilles' businesses, the creation of offshore companies became extremely lucrative for the Antilles' economy.[240]

Spurred by this success, the Antilles' international business sector sought to expand the range of the jurisdiction's offshore financial services. For example, lured by the lack of insurance regulation, foreign corporations set up a number of captive insurance companies in the Antilles during the 1970s.[241] Under a captive insurance arrangement, a U.S. corporation, for example, could self-insure various risks by paying premiums to a wholly-owned insurance subsidiary in a low- or no-tax jurisdiction like the Antilles.[242] (A principal benefit of captive insurance is that it permits the self-insured corporation to reap the returns on premium dollars invested by the subsidiary.)[243] By the end of 1976, about sixty Antilles captives were in existence.[244] Similarly, some early hedge funds created by industry pioneers including George Soros, Paul Tudor Jones, and Julian Robertson established their domiciles in Curaçao from the late 1960s to the early 1980s.[245] Although Antilles corporate law was not perfect for use by hedge funds, and no specific hedge fund entity had been created, the inadequacies of the N.V. structure for funds could be readily resolved, albeit at a cost.[246] This helped create additional back-office work for the island's trust

238. Fialka, *supra* note 220, at 788.

239. LANGER, *supra* note 9, at 131.

240. *1983 Tax Evasion Hearings*, *supra* note 4, at 57 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) (listing fees for establishing a new corporation in the Netherland Antilles equaling just under $1000 for itemized expenses and stipulating that other charges may occur).

241. BEERS, *supra* note 215, at 38.

242. *See* Andrew P. Morriss, *The Role of Offshore Financial Centers in Regulatory* Competition, 15 NEXUS (forthcoming 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1275390 (describing how a company can reduce its costs by self insuring through a captive insurance company).

243. *See* Gordon A. Schaller & Scott A. Harshman, *Use of Captive Insurance Companies in Estate Planning*, 33 AM. C. TR. EST. COUNS. J. 252, 253 (2008) ("However, with a captive insurance company, the parent or related companies will benefit from good claims experience, and surplus in the company may be available to the shareholders by way of dividends.").

244. BEERS, *supra* note 215, at 38. Bermuda ultimately became the dominant jurisdiction in this market in part by developing a specialized statute and regulatory framework for captive insurance. Schaller & Harshman, *supra* note 243, at 254. ("The largest venue for captives is Bermuda."); Jan Woloniecki & Kim Wilkerson, *The U.S. Corporate Defendant's Captive Insurer's Dilemma: Third Party Liability Claims and Recovery Under English Law*, 73 DEF. COUNS. J. 291, 298 (2006) ("Bermuda is . . . the world's leading captive domicile (with over 1,500 captive insurance companies incorporated and managed in Bermuda, many of them owned by Fortune 500 companies in the United States) . . . .").

245. *See* Susan L. Barreto, *The Challenge of Choosing an Offshore Jurisdiction*, REUTERS HEDGEWORLD, May 31, 2002 ("[I]n the 1960s, the Netherlands Antilles was the place. The Antilles was the jurisdiction for hedge fund industry with Paul Tudor Jones, Julian Robertson and George Soros using the islands as the base for their funds . . . .").

246. For example, the Antillean N.V. had a minimum capital requirement of $30,000 and requirement of $1 share par value. If the stock price fell below par, investors could be liable for corporate debts up to par. The N.V. also required that 20 percent of the shares be outstanding. Antilles attorneys devised various work-arounds, including using multiple classes of stock to both maintain control and meet the various statutory requirements. Interview, Andersen, Eclipse Consulting, *supra* note 89.

companies.[247] As a result, further expertise in hedge fund administration and accounting developed on the island.

These expansions of the Antilles' business came about through new uses of the existing N.V. entity (hedge funds) or absence of regulation (captive insurance) and were not accompanied by legislative action to create new, specialized business entities for specific markets, as began to occur in other, hungrier jurisdictions.[248] There was also no change in regulatory capacity. The Antilles failed to expand and upgrade its financial regulatory bodies to build confidence in the onshore business and regulatory communities in the Antilles' ability to control illegal activity, as occurred in other jurisdictions. Moreover, the Antilles' continued to require that legal documents be filed in Dutch, a practice one attorney in a competing jurisdiction characterized as "medieval" and which increased transactions costs for non-Dutch companies.[249] Perhaps lulled into a false sense of security by its monopoly position in the lucrative international finance subsidiary business and distracted by inter-island squabbling and the ongoing struggles over Dutch involvement in insular governance,[250] the Antilles' government did not innovate. Economist J.R. Hicks noted that "the best of all monopoly profits is a quiet life,"[251] and the Antilles' failure to innovate in the 1970s can be explained as the natural reaction of a monopolist that believed its position to be secure.

E. Trouble on the Horizon

As the use of the U.S.-Netherlands tax treaty expanded, there were American concerns that persons residing outside the Antilles might engage in "treaty shopping"; that is, gain access to the treaty's benefits by forming Antilles entities that were not technically resident there.[252] Since, like most treaties from this era, the U.S.-

247. Interview, Andersen, Eclipse Consulting, *supra* note 89.

248. Morriss & Boise, *supra* note 193, at 29; Barreto, *supra* note 245, ("[S]ince the use of the N.V. fund structure forced managers to pay taxes in the Netherlands Antilles, the hedge fund vehicle became less popular than other fund structures in other jurisdictions, according to AmiCorp. As a result, much of the offshore hedge fund business shifted to the British Virgin Islands in the late 80s or early 90s. Wholesale legislation was part of the reason for the shift . . . .").

249. *See* Interview with Anthony Travers, Chairman, Cayman Is. Fin. Servs. Ass'n (Mar. 9, 2009).

250. For example,

> The absence of federally [Antilles-wide] based parties covering more than one island forces Prime Ministers to live in a quandary between the necessities of the whole and those of Curaçao's electorate. A Prime Minister that pays too much attention to the well being of the Netherlands Antilles but is unconcerned with his island runs the risk of losing the insular vote. But a minister that emphasizes the benefits of his electorate will lack support from the parties of the other islands in the task of forming and maintaining the federal government.

Rita Giacalone, *The Political Status of Curaçao at the End of the Twentieth Century*, *in* ISLANDS AT THE CROSSROADS: POLITICS IN THE NON-INDEPENDENT CARIBBEAN 101 (Lynne Reiner Publishers, Inc. 2001) (quoting Rita Giacalone, Freddy Martinez & Peter Verton, *Curazao y Aruba entre la autonomia y la independencia* 113–14 (Mérida: CDCH—Universidad de Los Andes, 1990)).

251. J.R. Hicks, *Annual Survey of Economic Theory: The Theory of Monopoly*, 3 ECONOMETRICA 1, 8 (1935).

252. The crucial problem in resolving "treaty shopping" is defining who counts as a resident. The U.S. position was that the treaty was flawed because under Antillean law "most anybody can become a resident, regardless of their citizenship; a resident for purposes of application of the treaty." *1983 Tax Evasion Hearings*, *supra* note 4, at 14 (statement of William J. Anderson, Director, General Government Division, General Accounting Office). *See also 1983 Tax Evasion Hearings*, *supra* note 4, at 225

Netherlands Antilles treaty lacked significant anti-treaty shopping, or "limitation of benefits" provisions,[253] it proved relatively easy for third-country citizens to create companies in the Antilles in order to secure the treaty's benefits.[254] The United

(statement of Roscoe L. Egger, Jr., Commissioner, Internal Revenue Service) ("[T]he Netherlands Antilles serves as a useful conduit for payments to nonqualifying recipients in third countries since such payments are subject only to minimal Netherlands Antilles tax. In many cases, companies are set up there strictly to claim reduced U.S. tax rates or exemptions under the Netherlands Antilles treaty while incurring no real tax consequences in the Netherlands Antilles itself."). The result of treaty shopping was, the United States contended, a loss of tax revenue to the investor, since instead of splitting the tax revenue with the investor's tax jurisdiction, both the U.S. and the other jurisdiction gave up some of the revenue. *1983 Tax Evasion Hearings*, *supra* note 4, at 261 (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Department of Treasury). From the Antillean perspective, however, this was just applying a basic international law norm. *1983 Tax Evasion Hearings*, *supra* note 4, at 803 (statement of Harold Henriquez, Minister for the Netherlands Antilles Affairs, Government of the Netherlands Antilles). An important part of the problem was a lack of clear guidelines on what constituted "treaty shopping." *1983 Tax Evasion Hearings*, *supra* note 4, at 196 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen). Providing some support for the Antillean position was the Treasury's lack of a model "limitation of benefits provision" for tax treaties. Treasury justified this omission on the grounds that it did not think "a single model would be appropriate" because of the "wide range of international economic relationships and the diversity of foreign tax systems" . . . instead, Treasury advocated approaching "each treaty relationship separately." *1983 Tax Evasion Hearings*, *supra* note 4, at 261 (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Department of Treasury). Because there was no data on the extent of "treaty shopping" or other abuses, in part because of the use of bearer shares, neither side was able to produce reliable estimates of the extent of any particular practice. *1983 Tax Evasion Hearings*, *supra* note 4, at 13 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) ("no data" on extent of legitimate compared to illegitimate transactions); *id.* at 29 ("[I]n many cases, the United States is hard-pressed to detect or deter treaty shopping. This is because many treaty havens liberally define who qualifies as a 'resident' and have bank secrecy laws that prevent I.R.S. from identifying individuals who, in the eyes of the United States, are not bona fide residents of the treaty haven."); *1983 Tax Evasion Hearings*, *supra* note 4, at 92 (statement of Robert Edwards, Deputy Commissioner, Florida Department of Law Enforcement) (Florida law enforcement official thinks, without data, that there is widespread money laundering in the Netherlands Antilles); Douglas J. Workman, *The Use of Offshore Tax Havens for the Purpose of Criminally Evading Income Taxes,* 73 J. CRIM. L. & CRIMINOLOGY 675, 677 (1982) ("Often the distinction between tax avoidance and tax evasion in the use of foreign tax havens is imprecise because the law governing the transactions is unclear and the requisite data is incomplete."); Milka Casanegra de Jantscher, *Tax Havens Explained,* 13 FIN. & DEV. 31, 31 (1976) (data on tax havens "woefully meager" and "exaggerations flourish"). In the early 1980s, the United States had more than fifty tax treaties, fifteen of which were with tax haven jurisdictions. *1983 Tax Evasion Hearings*, *supra* note 4, at 27 (statement of William J. Anderson, Director, General Government Division, General Accounting Office). *See also id.* at 47 ("[W]hen individuals or businesses use tax havens to perpetrate, facilitate, or conceal illegal activities, including tax evasion, it is highly unlikely that routine civil tax enforcement activities will detect many offenders.").

253. Beginning in 1980, the United States began including limitation of benefits provisions in all of its tax treaties as they were renegotiated. Robert H. Dilworth, *Financing International Operations of U.S. Multinationals, in* 843 TAX LAW AND ESTATE PLANNING 723, 758 (PLI Tax Law and Practice, Course Handbook Series No. 14322 2008) (noting that "all recent (since 1980) U.S. income tax treaties contain 'Limitation of Benefits' provisions"). Such provisions limit the treaty's benefits to persons who are bona fide residents of the United States or the treaty country. For example, a corporation in a treaty country may not be eligible to receive treaty benefits unless a minimum percentage of its shareholders are individuals who are residents of the treaty country or the United States. *See, e.g.,* U.S. MODEL INCOME TAX CONVENTION, § 22 (1996). *See also* Vincent P. Belotsky, Jr., *The Prevention of Tax Havens via Income Tax Treaties,* 17 CAL. W. INT'L L.J. 43, 67–68 (1987) (discussing evolution of limitation of benefits provisions in model treaties); Kenneth A. Grady, *Income Tax Treaty Shopping: An Overview of Prevention Techniques,* 5 NW. J. INT'L L. & BUS. J. 626, 657, n. 3 (1983–1984) (noting that *Aiken Industries, Inc. v. Commissioner,* 56 T.C. 925 (1971) *acq.* 1972–2 C.B. 1, the first major treaty shopping case, was not decided until 1971); *id.* at 634 (first limitations of benefits provision included in U.S. tax treaty in 1962).

254. *1983 Tax Evasion Hearings*, *supra* note 4, at 197 (statement of Marshall J. Langer, Attorney of

States took the position that treaty benefits were "intended to accrue only to bona fide residents of the treaty country" and that access by de facto residents of non-treaty jurisdictions constituted an abuse of the treaty.[255] By the early 1980s, U.S. Treasury officials were complaining that the Antilles treaty had become a "one-way treaty with the world"[256] since residents of any country could form an Antillean entity and gain access to the treaty's benefits. Compounding the problem was the fact that the Antilles permitted corporations to issue bearer shares and offered other forms of strong confidentiality. Since these measures prevented U.S. tax authorities from obtaining information on the beneficial ownership of Antillean entities, it was virtually impossible for U.S. tax authorities to limit the use of the treaty to individuals resident in the Antilles.[257]

Restricting access to treaty benefits was important to the United States for several reasons. First, as a "treaty to the world," the U.S.-Netherlands Antilles treaty's cost, in terms of foregone tax revenue, was exponentially greater than it would have been if its provisions had applied only to individuals resident in the Antilles (rather than to companies). Lost U.S. tax revenue from interest and dividends paid to all foreign persons not qualified to receive treaty benefits was estimated to be around $800 million in 1982.[258] The portion of this lost tax revenue

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Counsel, Shutts & Bowen). The problem from the American perspective was that the check on the legitimacy of a transaction occurred only when the Antillean structure was created. As a GAO investigator described it:

> [T]he Netherlands Antilles has really done nothing to verify the country of residency of those people who tend to set up, that is those who set up to do business through the Netherlands Antilles .... something like 99 percent of their referrals were generated from U.S. law firms. The Netherlands Antilles accepts the mere affirmation of the attorney involved that in fact this person, this corporation qualifies under the treaty. They do not look beyond that, so therefore you can say they are doing nothing.

1983 Tax Evasion Hearings, *supra* note 4, at 18 (statement of William J. Anderson, Director, General Government Division, General Accounting Office).

255. *1983 Tax Evasion Hearings*, *supra* note 4, at 29 (statement of William J. Anderson, Director, General Government Division, General Accounting Office).

256. John Cummings, *Tiny Islands Are Giant Tax Haven*, NEWSDAY, July 31, 1983, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 768; *1983 Tax Evasion Hearings*, *supra* note 4, at 9 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) ("Treasury's primary concern with the existing treaty centers on its belief that it is being used extensively for treaty-shopping purposes. In particular, Treasury is concerned about third-country investors' use of the treaty."). Other jurisdictions, too, were negatively affected by their residents' use of the U.S.-Netherlands Antilles treaty. In particular, Latin American governments that taxed income on a territorial basis (as most did in the 1960s) complained that the Antilles treaty was "encouraging flight capital" to the United States. LANGER, *supra* note 9, at 194–95.

257. *1983 Tax Evasion Hearings*, *supra* note 4, at 570 (Memorandum from Peter S. Barash and Dean T. Scott to the Chairman and Members of the Commerce, Consumer, and Monetary Affairs Subcommittee (Apr. 5, 1983)) (discussing problem of Americans using anonymous corporations to hide income and assets); *1983 Tax Evasion Hearings*, *supra* note 4, at 29 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) ("[I]n many cases, the United States is hard-pressed to detect or deter treaty shopping. This is because many treaty havens liberally define who qualifies as a 'resident' and have bank secrecy laws that prevent I.R.S. from identifying individuals who, in the eyes of the United States, are not bona fide residents of the treaty haven.").

258. *Improper Use of Foreign Addresses To Evade U.S. Taxes: Hearings Before the Subcomm. of Commerce, Consumer, and Monetary Affairs of the Comm. on Government Operations H.R.*, 97th Cong., 2d Sess. 33 (1982); *1983 Tax Evasion Hearings*, *supra* note 4, at 44 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) (noting that there were payments of $9.6 billion to foreign persons of U.S. source income in 1981 and that if the 30 percent withholding tax had

attributable to interest payments made to non-qualified persons through the Antilles was estimated to be in the neighborhood of $100 million per year.[259] Second, the combination of Antilles bearer shares and the Antilles' favorable tax environment produced a significant risk that U.S. taxpayers would use Antilles entities to avoid U.S. income tax, as well—a much more serious problem for the U.S. Treasury.[260] For example, a U.S. taxpayer paying income taxes at a marginal rate above fifteen percent could form an Antilles' N.V. using bearer shares and then invest through the N.V. into the U.S. securities markets, paying the treaty rate of fifteen percent on dividends and evading the higher income tax he owed.[261] Third, the United States worried that the widespread use of the Antilles treaty by non-Antillean individuals would reduce the incentive for governments of countries without a tax treaty with the U.S. to negotiate one.[262] Negotiating such treaties was important to the United States because it could use the offer of a reduction of the thirty percent withholding tax as a bargaining chip to obtain exchange of information provisions that the U.S. Treasury wanted to use to identify tax evasion by U.S. citizens and residents.[263]

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applied to all of it, the U.S. would have received $2.9 billion in tax revenue instead of the $727 million it actually received, although certainly some of the payments were legitimately exempt).

259. *See* Tim Vettel, *Revenue from Antilles Treaty Termination Could Fund R & D Allocation Proposal*, 36 TAX NOTES 1120, 1120 (1987).

260. *1983 Tax Evasion Hearings*, *supra* note 4, at 9 (Statement of William J. Anderson, Director, General Government Division, General Accounting Office) ("[Treasury] suspects that U.S. citizens are taking advantage of the anonymity provided by the Antilles bearer share companies to evade U.S. taxes. For this reason, Treasury is now seeking to incorporate stronger exchange of information and anti-abuse measures in the renegotiated treaty."); Internal Memorandum from Branch Chief S. Branch, Internal Revenue Serv., to Assistant Chief, Criminal Investigation Div. Jacksonville's Dist. Office (Nov. 23, 1983) *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 574 ("[T]he government of the Netherlands Antilles will not furnish information concerning returns that are filed and therefore there is no way to dispute these companies claims concerning their reporting of this income in the Netherlands Antilles."). The income tax problem was more serious because by the 1970s the 30% withholding tax was largely used as a bargaining chip to persuade countries to negotiate tax treaties. *1983 Tax Evasion Hearings*, *supra* note 4, at 210 (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Department of Treasury). For example, the model U.S. tax treaty provided for complete exemption from it for interest. *Id.*

261. The practice of citizens or residents investing in their home country through controlled entities resident in an offshore financial center or other tax-favored jurisdiction (e.g., one having a double taxation treaty with the home country) in order to evade taxes sometimes is referred to as "round-tripping." *See, e.g.*, Manjula Chawla and Srinivasa Rao, *Should Round Tripping be Banned?*, ECON. TIMES, Aug. 25, 2008 *available at* http://economictimes.indiatimes.com/Opinion/Should-round-tripping-be-banned/articleshow/3400528.cms?curpg=1 (discussing round-tripping by Indian residents using Mauritian entities to take advantage of the India-Mauritius double-taxation treaty); S. Arun, *Round-tripped FDI from Tax Havens Under OECD Review*, FIN. EXPRESS, Apr. 13, 2009 *available at* http://www.financialexpress.com/news/roundtripped-fdi-from-tax-havens-under-oecd-review/446183/.

262. *1983 Tax Evasion Hearings*, *supra* note 4, at 261 (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Department of Treasury); Fialka, *supra* note 220, at 787 (stating that Treasury believes it cannot get non-treaty countries to negotiate because their nationals are using Antilles structures).

263. *1983 Tax Evasion Hearings*, *supra* note 4, at 50 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) ("Treasury is seeking to include strong exchange of information and anti-abuse measures in all new and renegotiated treaties."); *1983 Tax Evasion Hearings*, *supra* note 4, at 210 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen) (Treasury uses the 30% rate as a bargaining chip). *See 1983 Tax Evasion Hearings*, *supra* note 4, at 569 (Staff Memorandum, April 5, 1983) ("Although the Antilles treaty provides generally for the exchange of income information documents between the Antilles Government and the I.R.S., virtually no information is actually exchanged.").

From the Antilles' point of view, "treaty shopping" was "simply a recently created pejorative term" for a practice based on "the universal norm of treating corporations as separate from their shareholders, and the definition of corporate residence which is framed in terms of the place of incorporation or management of the corporation regardless of the residence of its shareholders."[264] In other words, Antilleans argued that so long as the separate legal existence of corporations was respected, individuals from any jurisdiction should be free to make use of the treaty so long as they complied with Antilles law on the formalities of creating a corporate entity. The treaty-shopping issue had first surfaced in the renegotiation of the treaty in 1962, when the U.S. attempted to make it less attractive to non-Antillean persons seeking to invest in the United States.[265] The revised treaty did not fully address the U.S. concerns, however, and treaty shopping would be a growing source of conflict between the Antilles and the United States as the use of the treaty became more widespread.

In hindsight, it seems obvious that the volume of Antilles business structures ultimately would provoke a U.S. reaction. The treaty-shopping concern resurfaced in the effort in the early 1970s to eliminate the need for Antilles vehicles by allowing firms to use U.S. subsidiaries to gain access to the Eurocurrency markets, an effort that had some initial success but which, because of drafting flaws, ultimately did not succeed in eliminating Antilles vehicles.[266] It also featured in the backlash against the use of Antilles N.V.s to acquire U.S. real property.[267] By as early as 1976,[268] the U.S. had begun discussions with the Antilles and the Dutch about the use of the tax treaty to avoid the withholding tax, suggesting that the treaty's protections might not last forever. And the Internal Revenue Service (IRS) withdrew its sanction of international finance subsidiaries in 1974, causing a short term slump in the market for Antilles subsidiaries.[269]

There were problems developing from another direction as well. Starting in the 1970s, Dutch financial sector companies, including banks and insurance companies, became increasingly international as the size of the financial sector grew from twelve percent to fifty-seven percent of Dutch foreign direct investment (FDI).[270] Indeed,

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264. *1983 Tax Evasion Hearings*, *supra* note 4, at 803 (statement of Harold Henriquez, Minister for the Netherlands Antilles Affairs, Government of the Netherlands Antilles).

265. Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71. LANGER, *supra* note 9, at 194–95; Grady, *supra* note 253, at 638–39 (describing how protocol failed to limit treaty shopping).

266. BEERS, *supra* note 215, at 33 ("This development has been curtailed because the United States Congress at the end of 1971 and in 1973 enacted legislation designed to encourage the creation of international finance subsidiaries within the United States, in order to eliminate the need for United States companies to make use of subsidiaries in foreign territories, such as the Netherlands Antilles. There are still some deficiencies in the United States legislation and as a consequence some Eurodollar offerings continue to be made through Netherlands Antilles finance subsidiaries, but on a much smaller scale."); *1983 Tax Evasion Hearings*, *supra* note 4, at 201 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen) (discussing 1971 legislation).

267. *See* Jeff Girth, *Documents Link Antilles to U.S. Tax Evasion*, N.Y. TIMES, Apr. 12, 1983, at A1, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4 (summarizing Dr. Charles Kimball's scandalous reports that favorable treaty conditions allowed wide-scale money laundering, achieved by using N.V.s to purchase real property in South Florida, and reporting that the IRS would investigate these transactions).

268. Interview, Andersen, Eclipse Consulting, *supra* note 89. The elimination of the withholding tax was proposed in part to gain leverage in negotiations with the Antilles. Cummings, *supra* note 256, at 768.

269. Irish, *supra* note 221, at 468.

270. SLUYTERMAN, *supra* note 1, at 224. The Dutch service sector became increasingly internationalized due to global liberalization of markets. *Id.*

the IRS listed the Netherlands as a tax haven in a 1981 report.[271] Moreover, as European economic integration increased, Dutch economic interests began to increasingly diverge from the economic interests of the Antilles.

The bonds with the Netherlands were fraying in the political realm as well. Around 1970 "The Hague tried to erase the postcolonial ties laid out in the Charter of 1954 .... Much to The Hague's disappointment, the Antilles and Aruba ... turned down the 'gift' of the transferral of sovereignty, despite Dutch promises to guarantee their territorial integrity and to continue extending financial support."[272] Finally, even though the offshore sector was lucrative, it failed to outpace the islands' economic problems. The Antilles' GDP per capita remained stuck between $10,000 and $11,000 from 1960 to 1990, even as Curaçao's competitors such as the Cayman Islands tripled theirs.[273]

F. "Then Disaster Struck"[274]

American dissatisfaction with the use of offshore entities to avoid U.S. taxes increased as the volume of the transactions grew. As one Curaçao attorney termed it, a "new wind" was blowing through the United States Treasury.[275] Beginning in 1979, Treasury took an increasingly hard line on "treaty shopping" and "abuses."[276] For example, the United States terminated its tax treaty effective January 1, 1983 with the British Virgin Islands, a tiny jurisdiction with only a small dollar-volume of U.S.-related financial services business, in part to send a signal that the U.S. took the problem seriously.[277] Six months later, the United States announced it was

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271. IRS, TAX HAVENS AND THEIR USE BY UNITED STATES TAXPAYERS—AN OVERVIEW 177 (1981). The Netherlands was also a prime location for treaty shopping:

> Tax treaties to which the Netherlands is a party ... are attractive to residents of third countries because the Netherlands is a financial center that imposes no withholding tax on interest paid by Dutch entities to foreign persons, the internal income tax structure is favorable, and the tax treaties provide for favorable treatment of interest income paid to Dutch entities.

Irish, *supra* note 221, at 471.

272. OOSTINDIE, *supra* note 21, at 15.

273. OOSTINDIE & KLINKERS, *supra* note 6, at 154–55. Oostindie and Klinkers report that Curaçao's GDP per capita was slightly higher than the Antilles' figures during this period, but "'stagnated' around $12,000." *Id.* at 157.

274. Interview, Elias, United Trust Co., *supra* note 13.

275. *Id.*

276. *1983 Tax Evasion Hearings*, *supra* note 4, at 50 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) ("Over the past 5 years, the Treasury Department has become increasingly concerned about tax treaty abuse by both U.S. and foreign investors. In an effort to remedy the problem—which centers primarily on tax haven countries which have treaties with the United States—the Treasury Department has decided to renegotiate all applicable treaties. In so doing, Treasury appears to be taking a hard line approach to renegotiations—an approach which is both warranted and necessary from a tax policy perspective. That is, Treasury is seeking to include strong exchange of information and anti-abuse measures in all new and renegotiated treaties."); *see also* Belotsky, *supra* note 253, at 70–71 (describing reasons for U.S. "hard line" on treaty shopping).

277. *1983 Tax Evasion Hearings*, *supra* note 4, at 17 (statement of William J. Anderson, Director, General Government Division, General Accounting Office). The BVI refused to accept information exchange provisions and so Treasury canceled the treaty, sending "a meaningful signal to the international tax community." *Id.* at 53. The volume of transactions was relatively low with the BVI, with only $24 million paid to BVI residents in 1981. *Id.* In addition, Treasury thought that the BVI treaty did "stand

terminating tax treaties with an additional eighteen former British and Belgian territories.[278] A general policy shift away from tolerating at least some tax-oriented financial intermediation had begun. And with the Netherlands Antilles being one of the top five destinations for payments of U.S. source income to foreigners in the early 1980s, Treasury's attention naturally focused on the islands.[279]

Efforts to renegotiate the treaty with the Antilles began in earnest in 1981,[280] with the United States focused on incorporating provisions for information exchange and the limitation of benefits in the treaty[281] and the Antilles government resistant to these changes.[282] By 1983, the IRS had accused the Antilles of accommodating treaty shopping,[283] Congressional committees began holding hearings on the Antilles

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out" in terms of noncompliance. *1983 Tax Evasion Hearings*, *supra* note 4, at 264 (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Department of Treasury). The impact on BVI was substantial, however, as the islands earned 10% of their national income from offshore banking involving U.S. residents and one result of the treaty cancellation was likely reduced cooperation by the BVI government on other matters. *1983 Tax Evasion Hearings*, *supra* note 4, at 53 (statement of William J. Anderson, Director, General Government Division, General Accounting Office).

278. The jurisdictions were Anguilla, Barbados, Belize, Burundi, Dominica, Falkland Islands, The Gambia, Grenada, Malawi, Montserrat, Rwanda, St. Christopher-Nevis, St. Lucia, St. Vincent the Grenadines, Seychelles, Sierra Leone, Zambia, and Zaire. *1983 Tax Evasion Hearings*, *supra* note 4, at 565 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen). Tax treaties with former British colonies Antigua and Barbuda were also terminated effective August 26, 1983. Belotsky, *supra* note 253, at 90.

279. *See 1983 Tax Evasion Hearings*, *supra* note 4, at 569 (Memorandum to the Commerce, Consumer, and Monetary Affairs Subcommittee) ("The Netherlands Antilles is the world's most widely-used tax treaty country for tax evasion purposes."); *1983 Tax Evasion Hearings*, *supra* note 4, at 44 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) (stating that 68% of U.S. source payments in early 1980s were made to residents of Canada, the Netherlands Antilles, the Netherlands, Switzerland, and the United Kingdom, and that a total of $9.6 billion was paid to foreign nationals, on which only $727 million in withholding tax was paid); If the total amount had been taxed, $2.9 billion would have been paid. *Id.* Some of the untaxed payments were legitimately exempted from the withholding tax in part or entirely under various tax treaties, of course. *Id.* A *Wall Street Journal* story quoted Christopher G. Smeets, son of Anton Smeets and the president of the Curaçao International Trust Co., one of the largest firms in the offshore sector, as saying that the American interest in renegotiating the treaty "perhaps" resulted because "my father was too clever . . . he did too good of a job . . . we became too big too fast and now there are other people . . . who have become jealous." Fialka, *supra* note 220, at 787.

280. *1983 Tax Evasion Hearings*, *supra* note 4, at 2 ("[S]erious efforts to revise the treaty began in 1981"); *1983 Tax Evasion Hearings*, *supra* note 4, at 7–8 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) (describing how Treasury began a program of tax treaty renegotiation in the late 1970s and took "a hard line approach" in negotiations). *1983 Tax Evasion Hearings*, *supra* note 4, at 571 (Memorandum to the Commerce, Consumer, and Monetary Affairs Subcommittee, (Apr. 5, 1983)) (stating that negotiations formally began in 1979).

281. *1983 Tax Evasion Hearings*, *supra* note 4, at 9 (statement of William J. Anderson, Director, General Government Division, General Accounting Office); *1983 Tax Evasion Hearings*, *supra* note 4, at 273 (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Department of Treasury) (describing a "firm policy" to include limitation of benefits provision in new treaties).

282. *1983 Tax Evasion Hearings*, *supra* note 4, at 571 (Memorandum to the Commerce, Consumer, and Monetary Affairs Subcommittee, (Apr. 5, 1983)) (stating that negotiations deadlocked in April 1983 because Antilles will not agree to "all necessary changes"). Antilles government's lack of cooperation is "motivated by the income it collects by imposing a small tax on the dollars flowing into and through the Antilles. It has been estimated that $100 million a year is earned by the Antilles Government (or roughly one-third its federal budget) from the small tax imposed on these transactions." *Id.*

283. Interview, Elias, United Trust Co., *supra* note 13; *1983 Tax Evasion Hearings*, *supra* note 4, at 9 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) ("Treasury's primary concern with the existing treaty centers on its belief that it is being used extensively for treaty-shopping purposes. In particular, Treasury is concerned about third-country investors' use of

financial sector,[284] and J. Roger Mintz, the U.S. Assistant Secretary of the Treasury for Tax Policy, was pushing strongly for repeal of the U.S.-Netherlands Antilles tax treaty, stating that "the United States is a lot better off without it."[285] Newspaper accounts of the negotiations suggested that the prospects of a new treaty were growing dim and echoed Treasury's view that the treaty was being abused.[286] American lawyers and officials were quoted in the media as saying, among other things, "[c]an you imagine anyone in their right mind setting up a system that goes through the Netherlands Antilles,"[287] that "[f]or the nation's international capital markets to be so dependent on six tiny islands is ridiculous,"[288] and that it was "ridiculous" for U.S. capital markets to be "dependent on a handful of professionals in the Netherlands Antilles."[289]

Notwithstanding Treasury's desire to repeal the treaty, the United States also had several policy goals that would be served by keeping it in place. First, the Antilles provided U.S. companies with relatively easy and familiar access to the Eurobond market, making treaty repeal potentially disruptive to financial markets.[290] Second, domestic political considerations made repeal of the withholding tax difficult. Congress had just created a ten percent "withholding tax" on dividends and interest paid by U.S. entities to U.S. taxpayers. Although this was a true withholding

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the treaty. It also suspects that U.S. citizens are taking advantage of the anonymity provided by the Antilles bearer share companies to evade U.S. taxes.").

284. *See 1983 Tax Evasion Hearings*, *supra* note 4, at 2 (stating that the Subcommittee "is interested in determining whether the United States and Antilles Governments have been sufficiently diligent in preventing treaty abuses.").

285. Kenneth N. Gilpin, *U.S. Keeps Tax Status on Antilles*, N.Y. TIMES, July 3, 1987; *see also* Interview, Elias, United Trust Co., *supra* note 13 (noting that Mintz was pushing strongly for appeal).

286. *See, e.g.*, *Caribbean Tax Haven Faces Heat*, CHI. TRIB., Apr. 13, 1983, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 775 (discussing I.R.S. memo on issue leaked to paper); *U.S. Seeks New Treaty With Island 'Tax Haven'*, MIAMI HERALD, Apr. 14, 1983, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 774 (focusing on the U.S. position); *Antilles 'Firms' Help Many Evade Taxes*, L.A. TIMES, Apr. 12, 1983, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 771 (discussing House Government Operations Committee staff report).

287. Fialka, *supra* note 220, at 788 (quoting a "former Treasury lawyer").

288. James O'Shea, *Popular Antilles Tax Haven Poses Catch 22 for the IRS*, CHI. TRIB., Nov. 21, 1982, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 778.

289. William Baldwin, *The Curaçao Connection*, FORBES, Oct. 25, 1982, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 780 (quoting "Washington, DC lawyer H. David Rosenbloom, former international tax counsel at Treasury").

290. *See 1983 Tax Evasion Hearings*, *supra* note 4, at 13–14 (statement of William J. Anderson, Director, General Government Division, General Accounting Office). The negotiations themselves caused problems. As a *Business Week* story on the negotiations in February 1983 noted:

> So few clues have leaked out of the treaty talks that 'the international financial community is left in limbo, with huge Eurobond and private financings hung in the balance,' says Richard Hammer, director of international taxes for accounts Price Waterhouse & Co. Adds General Electric Co.'s tax manager, John McCoy: "This is having an impact. People have been waiting and waiting on this treaty—they're stirred up."

A Treaty That May Sink Havens, BUS. WK., Feb. 14, 1983, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 781. *1983 Tax Evasion Hearings*, *supra* note 4, at 203 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen) (noting that the Antilles' "virtual monopoly" on finance subsidiary transactions made it difficult for Treasury to pressure the Antilles into accepting its proposals for a revised treaty); *see also 1983 Tax Evasion Hearings*, *supra* note 4, at 571 (Memorandum to the Commerce, Consumer, and Monetary Affairs Subcommittee (Apr. 5, 1983)) (describing how Treasury's leverage is limited because Antilles are only place where Eurobonds can be floated by U.S. firms).

tax, which allowed a refund of excess amounts collected, it was politically difficult to repeal a tax on foreigners so soon after imposing one with the same name on U.S. taxpayers.[291] Third, the U.S. needed the Antilles' cooperation in containing illegal drug shipments to the United States.[292] Finally, the United States had an interest in encouraging political stability in the Antilles.[293] The importance of the offshore financial sector to the Antilles' economy made this a real concern.[294] (Lest the reader think this was not considered particularly important, recall that the United States invaded Grenada in October 1983, and Panama in December 1989.[295] Both invasions evidence an active U.S. foreign policy concern with the Caribbean during the 1980s.) An additional complication was that once the United States had committed to its hard-line position on renegotiations by canceling the BVI treaty, failure to achieve a significant reform of the Antilles treaty would undermine the strong message that had been sent by the BVI cancellation.[296]

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291. *1983 Tax Evasion Hearings*, *supra* note 4, at 201 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen); William Baldwin, *The Curaçao Connection*, FORBES, Oct. 25, 1982, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 780.

292. *1983 Tax Evasion Hearings*, *supra* note 4, at 13–14 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) (describing Antilles' intelligence on drug trafficking as "of vital importance" to U.S. antinarcotics activities).

293. *Id.* at 55 (noting that negotiations were complicated because "the economy of the Netherland Antilles, a pro-American Caribbean country, depend[ed] very heavily on offshore banking activities"); "[W]hile it is clear, from a tax policy perspective, that the U.S. can no longer tolerate extensive abuse of the current tax treaty, other concerns come into play. The status of the Netherlands Antilles' economy is one such concern[. . . .]" *Id.* at 64; Cummings, *supra* note 256, at 769 (noting that the United States had an important interest in "buttressing the economies of Caribbean nations against Marxist penetration" and feared that the Antilles could be vulnerable).

294. *A Treaty That May Sink Havens*, BUS. WK., Feb. 14, 1983, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 782. ("[T]he Antilles minister in Washington [noted], 'Tourism, our No. 1 industry, is uncertain. Oil, No. 2, is uncertain. We need the offshore investment business. It produces 25% or 30% of our $120 million federal budget .... If we lose our tax haven, our unemployment rate ... would go from 20% to 27%.'").

295. JOINT HISTORY OFFICE, OFFICE OF THE CHAIRMAN OF THE JOINT CHIEFS OF STAFF, OPERATION URGENT FURY GRENADA: THE PLANNING AND EXECUTION OF JOINT OPERATIONS IN GRENADA 12 OCTOBER–2 NOVEMBER 1983 (1997); JOINT HISTORY OFFICE, OFFICE OF THE CHAIRMAN OF THE JOINT CHIEFS OF STAFF, OPERATION JUST CAUSE PANAMA: THE PLANNING AND EXECUTION OF JOINT OPERATIONS IN PANAMA FEBRUARY 1988–JANUARY 1990 (1995).

296. *1983 Tax Evasion Hearings*, *supra* note 4, at 17 (statement of William J. Anderson, Director, General Government Division, General Accounting Office). There were alternative means of accomplishing some of these U.S. policy goals. The need for the Antilles route to the Eurobond market was a result of the U.S. withholding tax. The U.S. could either repeal the tax or give another jurisdiction tax treatment similar to that given to the Antilles but in a treaty with limitation of benefits provisions. *Id.* at 10 (noting that access to the Eurobond market could be "just as easily achieved by changing or eliminating the withholding tax requirement applicable to such borrowings—something that Treasury itself has proposed in the past."); *1983 Tax Evasion Hearings*, *supra* note 4, at 277 (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Department of Treasury) (noting that Treasury favored repeal of withholding tax on certain forms of interest paid to foreign persons, including Eurodollar loan interest); *1983 Tax Evasion Hearings*, *supra* note 4, at 168 (statement of Robert Butcher, Vice President, Citicorp) (noting that Citibank had repeatedly called for repeal of the withholding tax); *id.* (noting that UK had proposed to change its law to allow direct payments to overseas payment agents without a withholding tax in March 1983); *1983 Tax Evasion Hearings*, *supra* note 4, at 204 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen) (suggesting creating a competitive center). There were potentially more cooperative jurisdictions. For example, Switzerland cooperated with the United States by determining if the withholding tax exemption under the treaty was appropriately invoked or not. Where it was not, the Swiss collected the withholding tax and sent it to the United States. *1983 Tax Evasion Hearings*, *supra* note 4, at 9 (statement of William J. Anderson, Director, General Government Division, General Accounting Office). The island of Guam, a U.S. dependency, took steps to establish

The Antilles wanted to maintain its offshore financial sector and therefore sought to make the 1980s negotiations with the United States successful. The Antilles were prepared to agree to share with the U.S. Treasury information about American citizens and residents, but not information about residents of other countries.[297] The sticking point appeared to be the shared belief by the United States and the Antilles that the latter's offshore financial sector could not survive the information-sharing and limitation-of-benefits provisions the United States was demanding.[298] Both believed that a new treaty acceptable to the United States would spell disaster for the existing offshore business; they disagreed on the desirability of that outcome. There was thus a real impediment to a new agreement that could not be resolved through negotiation.

The U.S. increased pressure on the Antilles by repealing the U.S. withholding tax on interest payments effective July 18, 1984.[299] (There was, and continues to be, a general trend toward the repeal of such taxes worldwide as part of the opening of

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itself as a potential competitor to the Netherlands Antilles, but Treasury acted swiftly to block the effort. *See The Next Tax Haven Could Be Guam*, USA TODAY, Oct. 12, 1982, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 740; Gordan C. Chang, *Guam May Replace Antilles as Popular Tax Haven*, WALL ST. J., Oct. 3, 1982, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 741; Letter from Ricardo J. Bordallo, Governor of Guam, to President Ronald Reagan (Jan. 7, 1983) (*reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 731) (objecting to IRS efforts to block Guam's efforts). However, neither of these alternatives were themselves cost-free. In addition, any change in U.S. policy would have to take into account the impact on the existing bond market. Most Eurobonds required the borrower to "gross up" any taxes that ultimately might be imposed on the interest payments due on the bonds. Eurobonds issued through the Antilles typically required that the borrower "gross up" the bond (i.e., pay the cost of any taxes imposed). *1983 Tax Evasion Hearings*, *supra* note 4, at 175 (statement of Robert Butcher, Vice President, Citicorp). This provision applied only to non-U.S. persons holding the bonds, however, thus deterring Americans from attempting to avoid taxes by purchasing bearer Eurobonds issued by U.S. companies rather than U.S. bonds issued domestically by the same borrower. *Id.* at 176. As a result, a change in U.S. policy that caused the imposition of withholding taxes would be extremely costly to U.S. borrowers.

297. John Cummings, *Tiny Islands Are Giant Tax Haven*, July 31, 1983, NEWSDAY *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 768–69; *1983 Tax Evasion Hearings*, *supra* note 4, at 807–08 (statement of Harold Henriquez, Minister for the Netherlands Antilles Affairs, Government of the Netherlands Antilles).

298. *1983 Tax Evasion Hearings*, *supra* note 4, at 9–10 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) ("The Netherlands Antilles has not taken any unilateral actions to remedy treaty-related abuses, nor is it expected to soon do so, absent a treaty with revisions. This is because, according to Netherlands Antilles officials, such actions would have the effect of essentially closing down the offshore financing business in that country. Thus, absent strong action, Treasury cannot soon expect to reverse the growth in, much less halt, undesirable use of the U.S. tax treaty with the Netherlands Antilles."); Belotsky, *supra* note 253, at 83 ("There is little incentive, however, for tax haven countries such as the Netherlands Antilles to make concessions in a new treaty which the United States would regard as meaningful.").

299. Interview, Elias, United Trust Co., *supra* note 13; Interview, Andersen, Eclipse Consulting, *supra* note 89; Deficit Reduction Act of 1984, Pub. L. No. 98–369 § 127(a), 98 Stat. 494, 648–50 ("Repeal of the 30 Percent Tax on Interest Received by Foreigners on Certain Portfolio Investments."). *See also* Michael J. Gratz and Itai Grinberg, *Taxing International Portfolio Income,* 56 TAX L. REV. 537, 577 n.186 (2003) (discussing the effects of the repeal of the withholding tax); Leslie E. Papke, *One-Way Treaty With the World: The U.S. Withholding Tax and the Netherlands Antilles*, 7 INT'L TAX & PUB. FIN. 295, 295 (2000) (exploring broad impacts of the repeal of the withholding tax); Chris R. Carson, *Nonresident Alien Income and Tax Withheld, 1983*, *available at* http://www.irs.gov/pub/irs-soi/83nonralintw.pdf (noting that the Deficit Reduction Act of 1984 was "expected to all but eliminate the use of the Antilles for future Eurobond financing").

capital markets.)[300] The repeal diminished the attractiveness of the Antilles sandwich structure by removing an obstacle to directly tapping the Eurobond market.[301] The repeal did not eliminate it entirely, however, because the Antilles sandwich structure was useful as a conduit to move cash offshore into subsidiaries in lower tax jurisdictions. That is, a U.S. corporation could make deductible interest payments to a finance subsidiary at an interest rate higher than the rate paid by the subsidiary on the Eurobonds it issued to foreign investors. The "spread" between the two interest rates was profit to the finance subsidiary in the Antilles and subject to that jurisdiction's low corporate tax rates. The greater the interest rate spread, the more U.S. earnings of the corporation (in the form of deductible interest payments) escaped U.S. taxation. That money could then be used to fund foreign operations.

In 1982, the United States again increased pressure on the Antilles as IRS field offices began to question the tax status of Antillean finance subsidiaries.[302] Not only did IRS field offices begin to dispute withholding tax exemption claims during audits, but on March 9, 1983, Treasury denied the Federal National Mortgage Association's request to establish a Netherlands Antilles finance subsidiary because the department feared approval "could have an adverse effect on our negotiations [over the tax treaty], which currently are at a sensitive stage."[303]

Although there were reports that the United States had made its "final, bottomline offer" in early 1983,[304] the pressure must have had some impact on the

300. Interview, Behr, HBM Group, *supra* note 103; Mitchell B. Weiss, *International Tax Competition: An Efficient or Inefficient Phenomenon?*, 16 AKRON TAX J. 99, 108 & n.27 (2001) ("Thus, not surprisingly, one country after the next responded in kind [to the repeal of U.S. withholding tax on interest income], introducing measures that not only discouraged the outbound migration of their country's capital, but also encouraged the importation of large amounts of capital from higher-taxing jurisdictions. Some countries created tax-exempt domestic investment opportunities; some relaxed their enforcement efforts; but most followed the U.S.'s lead, exempting their withholding tax on imported interest income and substantially cutting their corporate and individual tax rates."); *see* Maines, *supra* note 200 (describing various U.S. measures employed to curtail outbound flows of capital); Interest Equalization Tax, Pub. L. No. 88–563, 78 Stat. 809 (1964).

301. Interview, Andersen, Eclipse Consulting, *supra* note 89.

302. *1983 Tax Evasion Hearings*, *supra* note 4, at 263 (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Department of Treasury) (noting IRS inquiry into the appropriateness of tax treatment of Antilles entities and tax status "not entirely settled"); William Baldwin, *The Curaçao Connection*, FORBES, Oct. 25, 1982, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 780 (reporting on Houston I.R.S. office's attempt to limit benefits of treaty to Curaçao residents). *See also 1983 Tax Evasion Hearings*, *supra* note 4, at 65 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) ("[The I.R.S.] did not challenge continued and expanded use of such finance subsidiaries by U.S. corporations until 1982. At that time, of course, Treasury was involved in renegotiating the Netherlands Antilles tax treaty."); Letter to Roscoe Egger, Jr., I.R.S. Commissioner, from Price Waterhouse & Co. (Sept. 29, 1982) (*reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 608) (expressing concern over the "newly established position" of the I.R.S. on finance subsidiaries, which it contends is a "sharp reversal of long standing practice"); James O'Shea, *Popular Antilles Tax Haven Poses Catch 22 for the IRS*, CHI. TRIB., Nov. 21, 1982, *reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 776–77 (describing impact of disclosure in Texas Air Corp. SEC filing of tax dispute with IRS over Antilles finance subsidiary).

303. Letter from Donald T. Regan, Secretary of the Treasury, to Donald O. Maxwell, the Chairman of the Board & Chief Executive Officer of the Federal National Mortgage Association (Mar. 9, 1983) (*reprinted in 1983 Tax Evasion Hearings*, *supra* note 4, at 612). A media report focused on the incongruity of a federal entity attempting to avoid federal taxes. Fialka, *supra* note 220, at 788 ("'Here was a federal agency that wanted to go through the Antilles to escape a federal tax,' one former official noted. 'I found that mind boggling.'").

304. Memorandum from the 1983 Tax Evasion Hearings, *supra* note 4, at 571–72 (April 5, 1983) (describing offer as including exchange of information).

Antillean negotiators, for in April 1983 Treasury reported that "most of the issues" between the United States and the Antilles had been resolved and a new treaty would be signed "in a matter of weeks or months at the most."[305] No treaty was forthcoming, however, and efforts to finalize a renegotiated treaty dragged on from 1983 to 1986.[306] Although a new treaty was initially agreed to by the two governments, it failed to be ratified, in part because subsequent changes to U.S. tax law in the 1986 tax reforms were inconsistent with the new treaty.[307] Rather than a new treaty, on June 29, 1987, Assistant Treasury Secretary Mintz announced that the United States would cancel its tax treaty with the Antilles in six months.[308]

The announcement caused chaos in international markets because of the impact of treaty cancellation on the $40–50 billion of outstanding bonds that had been issued in reliance on the treaty exemption prior to the U.S. repeal of the withholding tax.[309] The repeal of the tax had been prospective only, leaving interest payments on bonds issued prior to repeal subject to the withholding tax unless covered by a tax treaty.[310] Thus, cancellation of the U.S.-Netherlands Antilles tax treaty had the effect of making all interest payments on bonds issued prior to the withholding tax repeal subject to withholding tax. Since these bonds generally made the borrower responsible for any taxes or interest payments, this would cost U.S. borrowers thirty percent of future interest payments, although many bonds also permitted redemption under such circumstances.[311] To prevent the instability in the bond market this would

305. *1983 Tax Evasion Hearings*, *supra* note 4, at 265 (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Department of Treasury).

306. Interview, Elias, United Trust Co., *supra* note 13.

307. Mark B. Schoeller, Comment, *The Termination of the United States-Netherlands Antilles Income Tax Convention: A Failure of U.S. Tax Policy*, 10 U. PA. J. INT'L BUS. L. 493, 506–07 (1988).

308. *See* Treas. Dep't. News Release 87–3894 (June 29, 1987); *see generally* Rose Gutfeld & Ann Monroe, *U.S. Is Ending 1948 Tax Treaty With the Antilles*, WALL ST. J., June 30, 1987, at 7; Interview, Elias, United Trust Co., *supra* note 13. At the same time, the United Kingdom announced it would review its tax treaty with the Antilles (although with less effect, as there were far fewer Antilles finance subsidiaries owned by British corporations). *See Britain Reviews Tax Pact With Netherlands Antilles*, WALL ST. J., July 2, 1987, at 30; Interview with Guiveron T. Weert & Errol Gova, Bank van de Nederlandse Antillen, Curaçao, Netherlands Antilles (May 21, 2008) [hereinafter Interview, Weert & Gova, Bank van de Nederlandse Antillen]; Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71.

309. Interview, Elias, United Trust Co., *supra* note 13; Kenneth N. Gilpin, *U.S. Keeps Tax Status on Antilles*, N.Y. TIMES, July 3, 1987, at D1 (noting that the announcement of the treaty cancellation "sent shock waves through the bond markets worldwide," causing losses in value of "as much as seven points" in some bonds' value, because it would have subjected $32 billion in corporate debt sold through the Antillean subsidiaries to the withholding tax and would likely prompt issuing companies to redeem them and refinance); James A. Duncan & Albert S. Pergam, *Euromarket participants evaluate treaty revocation*, 6 INT'L FIN. L. REV. 12, 12 (1987) (noting that Reagan administration was "[s]tung by the vehemence of the response to its revocation of the treaty" and moved quickly to modify the treaty cancellation to protect existing bonds).

310. Interview, Elias, United Trust Co., *supra* note 13; Interview, Andersen, Eclipse Consulting, *supra* note 89.

311. Duncan & Pergam, *supra* note 309, at 13 ("Eurobond documentation typically requires issuers to bear the cost if such taxes are imposed after the bonds are issued (by paying additional interest sufficient to offset the amount of any taxes required to be withheld from interest payments), but permits issuers to redeem outstanding obligations at par if this obligation to 'gross up' interest payments is triggered."). Eurobonds differed significantly with respect to the call provision. Where bonds were immediately callable, issuers benefited as they could refinance at lower rates after redeeming at par bonds currently selling above par. Where bonds were not immediately callable, issuers faced higher interest payments. *Id.* at 13–14.

have produced, the United States quickly reinstated the treaty exemption from withholding tax (Article VIII) for interest paid on existing bonds.[312]

While the Antilles' Finance Minister called the cancellation of the treaty "a national disaster,"[313] media coverage in the United States—even in the pro-business *Wall Street Journal*—was unsympathetic. A page-one *Journal* report on the treaty cancellation concluded with an anecdote about "Juan Fulano" (Spanish for John Doe), a mysterious "fat man" in a "dark corner of one of Curaçao's finest hotels" confiding at 3:15 a.m. that the Antilles were the "ideal" offshore jurisdiction because they were "Pros. Discreet .... In the Antilles, you rarely have to pay a bribe, and you almost never have to pay a tax."[314]

Shorn of the treaty that had been the cornerstone of its financial strength, the mighty Antilles was now as powerless in the face of growing competition from other offshore jurisdictions as Samson before the Philistines. In particular, the Antilles confronted a substantial threat from zero-rate or "nil" tax jurisdictions like the Cayman Islands and the British Virgin Islands[315] that had expanded dramatically in the 1980s.[316] Not only did these jurisdictions offer a zero tax rate, making a tax treaty superfluous for some financial structures, but they also offered familiar, common-law, English-language legal systems. By contrast, the Antilles' civil-law, Dutch-language system became even less attractive than it previously had been to Americans considering doing business there.[317] Finally, legal ethics rules governing Dutch and Antilles' lawyers prohibited them from advertising legal services, further handicapping them in competition against the lawyers in Cayman and other jurisdictions who were subject to no such restrictions.[318] The result was that the Antilles "got slaughtered" and "absolutely run over" in the market and the use of N.V.s by foreign business was never again a significant part of the financial sector.[319]

III. REGIME FLEXIBILITY, THE ANTILLES, AND THE FUTURE OF OFFSHORE FINANCIAL INTERMEDIATION

It seems unlikely that anyone forecasting the future of the world financial system at the close of World War II would have predicted that the Antilles would play a major role in it. Not even Anton Smeets, the entrepreneurial notary who laid the foundations for the Antilles' offshore financial sector, likely anticipated that Antilles corporations would be vehicles for significant real property and other investment holdings in the United States in the 1970s, or that billions of dollars in Eurobonds would be issued through the Antilles' finance subsidiaries in the early 1980s. It also does not appear that many in the Antilles foresaw the abrupt end of the boom in the mid-1980s. In retrospect, however, we believe that from the

312. *See* Treas. Dep't. News Release 87-4404, (July 10, 1987); *see also* Gilpin, *supra* note 285; Interview, Elias, United Trust Co., *supra* note 13.

313. McCoy, *supra* note 29.

314. *Id.*

315. Irish, *supra* note 221, at 456 (characterizing the Cayman Islands and British Virgin Islands as pure tax havens).

316. Interview, Weert & Gova, Bank van de Nederlandse Antillen, *supra* note 308; Interview, Andersen, Eclipse Consulting, *supra* note 89.

317. Interview, Andersen, Eclipse Consulting, *supra* note 89.

318. *Id.*

319. *Id.*

experience of the Antilles one can discern the contours of a theory that explains the relatively brief arc of that jurisdiction's success as an offshore financial intermediary and offers insight into the future prospects of both the Antilles and other offshore financial centers in the twenty-first century. This section sets out the elements of that theory.

A. A Theory of Regime Plasticity[320]

The rise and fall of the Antilles suggests four critical propositions for the offshore financial sector at large. First, there will always be differences among legal regimes, and those differences often may be arbitraged in order to make business transactions more cost-efficient. This arbitrage may be financially beneficial not only to the parties to the transactions but also to the jurisdiction in which the transactions take place if the jurisdiction can attract a sufficient volume of such transactions. Second, differences among legal regimes, while persistent, are nonetheless fluid, which makes the revenue flows realized by jurisdictions engaged in financial intermediation particularly vulnerable through changes in both business conditions and in the legal regimes that produce the intermediation opportunities. Third, the vulnerability of offshore jurisdictions to the elimination of revenue flows from financial intermediation activity places a premium on a jurisdiction's legislative agility. To survive in a world of perpetual change, an offshore jurisdiction must develop the ability to adapt quickly to change. Finally, whether an offshore jurisdiction can adapt to changes in business conditions and the alteration of legal regimes in onshore jurisdictions depends in great part on its own laws and the political arrangements under which it exists. Each of these propositions is addressed in turn in the following sections.

1. The Persistence of Difference

Although many jurisdictions' tax and regulatory systems have broad principles in common, differences in details are inevitable. Some such differences reflect policy choices, simple drafting preferences not related to policy concerns, or even inadvertent errors. We contend that such distinctions are an inevitable result of the inherent complexity of modern tax and regulatory systems coupled with strategic behavior by some jurisdictions seeking to attract business through manipulation of their regulatory regimes. As Erin O'Hara and Larry Ribstein recently noted, governments often fail to effectively control everyone everywhere.[321] Any state can make rules, but not every state legitimately can enforce them in all circumstances, especially those involving people or assets outside the state.[322] Because no single government can extend its courts and enforcement powers to cover the world, multiple states end up competing with no state able to exercise effective monopoly power over mobile entities.[323] In the end, the states compete for mobile parties and their assets by attempting to provide the laws people want.[324] Even resolute efforts at

320. See definition of "plasticity" *supra* note 15.
321. O'HARA & RIBSTEIN, *supra* note 87, at 60.
322. *Id.*
323. *Id.*
324. *Id.*

harmonization cannot eliminate jurisdictional variations entirely, and most harmonization efforts fall short of the level of effort needed to characterize them as "resolute." Differences arise both by intention and accident, and even accidental ones acquire constituencies once they have been in existence for a time.

Regardless of the rationale or lack thereof for any particular legal difference, as such differences multiply, opportunities arise to structure transactions to arbitrage them. The Antilles' ascendancy began with its creation of a tax regime that differed from and was more favorable to foreign investors than tax regimes in other jurisdictions. It continued with the subsequent identification and exploitation of an opportunity to use Antilles entities and treaty relationships to permit access by U.S. borrowers to the fiscal resources of the Eurobond market—access that was not available on the same terms through U.S. or other foreign entities. As tax expert Marshall Langer noted in his 1983 Congressional testimony about the use of Antilles finance structures by U.S. firms, it was not Antilles law alone that produced the demand for Antilles finance structures, but rather its interplay with U.S. law.[325] Of course, specific transactions depended on a multitude of details concerning everything from U.S. tax policy to European relaxation of currency controls and from declining communications costs to the increasing sophistication of legal counsel. However, it was the persistence of differences in the two legal regimes that propelled the Netherlands Antilles from a largely forgotten backwater to financial sector prominence.

Since difference has always been persistent, why is it that it has not always led to successful arbitrage? Historically, the exploitation of differences in legal regimes has been limited by the costs associated with cross-border transactions. These costs include providing adequate communications capabilities between two or more geographically distant jurisdictions; securing the services of lawyers, bankers, accountants, notaries, and other professionals in each jurisdiction to implement the transactions; and contending with the regulatory risks associated with doing business across multiple jurisdictions. All three of these, but particularly the first two, have been reduced dramatically for virtually all jurisdictions since World War II, greatly expanding the range of possibilities for exploiting arbitrage opportunities.

The history of the Antilles discussed in Part I highlights the steadily declining communications and professional services costs that, in the 1950s, began to shape the islands and eventually helped persuade firms to engage in international financial intermediation there. The original "offshore" transaction in the Antilles was the relocation of the statutory seats of Dutch multinationals at the outbreak of World War II. Prior to that time, communication between Europe and the Antilles was deemed too expensive, and the cost of securing professional infrastructure too high to make doing business in the Antilles feasible. The German invasion changed the equation, because the cost of remaining in the occupied Netherlands became greater for Dutch companies than the costs of going offshore. Today, the ongoing decline in the cost of communications—what *The Economist* has termed "the death of distance"[326]—continues to make the Antilles and similar, previously remote locations viable places in which to do business.

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325. *1983 Tax Evasion Hearings*, *supra* note 4, at 200 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen).

326. *See* FRANCES CAIRNCROSS, THE DEATH OF DISTANCE: HOW THE COMMUNICATIONS REVOLUTION WILL CHANGE OUR LIVES (2d ed. 2001). Cairncross's book was an expansion of her original article in *The Economist*, in which she coined the phrase "the death of distance." *See The Death*

Communications costs are not the only costs that have declined dramatically; the costs of securing professional services have also been reduced over time. Once Dutch firms began to establish themselves in the Antilles during the war, a professional services sector quickly sprang up to serve those companies. This made it possible to secure the professional services necessary to engage in financial transactions in the Antilles at a reasonable cost. Moreover, as the professional services infrastructure in a jurisdiction expands and becomes more sophisticated, ever-smaller legal regime differences become susceptible to cost-effective exploitation.

In addition, as familiarity with the Antilles legal regime grew following the advent of Dutch companies to the jurisdiction, the real or perceived regulatory and transactions costs of doing business in what some viewed as a half-forgotten colonial outpost also diminished. The early establishment of offshore financial activity gave the Antilles a taste of the benefits a financial sector could offer, thus providing an incentive for continued private sector and local government cooperation in the establishment of the sector, and further reducing future regulatory risk. This "virtuous circle" was subsequently repeated in the development of the Antilles' tax regime, the finance subsidiary business, and the use of Antilles N.V.s for foreign investment in U.S. real property and other assets.

Ironically, the decline in the regulatory risks of doing business offshore is attributable, in part, to the successful efforts of onshore jurisdictions to control competition in at least the more reputable offshore jurisdictions through international standards for anti-money laundering measures and the prevention of organized crime. Pushed by multilateral regulators, onshore jurisdiction law enforcement agencies, and competition amongst themselves, offshore jurisdictions have brought their financial systems into the twenty-first century (and in some instances have surpassed onshore jurisdictions), achieved compliance with international standards from organizations like the Financial Action Task Force (FATF),[327] and joined key certification organizations such as the International Organization of Securities Commissions (IOSCO).[328] No longer as easily dismissed as tax havens sullied by "the Grisham effect,"[329] today's offshore financial centers and the legal structures they offer have become a central element of the business structures of many multinational corporations. There may not be a single transaction as lucrative as the Antilles' sandwich was at its peak, but because important jurisdictional differences in tax and regulatory policies persist, opportunities for offshore financial intermediation will not disappear.

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of Distance, THE ECONOMIST, Sept. 30, 1995, at S5.

327. FATF is an inter-governmental body established by the G-7 Summit in 1989 to develop and promote national and international policies to combat money laundering and terrorist financing. *See generally* http://www.fatf-gafi.org (follow "About the FATF" hyperlink) (last visited Oct. 6, 2009).

328. Formed in 1983, IOSCO is a global organization of securities regulators that is recognized as the international standard setter for securities markets. *See generally* http://www.iosco.org/about/ (last visited Oct. 6, 2009) (providing general information on the organization and more specific information under the "Historical Background" tab).

329. John Grisham's popular novel *The Firm*, which was subsequently made into a blockbuster movie, featured the use of secret bank accounts in the Cayman Islands as a means of hiding ill-gotten gains. Grisham took artistic liberties with the details of Caymanian banking to suit the needs of the novel, and gave readers an inaccurate picture of Caymanian banking practices and law. *See generally* JOHN GRISHAM, THE FIRM (Dell Publishing Company 1992).

2. The Challenge of Change

The second proposition one may derive from the Antilles' experience is that differences among various legal regimes are fluid, rather than static. Thus, no particular opportunity for intermediation based on legal differences can last forever. Just as the coral reefs in Curaçao that shelter an astonishing array of sea life may be damaged by changes occurring elsewhere in the ocean,[330] so changes in the laws and regulations of one or more onshore jurisdictions may threaten financial intermediation transactions and the viability of the offshore financial centers through which they are conducted. Consequently, offshore centers like the Netherlands Antilles remain vulnerable because they cannot control whether, or for how long, the transactions on which they depend will remain economically viable.

Of course, international transactions are vulnerable to all sorts of change. A trading partner could institute a tariff or close its borders to imports; transportation costs could rise; or a new competitor could appear, capture market share and eliminate its predecessor. For the Antilles, this kind of change appeared in the form of a major competitive threat from commonwealth Caribbean jurisdictions such as the Cayman Islands and British Virgin Islands. But there is a different kind of vulnerability to change associated with offshore financial centers that relates to their ability to craft and enact laws that create exploitable differences between their own legal regimes and those of onshore jurisdictions. Financial intermediation that exploits legal differences frequently results in lost tax or business revenue for onshore jurisdictions. Thus, an offshore financial center must be concerned about the effects on onshore jurisdictions of the legal differences it creates. Because financial intermediation ultimately depends on all jurisdictions involved maintaining the legal regimes that permit it, once the costs of intermediation activity to one of the jurisdictions exceed its benefits, that jurisdiction has an incentive to change its laws to end that activity. Thus, an onshore jurisdiction acting to preserve its interests easily may destroy offshore arbitrage opportunities.

This was the case with respect to the Antilles' financial subsidiary business in the 1970s and 1980s. The use of Antilles N.V. vehicles to acquire U.S. real estate and other investments, and to give U.S. firms access to the Eurobond market, depended on U.S. and Antilles laws and regulations. These transactions made the Antilles' offshore financial sector successful, but they also increased foreign investment in U.S. debt. At least initially, the benefit to the U.S. was greater than the offsetting foregone withholding tax revenue. Over time, however, lost tax revenue grew dramatically as ever-larger numbers of firms in other jurisdictions began to create Antilles entities in order to benefit from the Antilles' favorable tax treaty with the United States. It is not particularly surprising that revenue concerns predominated in the early 1980s since the negotiation of tax treaties in the United States was, at that time, under the effective control of the Department of the Treasury, rather than the State Department.[331] Moreover, as the benefits of the U.S.-Antilles tax treaty were increasingly extended to persons not physically resident in the Antilles, the U.S.

330. *See* Barbara E. Brown & John C. Ogden, *Coral Bleaching,* 268 SCI. AM. 64–70 (Jan. 1993) (describing risks to coral reefs).

331. *1983 Tax Evasion Hearings*, *supra* note 4, at 16 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) (State Department "delegated" authority to negotiate tax treaties to Treasury).

Treasury worried that its "accidentally generous" treaty[332] was undermining broader policy goals by reducing the efficacy of a reduction in the withholding tax used by Treasury to incentivize third countries to enter into tax information agreements.

The challenges of change for the Antilles approached from another direction, as well. Beginning in the late 1970s[333] and continuing to the present, onshore jurisdictions have expressed a growing concern about the use of offshore financial centers to shield illicit activity.[334] In the late 1970s, there was a fear among developed countries that the growing volume of transactions in the Antilles would attract the attention of those who saw ways to use the entities available there—together with the island's use of bearer shares and bonds—to shield unsavory transactions from law enforcement scrutiny. The opposition to financial intermediation thus grew to include law enforcement and tax authorities around the world that were focused on the illegal uses of offshore financial centers.[335] The Organization for Economic Cooperation and Development (OECD), the European Union (EU), and some onshore jurisdictions such as France and Germany exerted and have continued to make significant efforts to restrict opportunities for offshore financial centers to engage in financial intermediation.[336] Reasonable people can differ over whether offshore financial centers in the 1970s (or today) primarily produced tax avoidance or tax evasion, or over whether they led to capital inflows or money laundering. However, regardless of the motive, as the offshore world grew in significance, it began to be perceived as a threat by onshore interests that had previously ignored it. Greater scrutiny of offshore financial centers and the possibility of resulting changes in legal regimes necessarily puts a premium on diversification and responsiveness to change, which we discuss in the following section.

3. The Imperative of Legislative Agility

The third proposition we take from the Antilles' saga is that to survive in the midst of change requires legislative agility. The Antilles' economic history vividly

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332. In the case of the Antilles, its tax treaty with the United States just happened to have the favorable withholding tax provision that made the Dutch sandwich possible while other jurisdictions' treaties did not. *See 1983 Tax Evasion Hearings*, *supra* note 4, at 205 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen) ("It is largely by accident that the U.K. overseas treaty doesn't work for this purpose while the Antilles treaty does. The 1945 U.K. treaty contained an interest article almost identical to the one in the Antilles treaty. However, the notes extending the 1945 U.K. treaty to overseas territories deleted the interest article for most of the U.K. territories to which the treaty was extended.").

333. Belotsky, *supra* note 253, at 45 ("Tax havens have existed for some time but did not begin to present themselves as a major loss of revenue problem for the United States until 1970.").

334. Stop Tax Haven Abuse Act, H.R. 1265, 111th Cong. (2009) (the purpose of this act is "[t]o restrict the use of offshore tax havens and abusive tax shelters to inappropriately avoid Federal taxation . . ."); Stop Tax Haven Abuse Act, S. 506, 111th Cong. (2009); Lynnley Browning, *A Swiss Bank is Set to Open its Secret Files*, N.Y. TIMES, Feb. 19, 2009, at A1 ("UBS, the largest bank in Switzerland, agreed . . . to divulge the names of well-heeled Americans whom [federal prosecutors] suspect of using offshore accounts at the bank to evade taxes.").

335. *See* Boise, *supra* note 14 (discussing the opposition).

336. *See* RAWI ABDELAL, CAPITAL RULES: THE CONSTRUCTION OF GLOBAL FINANCE 3–4 (2007) (summarizing critical role of French policy makers from the left because "[s]ocialists came to believe that capital controls did not work to prevent the rich and well-connected from spiriting their funds out of the country, but that they worked all too well to lock up the bank accounts of their working- and middle-class constituents and voters").

portrays the types of challenges that small open economies routinely confront. From its vulnerability to Venezuelan tariffs in the nineteenth-century, to the boom and bust of the refinery years in the mid-twentieth century, the Antilles' economy has been buffeted repeatedly by events outside its control. The collapse of the islands' financial sector in the 1980s only illustrates the speed with which a particular form of offshore financial intermediation can be dismantled by onshore jurisdictions. Although the Antilles' finance subsidiary regime survived for more than two decades, it unraveled within a relatively short period of time. Thus, the history of the Antilles provides a cautionary tale of the need for flexibility and agility in responding to changes in the economic environment and in the legal regimes in both competing and onshore jurisdictions.

Legislative agility as it relates to the success of offshore financial centers means at least three things. First, although some offshore jurisdictions initially may achieve success by virtue of fortuitous events occurring elsewhere,[337] most have exercised legislative powers to lay the groundwork that either created or enhanced legal differences capable of providing opportunities for arbitrage. Success in this regard generally is the product of private- or public-sector entrepreneurial visionaries and a concerned political leadership willing to listen to the ideas of these visionaries and implement them through often novel and creative laws.[338] In the case of the Antilles, Anton Smeets saw an opportunity in the relocation of the statutory seats of Dutch companies during wartime.[339] Of course, the market has changed considerably since then; onshore jurisdictions now view offshore financial centers with deep suspicion[340] and are less willing to enter into tax treaties and other arrangements that would facilitate offshore financial intermediation. Nonetheless, an offshore financial sector is unlikely to be created today absent a somewhat agile and creative legislature.

Second, the same legislative agility that creates offshore intermediation opportunities also must be exercised when business and political changes threaten the viability of those opportunities. Following liberation of the Netherlands from German occupation, sympathetic and forward-looking legislators sagely followed Smeets's advice in enacting the first-of-its-kind ring-fenced tax regime, which enticed many Dutch companies to stay in the Antilles.[341] Similar examples occur in the histories of other offshore jurisdictions.[342]

Law enforcement and national security concerns have led to pressures on offshore financial centers that were unimaginable forty years ago. Offshore financial centers have been required to adapt on a wide range of fronts, from accepting tax information agreements[343] with countries like the United States, to coping with the

337. *See supra* text accompanying note 333–336.

338. *See* Richard Hall, *The Attractiveness of the Cayman Islands to Asian Companies*, CAYMAN FIN. REV., July 2009, *available at* http://www.compasscayman.com/cfr/cfr.aspx?id=1886&terms=richard+hall (listing the appeal of the Cayman Islands' law for Asian Companies).

339. Dr. Camille Stoll-Davey, Presentation, March 2008 (on file with author).

340. Interview, Behr, HBM Group, *supra* note 103.

341. *Id.*

342. *See* Boise, *supra* note 14 (describing other offshore jurisdictions, including the Cayman Islands).

343. A tax information sharing agreement may be included within a tax treaty to facilitate exchanges of relevant information necessary to carry out the provisions of the treaty. U.S. TREAS. DEP'T., U.S. MODEL INCOME TAX CONVENTION (1996); REUVEN S. AVI-YONAH, U.S. INTERNATIONAL TAXATION: CASES AND MATERIALS 351 (2002). Exchange of information helps countries prevent fiscal evasion, one of the purposes of tax treaties. AVI-YONAH, at 354.

EU's savings directive.[344] Moreover, tax authorities are paying closer attention to structures designed to minimize (and sometimes evade) domestic income taxes. As a result, campaigns like the OECD's harmful tax competition initiative have taken their toll both by raising the cost of doing business in offshore financial centers and by making the reputation costs of offshore financial transactions higher.[345] Indeed, rather than the leniency in tax rulings from the Antilles authorities that might have dominated the calculation in the past, the extra scrutiny from onshore tax authorities that use an offshore structure could be determinative today. Effective responses to these challenges call for an adaptive regime.

Finally, it is crucial that an offshore jurisdiction be able to do each of the foregoing things rapidly. Today, innovations move much more quickly among offshore jurisdictions (and between offshore and onshore jurisdictions, as the advances in the onshore captive insurance industry in the United States demonstrate). Jurisdictions seeking to develop offshore financial sectors frequently have copied innovative laws (sometimes word-for-word) from other jurisdictions, even across the civil law-common law divide. For example, in the 1960s the Cayman Islands copied the successful Bahamian and Bermudian offshore centers' strategies.[346] Likewise, in the private foundation market, the Antilles' current competitors include the Bahamas and Nevis, both of which are English-language, common-law jurisdictions that have passed similar, private foundation laws.[347] The difference between the Bahamas-Cayman Islands competition in the 1960s and early 1970s and today's competitive market for private foundations is that copying occurs much more quickly today because of the expansion of worldwide communication capabilities. Offshore financial centers that do not formulate and implement responses to competitive challenges with sufficient alacrity will lose nascent financial intermediation opportunities.

In sum, legislative flexibility, as we define it, requires that a jurisdiction create the legal conditions for arbitrage, react effectively to changes affecting those legal conditions, and act in these matters with speed and certainty. One Antilles attorney used a particularly colorful metaphor in discussing how the island had to adapt to changes in U.S. and EU tax and regulatory policies, "If you stand in the ring with

344. The EU's savings tax directive required EU member states, as of July 2005, to either provide information on interest payments made by paying agents established in their jurisdictions to individuals resident in other member states, or to levy a withholding tax on such interest payments and transfer seventy-five percent of the tax revenue to the investor's state of residence. *See* Council Directive 2003/48/EC, On Taxation of Savings Income in the farm of Interest Payments, 2003 O.J. (L 157) 38–48. The directive contravened the strong secrecy traditions of many OFCs.

345. The classic example of a reputation cost constraint was the abortive effort by Stanley Works to avoid U.S. taxation of its foreign-source income through a corporate "inversion" transaction that would have resulted in it becoming a subsidiary of a newly incorporated Bermuda parent. *See* Craig M. Boise and James C. Koenig, *Practical and Policy Considerations in Corporate Inversions*, CORP. BUS. TAX'N MONTHLY 3 (Sept. 2002); *Stanley Works Drops Move to Bermuda,* L.A. TIMES, Aug. 2, 2002, at C–3; Dan Ackman, *Stanley Works Stays Home,* FORBES, Aug. 2002 (estimating annual tax savings of moving to Bermuda at $30 million).

346. MICHAEL CRATON, FOUNDED UPON THE SEAS; A HISTORY OF THE CAYMAN ISLANDS AND THEIR PEOPLE 353 (2003).

347. Foundations Act, No. 8 (2003) (St. Kitts & Nevis), *available at* http://www.fidesco.com/downloads/skn/Foundations%20Act,%202003.pdf; Foundations Act, No. 23 (2004) (Bah.), *available at* http://laws.bahamas.gov.bs/annuals/No23of2004style.html.

Mike Tyson and get hit, you are dead. You have to dodge and hope he gets tired out."[348]

4. Constitutional Concerns

The fourth proposition that may be drawn from the Antilles' experience is that a jurisdiction's capacity with respect to each of the first three propositions will be affected by its own constitution. By "constitution," we do not refer to a particular founding document such as the U.S. Constitution, although such a "capital C" constitution certainly may be relevant to our inquiry. Rather, we refer to the geopolitical arrangement from which a particular jurisdiction derives its sovereignty and the legal structures it employs internally. It is this "small c" constitution that will affect the ability of a jurisdiction to identify opportunities that result from the persistent differences between its legal regime and those of other jurisdictions, recognize and anticipate its vulnerability to changes taking place elsewhere, and respond flexibly to legal and business changes in competing offshore and onshore jurisdictions.

There are at least three "constitutional concerns" that affect the success of an offshore jurisdiction's financial intermediation sector.[349] First, an offshore jurisdiction must have legitimacy as a sovereign. Firms contemplating doing business in an offshore center like the Antilles must view that jurisdiction as having the authority to make laws in those areas that touch anticipated transactions. More importantly, those laws must be respected by onshore jurisdictions. In this regard, most offshore jurisdictions are fortunate to have been former colonies of long-established onshore jurisdictions. Consequently, both the offshore jurisdiction's legitimacy and that of its laws tend to be linked to a greater or lesser degree to an onshore jurisdiction regardless of the nature of the ongoing relationship between the onshore jurisdiction with its former colony. A former British colony, for example, benefits from a stature within the global community that is largely based on the collective recollections of a historical relationship, even if current links to the U.K. are attenuated.

Second, in addition to geopolitical legitimacy, the successful offshore jurisdiction must offer a high degree of political and economic stability. Any jurisdiction's desirability as an investment destination, whether it is an offshore financial center or otherwise, bears a direct relationship to its stability. In the case of the Antilles, as we described in Part I, the Kingdom Treaty provided a constitutional structure that excelled in this regard, as evidenced by the Antilles' lack of interest in obtaining independence from the Dutch Kingdom. The Antilles' continued association with the Kingdom, its use of a well-respected Dutch court as the final court of appeal, the Kingdom's guarantee of the rule of law, and other features of its relationship with the Netherlands permitted the Antilles to make a credible commitment to investors that their business structures would be protected. Even in the years immediately following the May 1969 riots that profoundly shook Dutch confidence in the Antilles' political leadership, business confidence continued and

348. Interview, Elias, United Trust Co., *supra* note 13.

349. For a fuller treatment of issues of sovereignty in offshore financial centers, *see* Boise & Morriss, *Offshore*, *supra* note 14.

the offshore sector grew significantly.[350] This was largely because of the Dutch commitment to ensuring political and legal stability in the islands.[351]

By contrast, however, the Bahamas failed to reassure investors that the transition from rule by the pre-independence "Bay Street Boys" clique to Lynden Pindling's post-independence nationalist majority government would not lead to wholesale renegotiation of the terms under which offshore activity occurred in the Bahamas.[352] This failure prompted large-scale capital flight from the Bahamas to Cayman.[353] In effect, jurisdictions must offer investors a bond for their future performance. One effective means of doing so is a constitutional structure that limits the ability to renege. However, combining that with sufficient flexibility to respond to changes is a tricky balancing act.

Third, and most importantly, a successful offshore jurisdiction's geopolitical circumstances must not unduly hinder or constrain its ability to exercise flexibility in responding to the inevitable challenge of changes in business conditions and legal regimes around the globe that could threaten its financial sector.

In sum, a jurisdiction described by our theory possesses sufficient legislative agility within a largely unrestrictive constitutional framework to permit it to find the persistent exploitable differences among legal regimes even as the jurisdiction's economic survival is challenged by external change. We assert that such a regime possesses *plasticity* rather than merely *flexibility* because the former suggests retention of the essence of a secure legal regime even as that regime reshapes itself in response to change. A jurisdiction must be able to adapt while offering sufficient guarantees that its flexibility in response to events does not include the ability to renege on the regulatory bargain it has offered investors to entice them to use it as the location for financial intermediation or arbitrage.

B. The Netherlands Antilles in the Aftermath of Treaty Repeal

Having articulated a theory of regime plasticity in offshore financial intermediation, we next turn to an assessment of the Netherlands Antilles' experience in light of that theory. Although helping to inform our theory of regime plasticity, the Antilles has not successfully modeled each of the four elements of that theory. The existence of the U.S.-Netherlands Antilles tax treaty is, of course, a clear example of the first element of our theory—the persistence of differences in legal regimes that may lead to arbitrage opportunities. Moreover, the loss of the treaty is just the sort of challenge presented by a change in legal regimes that offshore jurisdictions inevitably must confront under the second postulate of our theory. We turn our focus in this section to the third and fourth elements of our theory—namely, the Antilles' exercise of legislative agility in responding to the challenge of change, and the ways in which that agility might have been constrained by constitutional concerns.

350. LANGER, *supra* note 9, at 113; BANK VAN DE NEDERLANDSE ANTILLEN, *supra* note 159, at 8–9.

351. LANGER, *supra* note 9, at 113.

352. Morriss & Boise, *supra* note 193, at 25.

353. *Id.* at 23.

1. The Post-Treaty Antilles and Legislative Flexibility

It is unfortunate that despite its remarkable success in the two decades leading up to the U.S. cancellation of its tax treaty the Antilles financial sector was largely a failure in the decade that followed. The Antilles failed to anticipate and effectively react to the threat of treaty repeal, despite clear signs of the potential for substantial change to the differences in legal rules that permitted the offshore financial subsidiary business to thrive. The result has been a financial sector that, with a few exceptions, has remained stagnant.

This is not to say that following treaty repeal the Antilles failed to identify any new financial sector opportunities. The Antilles rather quickly attempted to transform the now-defunct Antilles sandwich into a "Dutch sandwich" structure that would appeal to foreign (but non-U.S.) shareholders in Dutch companies. Ordinarily, a dividend paid by a Dutch company to foreign shareholders would be subject to a twenty-five percent Dutch profits tax. By contrast, under the Netherlands-Netherlands Antilles tax treaty, a dividend payment from a Dutch company to a Netherlands Antilles holding company is subject to an eight and three-tenths percent withholding tax.[354] Thus, substantial Dutch tax could be avoided by shareholders of Dutch companies who formed Antilles holding companies through which to route dividend payments. This strategy initially was quite successful, making the Antilles the jurisdiction of choice for shifting dividend payments out of Europe.[355]

The Antilles also made efforts to expand its financial sector beyond holding company structures. In the 1980s, several influential individuals in the insurance industry urged the Antilles to create a captive insurance sector.[356] Their initial efforts led to the establishment of sixty to seventy captive insurance companies by the late 1980s.[357] However, unlike Bermuda and Cayman,[358] the Antilles failed to create any specialized legal or regulatory structures for captive insurers and eventually lost momentum compared to those jurisdictions. Worse, certain provisions of Antilles law affirmatively discouraged the captive insurance industry. One such provision severely limited the number of insurance companies that any one individual could manage, even though the minimal activity involved in such management would have permitted insurance managers to accept additional captive clients and made the sector economically viable.[359] Today, the Antilles are home to fewer than twenty

354. Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71. The revenue from this withholding tax is directly passed on to the Antilles government by the Dutch. *Id.*

355. Interview, Behr, HBM Group, *supra* note 103.

356. *See* Interview, Elias, United Trust Co., *supra* note 13 (establishing that the Antilles created a small, captive insurance sector after 1988).

357. BANK VAN DE NEDERLANDSE ANTILLEN, FINANCIAL INFORMATION GUIDE 38 (1990). By contrast, the Cayman Islands, which began to aggressively develop its captive insurance industry in the 1980s, had 777 captives at the end of 2008. *See* CAYMAN ISLANDS MONETARY AUTHORITY, LIST OF INSURANCE COMPANIES BY INSURANCE MANAGER, July 15, 2009, *available at* http://www.cimoney.com.ky/WorkArea/linkit.aspx?LinkIdentifier=id&ItemID=976 (providing list of captive insurance companies); Dennis J. Block, Nancy E. Barton & Stephen A. Radin, *Indemnification and Insurance of Corporate Officials 83*, *in* DIRECTORS' AND OFFICERS' LIABILITY INSURANCE 1991, at 9, 83 (1991) ("Until the mid-1980s, captive insurance subsidiaries were often domiciled in offshore places such as Bermuda or the Cayman Islands, which are free from U.S. insurance regulations.").

358. *See 1983 Tax Evasion Hearing*, *supra* note 4, at 205 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen).

359. Interview with Edgar Nunes, Atlas Ins. Co. & Felipe Croes, Managing Director, Irma Insurance,

captive insurers.[360] The failure to successfully launch a captive insurance industry appears to be a direct result of a lack of legislative agility. The Antilles also did not capitalize on key niche opportunities in the captive insurance market that might have been fruitful despite the general dominance of Bermuda and Cayman in the sector, and as a result, other jurisdictions stepped in. For example, Barbados made an aggressive bid for Canadian captive insurance business; now roughly 195 of that jurisdiction's 212 captives insure Canadian risks.[361]

Apart from the Dutch sandwich and the unsuccessful attempt to establish a captive insurance sector, it was nearly a decade after the cancellation of the U.S. tax treaty before Antilles passed any significant legislation to create exploitable legal differences that would resuscitate its offshore financial sector. This failure to adapt, of course, is inconsistent with our contention that, under the third prong of our theory, offshore jurisdictions must respond ever more rapidly to external changes that threaten their financial sectors.

2. The Post-Treaty Antilles and Constitutional Concerns

The Antilles' attempts to re-tool following the end of the finance subsidiary era have been hampered in important ways by constitutional concerns—the fourth element of our theory of regime plasticity. This element requires that an offshore jurisdiction have legitimacy as a sovereign, offer a high degree of political and economic stability, and not be hindered or constrained by its constitutional arrangements in responding to the inevitable challenge of changes in legal regimes around the globe that could threaten its financial sector. It is the final element of this formula that has proved problematic to the Antilles and prevented it from rebounding substantially from the blow of tax treaty repeal. This inability to recover is the result of several weaknesses in the Antilles constitutional arrangements.

The first weakness is the Kingdom Charter itself, which does not confer on the Antilles as much independence as possessed by British Overseas Territories like the Cayman Islands, British Crown Dependencies like the Isle of Man, and independent Commonwealth nations like Barbados.[362] Britain's relationship with its Crown Dependencies and Overseas Territories has provided a model, at least until recently, for a governmental arrangement that provides enough autonomy to permit creation of the legal differences necessary for an offshore industry to flourish, while providing a check on the local autonomy sufficient to reassure investors of the jurisdiction's political stability.[363] Even the French system, which is based on integrating its territories, rather than providing them a significant measure of autonomy, and which

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in Curaçao, Neth. Antilles (May 22, 2008) [hereinafter Interview, Nunes & Croes]. The government also failed to address the lack of sufficient local insurance industry staff, leading those involved in attempting to set up captives to complain that the government has not invested sufficiently in the enterprise. *Id.*

360. *Id.*

361. *Id.*

362. *Compare* U.S. Dep't. of State, *Background Note: Netherlands Antilles* (2009), *available at* http://www.state.gov/r/pa/ei/bgn/22528.htm (describing the Netherlands Antilles as enjoying "semi-autonomy on most internal matters") *with* Interview with Vaughan Carter (March 13, 2006) [hereinafter Interview, Carter] (describing the extent of the Cayman's autonomy from the UK).

363. Several events in the last few years, including the growing influence of the EU and efforts by the OECD and others to restrict the activities of tax havens have called into question the continuing utility of this model. *See* Interview, Carter, *supra* note 362 (describing tensions in the Cayman-UK relationship).

has largely precluded them from developing financial intermediation sectors, has been seen by Antilleans as preferable to the Dutch Charter arrangement.[364]

Although the virtues of the British, and particularly, the French systems may have been overstated, the Kingdom Charter clearly has had its shortcomings. In particular, it confers both too much and too little independence on the Antilles. On the one hand, the Antilles are sufficiently independent of the Kingdom's jurisdiction that they have been able to pass tax and other legislation that has permitted the development and maintenance of an offshore financial sector. On the other hand, the Antilles connection with the Netherlands is in some respects cumbersome enough that other important steps have been either slowed or halted altogether. The structure of the Charter, which provides each entity with a veto over revisions, allows change to be blocked.[365] At times this has advantaged Curaçao, but the advantage of such a blocking veto shifts between the Netherlands and the Caribbean, depending on which country seeks a change. With respect to adapting to changes in the offshore environment, the Dutch veto has been a disadvantage for the Antilles.

The Antilles also are independent enough within the Kingdom to be viewed as competitors for financial services business as the Dutch increasingly have emphasized that sector since the 1990s.[366] Hence, although in some cases the Kingdom's failure to act promptly on matters affecting the Antilles simply may be bureaucratic sluggishness, in others it may be motivated, at best, by negligent disregard of Antilles' interests, or at worst, by a desire to stifle competition from the Antilles. An example of the former is the Antilles' efforts to promote the Dutch sandwich. Although the new structure was briefly successful, offering an eight and three tenths percent tax rate on dividends paid by Dutch companies through Antilles holding companies, the Netherlands soon negotiated new tax treaties with Cyprus, Luxembourg, and Malta that provided for a zero withholding tax rate on dividends paid by Dutch companies to holding companies in those jurisdictions. Thus, the Netherlands not only negotiated away the Antilles' tactical advantage in treaties with other jurisdictions, it also has been unwilling to renegotiate its tax treaty with the Antilles to reduce the eight and three-tenths percent tax rate to the zero rate it was willing to offer other jurisdictions that lacked the historical and political relationship shared by the Netherlands and the Antilles.[367]

A major problem for the Antilles in developing a revitalized financial services sector has been the Antilles' lack of tax treaties with important markets like the U.S.,[368] and the uncompetitive terms of the Netherlands-Netherlands Antilles tax treaty (which imposed the eight and three-tenths percent withholding tax).[369] For

364. *See* ROBERT ALDRICH & JOHN CONNELL, FRANCE'S OVERSEAS FRONTIER 76 (1992) (describing close legal integration of overseas territories with metropolitan France following World War II).

365. STATUUT VOOR HET KONINKRIJK DER NEDERLANDEN [STATUUT NED] [Constitution], art. 12 (Neth.).

366. SLUYTERMAN, *supra* note 1, at 241 (describing how a "new realism" in the Netherlands about economy led to a turn to service sector in 1990s after focus on manufacturing in 1970s and 1980s); Interview, Elias, United Trust Co., *supra* note 13 (noting competition for management company (trust company) business). The Netherlands has historically had an extensive network of tax treaties, including "agreements with most industrial nations and many developing countries." Belotsky, *supra* note 253, at 90–91.

367. Interview, Behr, HBM Group, *supra* note 103.

368. Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71.

369. Interview, Behr, HBM Group, *supra* note 103.

example, Barbados, which could serve as a model for a tax-treaty-network jurisdiction, has sixteen tax treaties, including treaties with the United States, China, and the Netherlands, and nine investment treaties,[370] and aggressively seeks to negotiate new ones.[371] Although the Antilles was extremely anxious to negotiate a new U.S. treaty after the old treaty was canceled, the Netherlands controlled the critical Kingdom institutions that approved treaties.[372] Thus, more than twenty years later, the Antilles is still without a new treaty with the United States. Similar foot-dragging by the Kingdom occurred when the European Union issued its savings tax directive[373] and the Antilles sought a new treaty with the Netherlands to enable it to compete with other EU jurisdictions.[374]

Not only did the Netherlands compete with the Antilles for some business, but the Netherlands had important interests in conforming to European Union mandates and assisting in OECD measures that the Antilles did not share. As Professors Oostindie and Klinkers conclude, "[w]here the Netherlands had different priorities to those of the Antillean and Aruban governments, it was generally prepared to act upon them, regardless of the views of its Caribbean partners."[375] For example, the Dutch complied with EU demands that it close the "Antillean route" by which sugar and rice were imported into the Antilles and Aruba and lightly processed and then re-exported to the EU.[376] This led the Antilles to "[t]he painful realization that Europe mattered far more to The Hague than the 'Dutch' Caribbean" did.[377] Thus, notwithstanding that the Kingdom Charter gives the Antilles a strong position vis-a-vis the Dutch, over the last decade and a half the relationship between the Netherlands and the Antilles has been characterized by "constant political bickering, sparked by the Dutch."[378]

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370. *See* list at International Business Unit, Ministry of Foreign Affairs, Foreign Trade & International Business, Government of Barbados, *Bilateral Investment Treaties and Double Taxation Agreements, available at* http://www.investbarbados.org/dtas.php.

371. Interview with Ben Arrindell, Ernst & Young, Barbados, May 2007.

372. Ministry of Foreign Affairs and Foreign Trade of Barbados, Treaties, http://www.foreign.gov.bb/pageselect.cfm (last visited Nov. 19, 2009) (select "Treaties" on the left-side menu; then select "Treaties List" in the left-side menu; then select "Financial Services" in the drop-down menu and click "Go") (listing various treaties totaling sixteen related to tax and nine related to investment).

373. *See also* Press Release, Ministry of Foreign Affairs and Foreign Trade of Barbados, Barbados Signs Double Taxation Agreement with the Netherlands (December 2006), *available at* http://www.foreign.gov.bb/Userfiles/File/Taxation%20with%20Netherlands.pdf, (quoting the deputy prime minister, "'our security lies in having a multiplicity of such agreements . . .'" and noting a forthcoming agreement with Mexico and a recent agreement with Austria).

374. *See* STATUUT VOOR HET KONINKRIJK DER NEDERLANDEN [STATUUT NED] [Constitution] art. 26 (Neth.) (stating that the ". . .Government of the Kingdom shall assist in the conclusion of such an agreement, unless this would be inconsistent with the Country's ties with the Kingdom"); *see also* Hurst Hannum and Richard B. Lillich, *The Concept of Autonomy in International Law,* 74 AM. J. INT'L L. 858, 875 (1980) (discussing the relatively high degree of autonomy enjoyed by the Netherlands Antilles in reaching international financial agreements, subject to the limitation in Article 26 of the Charter of the Kingdom of the Netherlands).

375. OOSTINDIE & KLINKERS, *supra* note 6, at 134. This also was apparent at the "Futures Conference" held by the Kingdom in March 1993, at which it became evident that the Antillean and Aruban delegations had different views of the need for Kingdom involvement in governance in the Caribbean than did the Dutch. *Id.* at 136–37.

376. *Id.* at 144–45.

377. *Id.* at 145.

378. *Id.* at 219. As Curaçaoan writer Boeli van Leeuwen put it, "every time the Dutch laid out the game of chess, their Antillean and Aruban opponents hurried to pull out their game of dominoes instead."

Yet another source of tension between the Netherlands and the Antilles was that the Netherlands became more assertive about its views on governance issues in the Antilles as it began to accept that the islands would not agree to independence.[379] This led to a renewal of Dutch interest and involvement in Antilles governance in the 1990s and 2000s.[380] Indeed, the Kingdom (i.e., Dutch) takeover via an Order in Council of the Sint Maarten government because of serious governance problems from February 1993 to September 1994, with continuing involvement until March 1996, made clear that the Dutch were now willing to override local autonomy when they felt it necessary.[381] The Dutch also were unhappy with the both the level of Antillean migration to the Netherlands and the amount of aid the Dutch provided to the Antilles.[382] Difficulties like these in its relationship with the Netherlands hindered the Antilles' reinvention of the financial sector in the 1990s and 2000s. All of this suggests that a successful offshore jurisdiction must have more sovereignty—at least de facto, if not de jure—than the Antilles had in the 1980s and 1990s in order to nimbly adapt to the increasing pace of change in the financial industry.

The Antilles also have been hampered by their position within the EU. The European Union's political structure, to which the Antilles' fortunes are tied through their status within the Kingdom, does not give the Antilles sufficient autonomy to play a role within the EU analogous to the role the state of Delaware plays within the United States. Ironically, the Antilles' autonomy is too great to permit it to participate fully in the Dutch membership of the European Union. By contrast, the French Caribbean territories receive considerable development assistance from the EU by virtue of the fact that they have minimal autonomy from France.[383]

Finally, in addition to the constraints imposed by the political structure of the Kingdom, the Antilles must contend with an internal structural issue. The overall economy of the Antilles is large enough that its offshore financial sector does not occupy the predominant position within the economy that a financial sector often does in smaller offshore jurisdictions. As a result, the Antilles financial sector does not receive the same focused attention from government policy-makers as the Cayman financial sector (or even that of Delaware, in the United States).[384] The lack

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Id.

379. OOSTINDIE, *supra* note 21, at 15 ("Having accepted this state of affairs [regarding refusal to leave] by 1990, the Netherlands have since hammered home the need for the Antillean and Aruban authorities to model their policies on metropolitan standards . . . .").

380. OOSTINDIE & KLINKERS, *supra* note 6, at 131–32. *See also id.* at 221 ("[S]ince the beginning of the 1990s, *informal* Dutch involvement with the Antillean and Aruban governments has increased considerably.").

381. *Id.* at 134–35. Unfortunately, this involvement was insufficient to head off a "severe crisis in the Antillean administration economics and indeed society . . . at the end of the twentieth century . . ." *Id.* at 120. Relations worsened in 2002, when the outgoing Secretary of State "published an article in a leading Dutch newspaper" that expressed his "frustrations and clear warnings" about Antillean affairs. *Id.* at 150–51.

382. *Id.* at 148–49. In 2002, 115,000 *Curazoleños* lived in the Netherlands compared to 130,000 who actually lived on the island. *Id.* at 149. Per capita Dutch aid to the Antilles quadrupled from 1976 to the late 1990s. OOSTINDIE & KLINKERS, *supra* note 6, at 164. This has led to a growing Dutch insistence that aid transfers must eventually stop being necessary, although some argue that the total amount per Dutch taxpayer is negligible and that the Dutch question is primarily one of efficacy. *Id.* at 164–66.

383. In 2001, for example, French territories received between €2,900 and €3,800 per capita total transfers. *Id.* at 173. *See also* Fred Constant, *The French Antilles in the 1990s: Between European Unification and Political Territorialism, in* ISLANDS AT THE CROSSROADS: POLITICS IN THE NON-INDEPENDENT CARIBBEAN (Aaron Gamaliel Ramos & Angel Israel Rivera eds., 2001) at 80, 82–85.

384. For example, a 1975 survey of the Antilles' suitability as an offshore jurisdiction noted that the

of such attention has slowed the Antilles government's reaction to changes in the industry and made it difficult to compete with more focused jurisdictions.

IV. LESSONS FOR THE FUTURE OF OFFSHORE FINANCIAL INTERMEDIATION

Analysis of the Antilles' history under our theory of regime flexibility suggests some conclusions on both the prospects for the Antilles offshore financial sector and the future of the global offshore financial sector as a whole. We discuss these in the following sections.

A. The Prospects for the Antilles

Notwithstanding relative legislative paralysis in the years immediately following the repeal of the U.S.-Netherlands Antilles tax treaty, the Antilles eventually began to respond in ways suggestive of the imperative of legislative agility—the third element of our theory of regime plasticity. That response began in 1994 with passage of a new law that allowed "international insurance companies" that did not operate locally.[385] Unfortunately, the legislation came long after similar laws had been established in Bermuda and Cayman.[386] Today, the Antilles is home to fewer than 20 captive insurers, and growth in the sector is flat.[387] Key niche opportunities in the captive insurance market that might have been fruitful, despite the general dominance of Bermuda and Cayman in the sector, have been seized by other jurisdictions.[388]

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corporate law had not been changed in almost 40 years and was not updated in 1970 when the Dutch corporation law was "materially changed." LANGER, *supra* note 9, at 189. Compare Delaware's efforts to maintain its corporate statute, described here:

> An "advanced" and "flexible" corporate statute is one reason for Delaware's preeminence. Delaware adopted its first modern corporation statute in 1899 and since that time the Delaware legislature has amended the statute hundreds of times. In reality, however, the Delaware Bar Association's Section on General Corporation Law is responsible for revising the General Corporation Law. Members of the Section and its subcommittees carefully study and make suggestions concerning proposed amendments to the Delaware General Corporation Law. The General Assembly, in most cases, adopts the amendments recommended by the Section. In this fashion, Delaware's General Corporation Law is continually amended by the Bar Section on General Corporation Law and the General Assembly. The "close working relationship" between the Delaware General Assembly and the corporate bar works to ensure a swift response to corporate needs in the form of a flexible statute. This collaboration also reveals the significant degree of private and public interaction in the corporate lawmaking process.

Omari Scott Simmons, *Branding the Small Wonder: Delaware's Dominance and the Market for Corporate Law,* 42 U. RICH. L. REV. 1129, 1155–57 (2008) (citations omitted). On Cayman's adaptability, see Alan Markoff, *Part 2: The Freewheeling 1970s: The Cayman Islands: From Obscurity to Offshore Giant*, CAYMAN FIN. REV., July 15, 2009, *available at* http://www.compasscayman.com/cfr/cfr.aspx?id=713.

385. Interview, Nunes & Croes, *supra* note 359.

386. *See, e.g.*, Insurance Act, 1978, tit. 17, item 49 (Berm.); Insurance Law, 1979, law 24 (Cayman Is.).

387. Interview, Nunes & Croes, *supra* note 359.

388. For example, Barbados made an aggressive bid for Canadian captive insurance business; now roughly 195 of Barbados's 212 captives insure Canadian risks. *Id.*

The Antilles captive insurance legislation was followed by the 1998 introduction of an asset-protecting "private foundation" entity modeled on similar entities available in Panama and Liechtenstein.[389] Private foundations are analogous to common law trusts, but, unlike trusts, they are treated as separate entities.[390] Once created by its founder, the private foundation has the power to borrow, acquire assets, and make distributions for any purpose stated in its charter, although it cannot conduct business and so must only receive passive income.[391] Unlike an ordinary civil-law foundation, the private foundation need not have a charitable purpose.[392] To date, this effort has been more successful than the captive insurance sector. Only twelve private foundations were formed in the first year, but there are now more than 4,000, with new foundations being formed at a rate of roughly sixty to seventy per month.[393] Antilles private foundations are most popular in the Benelux countries because of the shared language[394] and because Antilles private foundations are priced more competitively than those formed in Liechtenstein.[395]

Despite the Antilles relative success with foundations, there remain important obstacles to the expansion of the business. First, the Antilles face competition from common law jurisdictions, like the United States, that recognize trusts rather than foundations.[396] Such jurisdictions are more attractive to prospective clients from common law jurisdictions, which means that growth in this sector for the Antilles will largely come from civil law jurisdictions.[397] A second, related obstacle is that while

389. Interview with Eric Passen, ATC Corporate Services, in Curaçao, Neth. Antilles (May 21, 2008) [hereinafter Interview, Passen, ATC Corp. Services]; Interview, Paassen-Delsol, Paassen Delsol, *supra* note 71. Private foundations are controlled by a board, which functions similarly to a trustee for a trust. The founder can influence the board in several ways: (1) a confidential private agreement can direct the board to act in the interests of particular beneficiaries; (2) the foundation articles can specify the beneficiary; (3) the founder may give the board a non-binding letter of wishes; and (4) a supervisory board, similar to a trust protector, can be appointed to insure the board complies with principal's wishes. Private foundations are generally cheaper to create and administer than are trusts because the fees are based on the work done, not on a percentage of the assets under management as is common with trusts. *Id.*; Interview with Zuleika S. Lasten, PricewaterhouseCoopers, Curaçao, Neth. Antilles (May 21, 2008).

390. *See* GLENN C. RELLUM, THE PRIVATE FOUNDATION A BETTER ALTERNATIVE FOR THE TRUST ENTITY (2007), *available at* http://www.sms-advocaten.com/pdf/spf-short-promotion-document.pdf (providing general information about private foundations in the Netherlands Antilles and description of their operation). Under a common-law trust arrangement, a "grantor" transfers assets to the trust, at which point title to the assets is held by a trustee for the benefit of named (or in some cases, unnamed) beneficiaries. This removes the assets from the estate of the grantor, and hence from the grantor's creditors. AUSTIN WAKEMAN SCOTT ET AL., SCOTT AND ASCHER ON TRUSTS 32–36 (2006) (explaining the general purpose and benefits of a trust). In addition, trusts frequently may be used to avoid estate and other forms of taxation, as well as to avoid probate procedures that otherwise would apply to the transfer of assets upon the grantor's death. *Id.* at 382–83 (discussing the increased use of trust to avoid more complex will and tax processes upon death of the trustor).

391. Interview, Passen, ATC Corp. Services, *supra* note 389 (noting that private foundations can make distributions to anyone).

392. *Id.*

393. *Id.*

394. *Id.*

395. *Id.* One practitioner estimated the cost difference as between US$5,000 to $6,000. *Id.*

396. *Id.* Recently, the Bahamas recently have made an aggressive bid to win foundation business from both civil and common-law jurisdictions by creating a private foundation entity within a common law system. *Id.* The Bahamian law is so new that many practitioners there are unaware of it. The lack of a track record for the structure in common-law jurisdictions may also hamper the Bahamas in competing in this market. *Id.*

397. Liechtenstein and Panama are the Antilles' biggest competitors for foundation business among jurisdictions having civil law systems. Interview, Passen, ATC Corp. Services, *supra* note 389. Civil law jurisdictions cannot compete with common law ones directly for trust business because of the lack of

the IRS has long recognized common-law trusts, American courts have not yet ruled on the tax treatment of foundations.[398] This uncertainty in tax treatment presents obvious regulatory risks for U.S. persons. Third, Antillean courts recognize forced heirship judgments from other jurisdictions, while the courts of at least one competitor—the Bahamas—do not.[399] Thus, Bahamian entities may be preferable for potential customers who desire to avoid the operation of the forced heirship statutes common in continental Europe and Latin America.[400] Finally, the recent use by German and other European tax authorities of data stolen by a bank employee in Liechtenstein identifying founders of private foundations there[401] may reduce demand for the structure, either by deterring those who intend to commit tax evasion (as opposed to legal avoidance) or by damaging the structure's reputation with reputable customers.

Of greater importance than either of these developments, however, was the passage in December 1999, of sweeping tax and business legislation known as the Nieuw Fiscaal Raamwerk (New Fiscal Framework).[402] The intent of the legislation was to jumpstart the Antilles' offshore financial services sector and re-establish the jurisdiction's reputation and image as an offshore financial center. The legislation, which took effect on January 1, 2001 (and was prompted by pressure from the OECD's harmful tax competition initiative[403]) eliminated the Antilles ring-fenced tax regime and replaced its progressive corporate tax rate schedule with a single thirty percent tax rate for all corporations, both onshore and offshore.[404] At the same time,

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common law trust jurisprudence. *Id.*; LANGER, *supra* note 9, at 188.

398. Interview, Passen, ATC Corp. Services, *supra* note 389.

399. *Id.*

400. *See* Joshua C. Tate, *Caregiving and the Case for Testamentary Freedom*, 42 U.C. DAVIS L. REV. 129, 138 (2008) ("In most civil law jurisdictions, descendants are generally entitled to a reserved share of the estate unless interested parties show some specific grounds for disinheritance.").

401. *Liechtenstein's Shadowy Informant: Tax Whistleblower Sold Data to the US*, SPIEGEL ONLINE INT., Feb. 25, 2008, *available at* http://www.spiegel.de/international/business/0,1518,537640,00.html [hereinafter *Liechtenstein's Shadowy Informant*]; *see* Mario A. Mata, *Asset Protection Planning for the Family Business Owner, in* ESTATE PLANNING FOR THE FAMILY BUSINESS OWNER 617, 737 (2007) ("A foundation in Liechtenstein is a fund or collection of property dedicated to a specific purpose. It is similar in some respects to a common law trust except that the foundation is a separate legal entity that is controlled by its board of directors and governed by the foundation deed which is the document establishing the foundation. The foundation deed, similar to a trust deed, must be filed with the public registry. However, although so filed, the foundation deed is not generally available for public inspection."); Edsel Doran, *Private Foundations: A New Option in the Netherlands Antilles*, 9 J. INT'L. TAX'N 39 (1998) ("Realizing the potential for developing the foundation even further as an alternative to the trust, and also to the Liechtenstein Anstalt (private establishment), the Netherlands Antilles will introduce the Curaçao private foundation at the beginning of 1998."); Dr. oec Kurt Alig, *Liechtenstein Tax System Has Advantages for Holding Companies and Foundations*, 8 J. INT'L. TAX'N 318, 7 (1997) ("The foundation is the preferred vehicle for asset management and asset protection purposes; during the last four years, the number of foundations has increased by approximately 25% and it looks as if this trend will continue.").

402. Nieuw Fiscaal Raamwerk 20 December 2001 PUBLICATIEBLAD [P.B.] 2001 nr. 146 (giving retroactive effect to the amended legislation). PRICE WATERHOUSE COOPERS, CORPORATE TAXES: WORLDWIDE SUMMARIES 2002–2003 582 (2002).

403. *See* Boise, *supra* note 14, at 20–21 (discussing the OECD harmful tax competition initiative, calling for the creation of a framework of defensive measures which member countries could choose to enforce against uncooperative tax havens).

404. PRICE WATERHOUSE COOPERS, *supra* note 402, at 582.

the Antilles introduced a new form of corporate entity that would permit offshore activity on a tax-exempt basis.[405]

The Framework, although long overdue, represents the sort of legislative agility that is necessary to maintain a successful offshore financial sector. In adopting the New Fiscal Framework,[406] the Antilles has signaled that it views its financial sector as important. Indeed, the sector produces a small but significant part of the Antilles gross domestic product[407] and it offers a number of important advantages to foreign investors. These include as sophisticated financial markets workforce, which serves its funds management business, and its reputation as a "cleaner" jurisdiction than some of its main competitors (e.g., Panama).[408] Moreover, the regulatory structures critical to an offshore financial sector's success are in place, and the Antilles court system also includes a final appeal to the highly respected Supreme Court of the Netherlands in The Hague.[409] Passage of the New Fiscal Framework also suggests that the Antilles has chosen to model its rebuilt financial sector along the lines of that of Barbados, with a more-than-nominal corporate income tax rate that makes possible the eventual establishment of a network of tax treaties with onshore jurisdictions.[410]

Of course, the Antilles begins at a significant disadvantage to Barbados, which has both a much more extensive tax treaty network and the sovereignty to move quickly when a treaty opportunity arises.[411] The Antilles also must compete against jurisdictions like Dubai, with far deeper pockets;[412] Singapore, with a deeply

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405. *Id.*

406. Nieuw Fiscaal Raamwerk 20 December 2001 P.B. 2001 nr. 146.

407. *See* BANK VAN DE NEDERLANDSE ANTILLEN, GENERAL ECONOMIC DEVELOPMENTS IN THE NETHERLANDS ANTILLES, QUARTERLY BULLETIN 2008–II, tbl. 3 (2008), *available at* http://www.centralbank.an/tablepopup.php?file=/qb/20082/index-03.htm.

408. Interview, Passen, ATC Corp. Services, *supra* note 389. For example, the independent Central Bank has taken on the task of developing a model for anti-money laundering regulation that would apply well beyond financial sector firms, as traditionally defined, to include jewelry stores, car dealerships, and other businesses that frequently are used for money laundering. Interview, Weert & Gova, Bank van de Nederlandse Antillen, *supra* note 308.

409. Interview, Elias, United Trust Co., *supra* note 13.

410. Nieuw Fiscaal Raamwerk 20 December 2001 P.B. 2001 nr. 146. This approach contrasts with that of jurisdictions like the British Virgin Islands or the Cayman Islands which because they have no income taxation, cannot enter into tax treaties with other jurisdictions, and must rely on either a high volume of transactions (e.g., international business corporations in the BVI) or high-value structures (e.g., hedge funds or captive insurance arrangements in the Cayman Islands). *See* PRICEWATERHOUSE COOPERS, *supra* note 402, at 582–84. (New Fiscal Framework legislation removed the distinction between onshore and offshore companies, simplified tax rates, and introduced a new corporate form to allow offshore operations on a tax-exempt basis); *Grey skies in the Caribbean; Tax and the Cayman Islands,* ECONOMIST, May 23, 2009 (Barbados has developed a network of tax treaties), available at http://www.economist.com/world/americas/displaystory.cfm?story_id=E1_TPSDSGST; PRICE WATERHOUSE COOPERS, TAX FACTS AND FIGURES: BARBADOS 2006 3 (2006) (Barbados corporate tax rates).

411. *See Grey skies in the Caribbean, supra* note 410 (Barbados has developed a network of tax treaties).

412. *See OFFSHORE; The Offshore Puzzle*, THE LAWYER, May 5, 2008, at 26 (describing Dubai's efforts to position itself as a rising new offshore financial center, with significant advantages over more established onshore and offshore financial centers). *See* Bill Maurer, *Re-regulating Offshore Finance?*, GEOGRAPHY COMPASS 155, 171 (2008) (citing Dubai as an example of a jurisdiction that would not be vulnerable to being bought off by OECD member states for reducing its tax competition effects, in part because of Dubai's extensive network of tax information exchange agreements and double tax treaties, and in part because Dubai itself has "been attempting to buy out large holdings in OECD member states."). *See* AL TAMINI & COMPANY, TAXATION LAW IN THE UAE, 12–16, *available at*

committed government prepared to put significant resources into the sector;[413] and Malta and Cyprus, which possess the twin advantages of having complete sovereignty and being located within the European Union.[414] In comparison with these jurisdictions, the Antilles is hampered by Dutch involvement in foreign affairs, a lack of public resources to invest in developing the sector, and a government that on a day-to-day basis is distracted by both the pending dissolution of the Antilles as a jurisdiction, and a more complex economy than some of its competitors.

Curaçao's future in the offshore financial sector largely will be shaped by developments in its relationship with the Kingdom of the Netherlands. That there will be a relationship is not in doubt, as the island has little desire for independence.[415] Nonetheless, the relationship is likely to be different twenty years from now as a result of key external and internal influences. Externally, the Netherlands' obligations to, and relationship with, the European Union is likely to bring changes to the relationships among the Kingdom jurisdictions. As Professors Oostindie and Klinkers observe, the Netherlands now "is less autonomous within the European Union (which already has taken over more than one half of all legislation relevant to the Netherlands) than the Antilles and Aruba are within the Kingdom."[416] Thus, decisions made by the European Union are increasingly likely to directly affect the Antilles.

Tensions within the Kingdom have heightened over time as well.[417] As institutions whose origins lie in Dutch-Indonesian relations have proved inadequate

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http://www.tamimi.com/files/Legal%20Brochures/taxationlaw.pdf (listing the United Arab Emirates double tax treaties and double taxation avoidance laws).

413. *See Singapore Proves Itself as Attractive Jurisdiction and Business Hub*, INT'L TAX REV., Sept. 2006, at 32 (Discussing Singapore's extensive network of tax treaties and favorable tax laws).

414. *Malta*, *in* COUNTRIES OF THE WORLD AND THEIR LEADERS YEARBOOK 2009, 1317–19 (2008); *Cyprus*, *in* COUNTRIES OF THE WORLD AND THEIR LEADERS YEARBOOK 2010, 580–83 (2010).

415. OOSTINDIE & KLINKERS, *supra* note 6, at 221 ("Overwhelming majorities on all islands indicated no interest in a transfer of sovereignty."). Arguments against independence center on free migration to the Netherlands, the value of being part of a "prosperous and stable Kingdom," and the emergence of transatlantic communities. OOSTINDIE, *supra* note 21, at 96. The example of Suriname also provides a strong argument against independence. *See id.* (describing how an array of problems, including economic collapse and massive emigration, plagued post-Independence Suriname).

416. OOSTINDIE & KLINKERS, *supra* note 6, at 230. Of course, the European Union is having an effect on all the dependent territories of its members, and so this trend is likely to affect other offshore jurisdictions as well.

417. *Id.* at 231 ("[T]he need of the Antilles and Aruba for a life line with the Netherlands has in no sense been reduced, but over time tensions between the tasks related to the Kingdom and the local autonomy have increased."). Indeed,

> [d]uring the 1990s in the Antilles and Aruba [ambivalence about the Dutch role] grew as Dutch involvement and—literal—Dutch presence increased on the islands. Inescapable as the constitutional and increasingly also demographic ties with the Netherlands may be, the atmosphere of administrative consultations is invariably tense and characterized by political bickering. The Caribbean argument that "the Netherlands is impeding our autonomy" was always playing a main role. An outsider could be surprised by this state of affairs. After all, none of the dependent territories in the Caribbean has been granted the same level of autonomy as the Antilles and Aruba. However, ever since the 1990s, the fear of restricted autonomy has become a major concern for Caribbean politicians. It is one thing to secure the best deal, it is another to hold onto it.

Id. at 224.

for the task of governing a geopolitical situation that has become quite different,[418] dissension has arisen over economic aid paid by the Netherlands to the Antilles, immigration of Antilles residents to the Netherlands,[419] the autonomy of the Antilles from the Netherlands, and a host of other issues.[420] As a result of these mounting pressures, a renegotiation of the Kingdom relationship was undertaken in 2005.[421] Under the resulting agreement, at a date yet to be determined (originally scheduled for December 15, 2008 and since postponed), the "Netherlands Antilles will cease to exist as a political entity; Bonaire, Sint Eustatius, and Saba will become special status municipalities within the Netherlands;"[422] and Curaçao and Sint Maarten will become separate countries within the Kingdom.[423] The economic inequalities in the relationship between the Caribbean islands and the European territory make the formal legal equality of the Kingdom structure questionable at best. This is because of the "simple truth that the Netherlands is of eminent and even increasing importance to both Caribbean countries whereas, in reverse, this is not at all the case; not economically, not politically, and not culturally."[424] To help rectify the economic disparity between the Netherlands, the two new Dutch countries, and the three overseas municipalities, the Netherlands has pledged financial support of more than one billion guilders.[425] This aid, however, increases the Caribbean islands' dependence on the Dutch.

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418. The Kingdom today consists of the Netherlands, with a population over sixteen and a half million, the Antilles, with a population of 227,000, and Aruba, with a population of 103,000. *See* CENTRAL INTELLIGENCE AGENCY, THE WORLD FACTBOOK *available at* https://www.cia.gov/library/publications/the-world-factbook/geos/nl.html (Netherlands); url to: https://www.cia.gov/library/publications/the-world-factbook/geos/nt.html (Netherlands Antilles); and https://www.cia.gov/library/publications/the-world-factbook/geos/aa.html (Aruba).

419. More than 125,000 Caribbean islanders live in the Netherlands, as well. *Id.* at 63.

420. For example, at a recent conference of former Prime Ministers of the Antilles, one commented in response to a question about whether the fiftieth anniversary of the Charter should be celebrated that:

> We will be celebrating fifty years of being dependent on Holland. In other words, of being a colonial territory of Holland. We should not be so proud that we are part of Holland. Holland used Indonesia. It fought a war with Indonesia. It got rid of Suriname. With us, they could not get rid of us because we had the *Statuut.* All the money they have taken from us . . . . because via us they could enter Latin America. We should not be so proud that we are part of Holland.

LOOKING BACK TO MOVE FORWARD: SPEECHES FROM THE FORUM OF FORMER PRIME MINISTERS OF THE NETHERLANDS ANTILLES 8 (Gracita R. Arrindell ed., 2006) (quoting Juan "Juancho" Miguel Gregorio Evertsz, Prime Minister from 1973–77). Another argued that:

> The Charter, Article 43, gave the government of the Kingdom the responsibility to guarantee good government in the Netherlands Antilles. So, although we had obtained our long-desired autonomy, the possibility for higher supervision was institutionalized. I guess that this gives a sense of comfort to the colonial mothers and fathers that they could slacken up on us a little but still maintain the guarantee of a grip.

Id. at 27 (quoting Maria Liberia Peters, Prime Minister from 1984–86, 1988–90, and 1990–93).

421. Press Release, Government of the Netherlands, Agreement on Division of Netherlands Antilles, (Feb. 13, 2007) *available at* http://www.government.nl/News/Press_releases_and_news_items/2007/February/Agreement_on_division_of_Netherlands_Antilles.

422. *Id.* This is a less autonomous status similar to that enjoyed by the French overseas territories.

423. *See* Government of the Netherlands, Curaçao, *supra,* note 6.

424. OOSTINDIE & KLINKERS, *supra* note 6, at 218.

425. *Dutch Make Available Over 1 Billion Guilders,* DAILY HERALD (2008), *available at* http://www.thedailyherald.com/news/daily/j226/accor226.html.

Looking ahead, the dual Dutch goals of addressing the Antilles' economic problems and ensuring good governance[426] could be achieved by Dutch support for a major revival of the Curaçaoan offshore financial sector. This would mirror the approach of the British who have (at least until recently) encouraged offshore financial sectors in Overseas Territories like Cayman and Crown Dependencies like the Isle of Man.[427] Professors Oostindie and Klinkers are skeptical of such an approach, however, arguing that the strategy successfully employed by the British is not a viable strategy for Curaçao because of the island's greater size.[428] It seems unlikely that the offshore financial sector could ever become as significant a portion of Curaçao's economy as it is of the Cayman's.[429] However, as noted above, passage of the New Fiscal Framework suggests that Curaçao has chosen to model its financial sector along the lines of that of Barbados, which has successfully built an offshore sector as part of a diversified economic development program.[430] Importantly, Curaçao's size and economy are comparable to those of Barbados. Moreover, the fragmentation of the Antilles into separate micro-jurisdictions may partially resolve this concern, freeing Curaçao's financial sector from the need to accommodate the other islands' interests.

In sum, a revival of a successful offshore financial sector in Curaçao depends on the island both: (1) sorting out and rationalizing its relationship with the Netherlands and the other Dutch Caribbean islands; and (2) developing an ability to respond more nimbly than it has to date to customer demand and changes in onshore jurisdictions' laws and regulations. If Curaçao is to rebuild, it needs modern-day entrepreneurs, like Anton Smeets, who are able to identify opportunities and build the legal and physical infrastructure to exploit them, and a government focused on supporting such efforts. Separating Curaçao from the Antilles may be a step toward that end.

B. Other Offshore Jurisdictions

There are at least forty-four jurisdictions in the world today with populations of less than 100,000 that have at least attempted to create offshore financial sectors.[431] Many of these jurisdictions are small island states having limited natural resource endowments.[432] In the Caribbean alone (defined broadly), Anguilla, Antigua and

426. OOSTINDIE & KLINKERS, *supra* note 6, at 151.

427. *Id.* at 176.

428. *Id.*

429. A recently released Oxford Economics report commissioned by the Cayman Islands Financial Services Association concluded that the financial sector comprises 55% of the Cayman economy. *See* OXFORD ECON., ECONOMIC BENEFITS OF THE FINANCIAL SERVICES INDUSTRY IN THE CAYMAN ISLANDS 1 (2009), *available at* http://www.caymanfinances.com/pdf/Impact_Study.pdf.

430. *See supra* text accompanying note 411.

431. Nieuw Fiscaal Raamwerk 20 December 2001 P.B. 2001 nr. 146. Int'l Monetary Fund [IMF], *Executive Board Integrates the Offshore Financial Center Assessment Program with the FSAP*, Public Information Notice (PIN) No. 08/82, July 9, 2008, *available at* http://www.imf.org/external/np/sec/pn/2008/pn0882.htm ("The OFC program began in 2000. Of the forty-four jurisdictions that were initially contacted, 42 were assessed and two jurisdictions received technical assistance in lieu of assessment. The first phase of assessment was completed in 2005.").

432. *See* David A. Ring, *Sustainability Dynamics: Land-Base Marine Pollution and Development Priorities in the Island States of the Commonwealth Caribbean*, 22 COLUM. J. ENVTL. L. 65, at 70 (1997); OOSTINDIE, *supra* note 21, at 113.

Barbuda, Bermuda, the British Virgin Islands, the Cayman Islands, Dominica, Grenada, Montserrat, St. Kitts and Nevis, and the Turks and Caicos Islands all have populations of fewer than 100,000 persons.[433] Among these jurisdictions, those that have achieved success with their offshore financial sectors top the list in terms of per capita gross domestic product (GDP), literacy rates, life expectancy, and most other indicators of flourishing economies.[434] The alternative economic futures for these jurisdictions are quite limited: tourism, offshore financial services, and dependency on a metropolitan state for transfer payments are among the few viable options.[435]

Tourism undoubtedly has an important role to play in the future of many small jurisdictions, but tourism's potential is limited in several crucial ways. First, tourism as an industry is primarily a source of low-wage service-sector jobs, not the sort of economic development that provides a path to a sustainable, high-wage economy with opportunities for large numbers of citizens within the jurisdiction. Second, a substantial amount of tourism in existing Caribbean offshore jurisdictions is related to the offshore financial services sector, with businesspeople incorporating a vacation into a visit for an annual board meeting or conference.[436] Without the offshore financial sector connection, such tourists might well choose to vacation elsewhere.

Third, tourism is dependent on sound economies in the onshore jurisdictions from which most tourists are drawn. An economic downturn in the United States, for example, significantly reduces income from tourism in many Caribbean destinations.[437] Fourth, tourism can strain the physical environment of a jurisdiction, increasing demand for scarce fresh water, generating trash that must be disposed of, producing waste discharge from cruise ships, and so on.[438] Indeed, the more successful the tourism industry, the greater the impact on the environment. While a full exploration of the potential of tourism as an economic development strategy is not our intention, we think it is safe to conclude that tourism alone is unlikely to

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433. CIA, THE WORLD FACTBOOK: COUNTRY COMPARISON–GDP PER CAPITA (PPP) (July 2009), *available at* https://www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html; CIA, THE WORLD FACTBOOK–COUNTRY COMPARISON–LIFE EXPECTANCY AT BIRTH (July 2009), *available at* https://www.cia.gov/library/publications/the-world-factbook/rankorder/2102rank.html.

434. CIA, THE WORLD FACTBOOK: COUNTRY COMPARISON–POPULATION (July 2009), *available at* https://www.cia.gov/library/publications/the-world-factbook/rankorder/2119rank.html.

435. Prof. Oostindie summarizes the problems small Caribbean states face in economic development well:

> Many Caribbean policy-makers must have sympathized with the desperate characterization of the development process by the former Jamaican MP, the late Michael Manley, as a struggle 'Up the Down Escalator.' The limitations of scale already apparent in the 1960s have continued to haunt planners. Moreover, the ongoing restructuring of the world economy left the entire Caribbean in an ever more marginal position within an Atlantic economy itself struggling to retain some of the gravity which had seemed unbeatable decades ago.

OOSTINDIE, *supra* note 21, at 113.

436. E-mail from Pilar Bush, Managing Director, AtWater Ltd., to Andrew P. Morriss, H. Ross and Helen Workman Professor of Law and Professor of Business, University of Illinois College of Law (Sept. 22, 2009 10:14 CST) (on file with author).

437. *See, e.g.*, *Caribbean Growth Dampened by Global Downturn*, IMF SURVEY MAGAZINE, Dec. 10, 2008 *available at* http://www.imf.org/external/pubs/ft/survey/so/2008/car121108a.htm ("Weaker foreign remittances and dampened economic activity in key sectors such as tourism would be the likely consequences of the slowdown in global economic activity.").

438. *See* DEBORAH MCLAREN, RETHINKING TOURISM AND ECOTRAVEL: THE PAVING OF PARADISE AND WHAT YOU CAN DO TO STOP IT 9–25 (Kumarian Press 1998) (describing environmental problems caused by tourism).

provide a sustainable economic future for more than a handful of the small states even in a location as desirable as the Caribbean. For small states with less sun and sand (e.g., the Isle of Man off the coast of Britain), or located farther from large numbers of relatively wealthy tourists (e.g., Vanuatu in the Pacific), tourism's potential is even more limited.

A second alternative is closer integration with a metropolitan country. This is the route that France has taken with many of its former colonial possessions,[439] but this route, too, has its difficulties. As Aldrich and Connell conclude in their survey of French overseas territories, those territories' relationships with France, "in which grandly conceived plans for future development have not been matched by reality," are characterized by a "subtle yet thoroughly pervasive structure of dependency."[440] In particular, "[m]etropolitan presence and aid seem to have brought relatively high standards of living, but equally extreme dependence and vulnerability."[441] As a result, the French Caribbean has been "an economic fiasco: a society which consumes but which produces practically nothing."[442] The French model has produced high living standards through subsidies, although the benefits of those standards appear to accrue mostly to French bureaucrats seconded to the islands for government service, and the local land-owning elite rather than to the society as a whole.[443]

Virtually the only alternative to dependency and tourism for small states is some form of financial services sector. Although not feasible for every small state, it is the most viable path for economic development for some small jurisdictions and so will remain attractive to Curaçao and others. As we outlined earlier, we believe that there will continue to be opportunities for offshore financial sectors to introduce financial intermediation products that make sufficient economic sense to provide a viable business model.[444] Of course, that many offshore jurisdictions have few economic alternatives to establishing offshore financial sectors is not a conclusive reason for onshore jurisdictions such as the United States to turn a blind eye to tax evasion occurring through those jurisdictions. Onshore jurisdictions clearly have a strong policy interest in preserving both the integrity of their domestic income tax systems and the stream of tax revenue that is critical to a mature welfare state.[445] Nonetheless, in the debate over the role of offshore financial centers it is important to acknowledge the benefits that an offshore financial sector may provide to the economic development of an offshore jurisdiction.

C. *Onshore Competitors*

The benefits of offshore financial intermediation do not flow unidirectionally from onshore jurisdictions to offshore jurisdictions. Where the persistence of legal

439. ALDRICH & CONNELL, *supra* note 364, at 72–73.

440. *Id.* at 163.

441. OOSTINDIE & KLINKERS, *supra* note 6, at 175.

442. ALDRICH & CONNELL, *supra* note 364, at 160.

443. *Id.*

444. *See supra*, Part III. A.1.

445. *See generally* Reuven Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1632–38 (2000) (detailing the importance of maintaining the welfare state in the era of globalization).

difference leads to arbitrage, both jurisdictions may benefit, just as both the United States and the Antilles benefited from the Antilles sandwich that utilized arbitrage of differences in the tax rules applicable to Antilles investors in U.S. debt versus investors in U.S. debt residing in other jurisdictions. In addition to these specific instances of mutual benefit related to particular arbitrage opportunities, a number of economists have concluded that offshore financial centers may actually stimulate onshore investment by reducing the tax costs in onshore jurisdictions of foreign investment, facilitating deferral of taxation of foreign income, or adding value to onshore goods and services.[446] Moreover, offshore financial centers "provide opportunities for tax planning by multinational corporations," "enhance efficiency" and, contrary to popular assumptions, may also retard rather than accelerate undesirable global tax competition.[447]

In addition to benefiting onshore jurisdictions *qua* onshore jurisdictions, offshore financial centers also have spurred innovation in onshore financial sector activity to such an extent that existing and aspiring offshore financial centers have begun to face significant competition for the financial products and services they offer from onshore jurisdictions. In other words, offshore jurisdictions have prodded onshore jurisdictions to be more offshore-like. Onshore competition in the area of traditionally offshore activities is more significant today than it was in the past and takes two forms. First, some onshore jurisdictions seek to provide their own financial products and services (frequently copied from offshore jurisdictions) that make going to an offshore jurisdiction unnecessary. For example, in the United States, the State of Vermont has established itself as a leading jurisdiction for captive insurance companies, a business originally pioneered offshore by Bermuda and the Cayman Islands.[448] Similarly, the United States competes in the worldwide banking market by offering what is essentially a ring-fenced zero tax regime for bank deposits by foreigners, competing with banks in offshore jurisdictions.[449] (Elsewhere we have argued that the degree to which onshore jurisdictions like the United States and United Kingdom resemble offshore financial centers in terms of the "offshore" services they provide has been obfuscated in the past by perpetuating the offshore/onshore dichotomy.)[450]

Second, in addition to providing competing products, onshore jurisdictions compete by exercising their own sovereignty to alter the terms of competition in their favor or in pursuit of domestic policy objectives. (We distinguish this from multilateral efforts at harmonization or creating a "level playing field" below.) The Antilles saga provides a vivid illustration of this. The United States terminated its

446. *See* Mihir A. Desai et al., *Do Tax Havens Divert Economic Activity?*, 90 ECON. LETTERS 219–20 (2006) (providing evidence that tax havens enhance activity in nearby non-havens).

447. *See* Dhammika Dharmapala, *What Problems and Opportunities are Created by Tax Havens?*, 24 OXFORD REV. OF ECON. POL'Y 661, 662 (2008) (noting that tax havens can enhance efficiency, mitigate tax competition, and enable tax planning for multinational corporations); *see* Desai et al., *supra* note 446 219, 220 (noting that tax havens may retard undesirable tax competition).

448. *See* Morriss, *supra* note 242, at 60 (explaining that Vermont, in its efforts to compete with Bermuda and the Cayman Islands, has become the domestic leader In captive insurance legislation).

449. *See* I.R.C. § 871(h) (2009); *1983 Tax Evasion Hearings*, *supra* note 4, at 182 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen) (noting interest has been tax free since 1921 and that U.S. taxpayers subsidize such accounts by providing free deposit insurance up to $100,000); Boise, *supra* note 14, at 32.

450. *See generally*, Boise, *supra* note 14, at 24–26 (explaining the claims asserted by onshore jurisdictions that OFCs are engaging in tax competition).

tax treaty with the Antilles and as a result there was a dramatic decline in the use of Antilles N.V.s as real estate investment vehicles and finance subsidiaries. The United States did so in part on domestic policy grounds, because it perceived the costs of continuing to sanction the Antilles sandwich as too high in terms of lost tax revenue. However, the United States also preferred to extend treaty benefits to jurisdictions that could offer more in exchange for those benefits.

The debate over the role played by offshore financial centers rarely examines onshore competitive interests. Just as we argued in the preceding subsection that the offshore jurisdictions have a legitimate interest in economic development in promoting their financial services sectors, so too it is important for the debate to recognize the legitimate interests that onshore jurisdictions have in restricting criminal enterprises, preventing tax evasion, and so forth. These interests were not asserted in the early days of offshore financial centers but first began to seriously appear in the 1980s when, as we have described, they played a role in the U.S. policy changes that ended the Curaçao boom. Of course, assertions of such interests may sometimes mask less acceptable reasons for policy changes, but it is important for all participants in the future debate over offshore financial centers' roles to recognize that there are legitimate onshore jurisdiction interests in these areas, and an accommodation that respects all parties' interests is likely to be preferable to one that does not.

This can be seen in particular in the debate over confidentiality laws. As Prof. Rose Marie Antoine has eloquently argued, the strong financial confidentiality laws in many offshore jurisdictions are a reflection of a long-standing commitment to protecting individual privacy in financial matters.[451] This commitment is common to many legal systems and in some is even constitutionally mandated.[452] Importantly, most financial privacy statutes of most common law offshore jurisdictions derive from, or are in fact codifications of, the 1923 decision of the British Court of Appeal in *Tournier v. National Provincial & Union Bank of England* and related court decisions.[453] Similarly, the availability of bearer shares in jurisdictions like Curaçao is consistent with long-standing practice in many civil law legal systems.[454]

Moreover, financial privacy is consistent with important social objectives, ranging from protection against criminal conspiracies to enabling people to secure their assets against kleptocratic regimes.[455] In this regard, for example, Curaçao has played an important role for more than a century in sheltering both the assets and

451. *See* ROSE-MARIE ANTOINE, CONFIDENTIALITY IN OFFSHORE FINANCIAL LAW 37 (2002) (describing how financial privacy concerns in many jurisdictions led to the development of financial confidentiality laws).

452. *Id.*

453. Tournier v. Nat'l Provincial and Union Bank of Eng., (1924) 1 K.B. 461 (Court of Appeal 1923) (U.K.); ANTOINE, *supra* note 451, at 31 ("The *locus classicus* on [confidentiality in finance] is the case of *Tournier v. National Provincial Bank*.").

454. *See* LANGER, *supra* note 9, at 101 ("Bearer shares, unknown in the United States, are common in Europe and in much of the rest of the world."); *See also 1983 Tax Evasion Hearings*, *supra* note 4, at 203–05 (statement of Marshall J. Langer, Attorney of Counsel, Shutts & Bowen) (discussing bearer bonds and shares).

455. *See* Morriss, *supra* note 242, (arguing that regulatory competition is inevitable and therefore there are non-financial reasons for encouraging a offshore financial jurisdictions).

the persons of Venezuelan dissidents.[456] Indeed, Curaçao's traditional role as an offshore financial center for Venezuelan dissidents provides a useful frame of reference for the current debate. A Venezuelan official denounced the island in the nineteenth century as "the headquarters of the enemies of Venezuelan peace."[457] Continuing, the official said that "it had no industry other than the traffic it had made in Venezuelan blood ... Curaçao has lived on our ruin and our calamities, speculating and enriching itself."[458] Although more colorfully phrased than the current debate, the substance of the Venezuelan complaint is little different from many of the current denunciations of offshore jurisdictions. Yet there is little question that many onshore and offshore jurisdictions share a common commitment to privacy principles generally. Outside the financial realm, for example, the European Union provides extremely strong privacy protection in a number of contexts.[459] Onshore jurisdictions need to acknowledge that offshore jurisdictions have arguments both historic and principled for maintaining financial confidentiality, and their sovereignty in determining the level of that confidentiality should be respected.

From the perspective of onshore jurisdiction law enforcement authorities and tax authorities, however, strong confidentiality laws are an impediment to the information sharing they view as critical to carrying out their missions.[460] This, too, is a legitimate perspective. Tax laws in onshore jurisdictions must be enforced, and it is undeniable that tax evaders have made use of the financial confidentiality rules of offshore jurisdictions to thwart collection of taxes. Offshore jurisdictions need to, and in many instances have, found ways of accommodating legitimate onshore jurisdiction needs for information in both the law enforcement and tax spheres. This is particularly true as "there is no way to determine objectively which regulations are reasonable and which not."[461]

Unfortunately, the current debate does not resemble a considered acknowledgement of the legitimate interests of all parties. For example, tax authorities in Germany, France, Britain, the United States, and elsewhere recently purchased data on private foundations established in Liechtenstein that was stolen by an employee of the Liechtensteinische Landesbank.[462] The purchase and subsequent use of this data by the onshore jurisdiction tax authorities to identify tax evaders has caused a furor among offshore jurisdictions; the use illustrates both a lack of respect for basic legal principles by the onshore tax authorities and the need for Liechtenstein to consider ways to prevent the abuse of its foundation entities.[463]

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456. *See* Cleland, *supra* note 21, at 138 (noting that "Bolivar, Paez, Miranda, Sublet, Guzman Blanco, Riero and other Venezuelan 'revolutionists' ..." spent time in Curaçao); *see* GOSLINGA, *supra* note 31, at 94–106 (documenting numerous near clashes between the nations of Venezuela and Curaçao because of dissidents residing on Curaçao).

457. GOSLINGA, *supra* note 31, at 91.

458. *Id.*

459. *See, e.g.*, Mark F. Kightlinger, *Twilight of the Idols? EU Internet Privacy and the Post Enlightenment Paradigm*, 14 COLUM. J. EUR. L. 1, 10–29 (2007–2008) (describing stringent European privacy laws for personal information outside finance).

460. *1983 Tax Evasion Hearings*, *supra* note 4, at 3 (statement of William J. Anderson, Director, General Government Division, General Accounting Office) ("Tax havens are a problem for the United States primarily because their banking and commercial secrecy laws limit U.S. access to the information it needs to assure compliance with domestic tax and other laws.").

461. O'HARA & RIBSTEIN, *supra* note 87, at 16.

462. *Liechtenstein's Shadowy Informant*, *supra* note 401.

463. *Id.*; *see* Tony Paterson, *Fury in Liechtenstein Over German Tax Inquiry*, INDEPENDENT, Feb. 20,

Similarly, the recent behavior of UBS employees in apparently actively abetting tax fraud by American taxpayers is indicative of problems in Switzerland's approach to international cooperation.[464]

While the line between tax avoidance and tax evasion may be difficult to draw at times, it appears from initial accounts that, in both the Liechtenstein and UBS cases, offshore entities were well across the divide and far into tax evasion territory. At the same time, the purchase of stolen property by European tax authorities also crosses an important line, with the facilitation of the violation of Liechtenstein's laws no less a legitimate subject of concern than the violation of Germany's tax laws. As the stronger partner in any negotiations, the larger onshore jurisdiction economies need to take care to explicitly acknowledge and protect the interests of their smaller counterparts in the same way that they take care to respect the legitimate interests of other nations in other types of negotiations.[465]

D. The Impact of Multilateral Institutions

Future debates over the role of offshore financial centers will include participation by multilateral institutions to a greater extent than in the past. The success of the offshore financial services sector itself produced this reaction. The European Union's Savings Directive, the FATF's efforts to restrict opportunities for money laundering, and the IMF's efforts at increasing regulatory effectiveness among offshore financial centers are all part of broad, multilateral efforts to combat serious problems in the international financial system. But they are also all examples of one set of interests attempting to apply a set of standards that advantage their own interests to the detriment of other jurisdictions.[466] The existence of mixed motives in such efforts is inevitable, as interest groups within jurisdictions seek advantages through the regulatory process. The design of the institutions engaged in such efforts can be structured to increase or decrease the special interest content of the resulting regulations, standards, and protocols.

Most importantly, multilateral institutions attempting to influence the provision of offshore financial services need to include as equals the jurisdictions engaged in providing such services and the principles and standards set through such institutions must apply with equal force to onshore and offshore jurisdictions alike. The careful exclusion of the tax exemption for interest paid on foreign-owned bank deposits

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2008, *available at* http://www.independent.co.uk/news/world/europe/fury-in-liechtenstein-over-german-tax-inquiry-784417.html; Ulrich Jaeger & Gunther Latsch, *How a Liechtenstein Bank Helped German Investigators,* DER SPEIGEL, Mar. 3, 2008, *available at* http://www.spiegel.de/international/business/0,1518,539107,00.html.

464. *See* Lynnley Browning, *Ex-UBS Banker Pleads Guilty in Tax Evasion*, N.Y. TIMES, June 20, 2008, at C1 (reporting that former Swiss banker admits helping Americans evade U.S. taxes using offshore accounts); Evan Perez & Carrick Mollenkamp, *Swiss Bank to Give Up Depositors' Names to Prosecutors*, WALL ST. J. EUROPE, Feb. 19, 2009, at A1 (reporting that Swiss bank agrees to cooperate with U.S. tax authorities).

465. *See generally* Allison Christians, *Sovereignty, Taxation and Social Contract*, 18 MINN. J. INT'L L. 99 (2009) (suggesting that this regard for other jurisdictions may be implied from a "social contract" among states).

466. *See* Boise, *supra* note 14; Richard K. Gordon, *The International Monetary Fund and the Regulation of Offshore Centers*, *in* REGULATORY COMPETITION AND OFFSHORE FINANCIAL CENTERS (Andrew P. Morriss ed., forthcoming 2010).

from the OECD's definition of harmful tax competition is a particularly egregious example of the sort of one-sided result that occurs when onshore jurisdictions write the rules by themselves or through proxy organizations.[467]

E. The Changing Climate

We believe it is likely that ten, twenty, and fifty years from now there will be successful offshore financial centers. The Antilles saga, however, cautions that the winners tomorrow may not be the same jurisdictions that are dominant today. This is partly because of the persistence of difference and the shifting of legal differences among various jurisdictions. But it is also because there is remarkable change in the air with respect to attitudes towards offshore financial centers. The near-collapse of global financial markets in late 2008 prompted unprecedented scrutiny into the activities of banks, insurance companies, hedge funds and other financial sector actors that caused the meltdown.[468] As has frequently been the case in the past, the offshore financial centers of the world have been blamed for the failure of the financial system.[469] This is so, despite clear evidence that offshore financial centers are at least as well regulated as onshore jurisdictions.[470]

The economic strain of the financial crisis in the United States coupled with evidence of widespread malfeasance among corporate executives in the U.S. financial services sector have led to deep concerns about the scope and effectiveness of global regulation of the financial markets. In this environment, offshore financial centers have become both easy targets of blame and the subject of pending legislation in Congress. The United States Senate currently is considering legislation called the Stop Tax Haven Abuse Act, which was proposed by Sen. Carl Levin and that has gained considerable attention because a less-comprehensive version was co-

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467. Boise, *supra* note 14, at 18.

468. *See* President Barack Obama, Remarks by the President on 21st Century Financial Regulatory Reform (June 17, 2009) (discussing proposed reform of financial markets) (transcript *available at* http://www.whitehouse.gov/the_press_office/Remarks-of-the-President-on-Regulatory-Reform/).

469. Nicholas Watt, *Brown Targets Switzerland in Global Tax Haven Crackdown: Tough Controls on Offshore Regimes as Avoidance Costs Taxpayers Billions*, GUARDIAN, Feb. 19, 2009, at 1, *available at* http://www.guardian.co.uk/business/2009/feb/19/gordon-brown-tax-avoidance-switzerland (noting Gordon Brown's plan to lead other nations in a crusade against offshore financial centers was well-timed as the economic downturn provides a ready excuse to close countless tax loopholes valued at hundreds of billions annually); Robert M. Morgenthau, Op-Ed., *Too Much Money Is Beyond Legal Reach*, WALL ST. J., Sept. 30, 2008, at A19 ("A major factor in the current financial crisis is the lack of transparency .... This opaqueness is compounded by vast sums of money that lie outside the jurisdiction of the U.S. regulators and other supervisory authorities."); M. Padmakshan, *Vatican Demands Closure of Tax Havens*, ECON. TIMES, Feb. 23, 2009, *available at* http://economictimes.indiatimes.com/News/Economy/Finance/Vatican_demands_closure_of_tax_havens/rssarticleshow/4172245.cms (summarizing the Vatican's belief that the global financial crisis was caused by offshore financial centers with "unhealthy and inequitable financial practices" that collectively form the chief means of transferring wealth from impoverished nation to wealthy nations). Offshore financial centers also were blamed for the Asian financial crisis of 1997. *See* Steven Radelet & Jeffrey Sachs, *The Onset of the East Asian Financial Crisis*, HARV. INST. FOR INT'L DEV., Mar. 1998, at 10, *available at* http://www.earthinstitute.columbia.edu/sitefiles/File/about/director/pubs/paper27.pdf (claiming that "inflow of foreign funds was a precondition for the subsequent crisis," the bulk of which came from offshore borrowing); Injoo Sohn, *East Asia's Counterweight Strategy: Asian Financial Cooperation and Evolving International Monetary Order*, *in* G-24 DISCUSSION PAPER SERIES 2 (U.N. Conference on Trade and Dev., United Nations 2007), *available at* http://www.unctad.org/en/docs/gdsmdpbg2420072_en.pdf (stating that offshore financial centres were widely believed to have contributed to speculation leading to Asian crisis).

470. Andrew P. Morriss, *Regulatory Intensity & Offshore Financial Centers* (forthcoming 2009).

signed by Senator Barak Obama before he was elected President.[471] Similar legislation is being considered in the House of Representatives.[472] The bills represent the most sweeping attack ever on tax evasion through offshore financial centers.[473]

Clearly both within the United States and around the globe, offshore financial centers are being forced to accede to the demands of onshore jurisdictions in terms of cooperation and mutual legal assistance and the dramatic scaling back of the scope of financial confidentiality. It remains to be seen whether onshore and offshore governments will recognize that the offshore financial intermediation that benefits offshore financial centers also creates benefits for onshore jurisdictions. An important lesson of the Antilles saga is that for nearly two decades financial intermediation in the Antilles benefitted the United States economy by lowering the cost of capital for U.S. firms and channeling foreign investment into the U.S. real estate market. The same set of arbitrage transactions created unprecedented economic growth, dramatic expansion of the professional class and a rising standard of living for all residents. Crisis in the global financial markets should not give rise to rash legislative, regulatory, and political measures that discourage the symbiotic relationships that may develop between onshore and offshore jurisdictions.

V. CONCLUSION

The history of the Antilles financial sector is both colorful and instructive. Much of the Antilles early success was the product of luck and events taking place far from its shores. However, in a world of persistent legal differences, the Antilles also were among the first to identify major financial intermediation opportunities and exercise legislative agility in creating the statutory framework to exploit those opportunities. However, this process is interactive rather than static. Our theory of regime plasticity holds that as offshore jurisdictions face the challenges of change, those that continue to exercise legislative agility to adapt will thrive. Others, however, are constrained by constitutional limitations in their response to change. Like the Antilles, these jurisdictions are politically or structurally unable to recognize and appropriately react to change, and as a result may find their offshore financial sectors decimated. There is evidence in the New Fiscal Framework and other recent initiatives, that Curaçao finally recognizes the need to aggressively seek arbitrage opportunities among the differences that exist between regimes.[474] Perhaps Curaçao

471. *See* Kevin Drawbaugh & Corbett Daly, *Obama Admin. Backs Tax Haven Bill*, REUTERS, Mar. 3, 2009, *available at* http://www.reuters.com/article/politicsNews/idUSTRE52271L20090303?pageNumber=1&virtualBrandChannel=0&sp=true (discussing Barak Obama's endorsement of the current proposed legislation and involvement in similar prior legislation).

472. *See id.* ("[B]ills unveiled on Monday in the Senate and House of Representatives . . . .").

473. In 2001, U.S. taxpayers paid about $1.77 trillion in taxes. By contrast, it is estimated that U.S. taxpayers utilize offshore tax havens to annually evade between $40 billion and $70 billion in U.S. tax liability. *See* STAFF OF S. COMM. ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS, 109TH CONG., TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY 1, 8–10 (Comm. Print 2006) ("Experts estimate that Americans now have more than $1 trillion in assets offshore and illegally evade between $40 and $70 billion in U.S. taxes each year through the use of offshore tax schemes."). A comparison of these figures suggests that tax evasion through the use of offshore tax havens amounts to only about three percent of the total annual income tax collected. Although meaningful, this percentage hardly indicates that tax evasion fostered by globalization is likely to undermine the U.S. income tax system.

474. Nieuw Fiscaal Raamwerk 20 December 2001 P.B. 2001 nr. 146.

in its re-envisioned role within the Dutch Kingdom will be sufficiently autonomous that the island can move forward once more with agility and speed to restore its once-thriving financial sector.

Shifting Viewpoints: The Foreign Trade Antitrust Improvement Act, A Substantive or Jurisdictional Approach

EDWARD VALDESPINO*

Since being passed in 1982, the Foreign Trade Antitrust Improvement Act (FTAIA) has been viewed predominantly as a jurisdictional limitation to the Sherman Act. All of the Circuits currently agree with this interpretation and although the Supreme Court has not ruled on this issue specifically, in its Empagran decision the Court refers to the FTAIA in jurisdictional terms. There are, however, those that see the FTAIA as a restriction on the substantive applicability of the Sherman Act rather than a jurisdictional limitation. This view is supported by Justice Scalia in his Hartford Fire dissent and by Judge Wood, of the 7th Circuit, in her dissent in United Phosphorus.

In 2006 the Supreme Court held in Arbaugh, a Title VII (Civil Rights Act of 1964) case, that, "when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character."[1] Since there is nothing in the language of the FTAIA indicating that its limitations are jurisdictional, the Arbaugh decision may require the Circuits to review their treatment of this issue.

This article will analyze these two very different treatments of the FTAIA and discuss the effects that the Arbaugh decision may have on its future. After an introductory overview of the issues in Part I, Part II will give a brief history and explanation of the FTAIA; Part III will analyze the differences between jurisdictional and substantive statutory interpretation; Part IV will discuss how these different interpretations are applied to the FTAIA in United Phosphorus and Hartford Fire. Part V will analyze the Arbaugh case and its possible effects on the statutory interpretation of the FTAIA; and finally, Part VI will discuss the future of the FTAIA.

SUMMARY

* The University of Texas School of Law, J.D. expected May 2010. The author would like to thank David Shank, Danielle Doremus, the staff of TILJ, and a very special thanks to Professor Jay Westbrook and Mr. Jonathan Pratter for their help and guidance.

1. Arbaugh v. Y&H Corp., 546 U.S. 500, 516 (2006).

I. INTRODUCTION: *ARBAUGH*, AN END TO JURISDICTIONAL DRIVE-BY'S ON THE FTAIA

From its nascent days to the present, the Foreign Trade Antitrust Improvement Act (FTAIA) has been viewed predominantly as a jurisdictional limitation to the

Sherman Act rather than a limit on its substantive applicability.[2] All of the Circuits currently interpret the FTAIA as jurisdictional, and although the Supreme Court has not ruled on this issue specifically, in its *Empagran* decision the Court refers to the FTAIA in jurisdictional terms.[3] There are however, those who see the FTAIA as a limit on the substantive applicability of the Sherman Act rather than a jurisdictional limitation, and the prevailing winds may be changing, eventually displacing the majority's view with that of the minority. This approach is supported, most notably and most vocally, by Justice Scalia in his dissent in *Hartford Fire*,[4] and by Judge Wood of the Seventh Circuit in her dissent in *United Phosphorus*.[5]

The Second Circuit has long been a progenitor of important decisions in the commercial sphere, and has been especially notable in the field of antitrust where Judge Learned Hand's 1945 *Alcoa* decision announced the "effects test" and the rule of extraterritoriality.[6] It is no wonder then that careful attention is paid to the decisions handed down from the Second Circuit and that these decisions are carefully scrutinized; changes in the treatment of issues there can have rippling effects throughout the judicial system. Judge Lynch of the Southern District of New York knows this well, and it comes as no surprise that he does not take lightly the possible shift coming in the Second Circuit's treatment of the Foreign Trade Antitrust Improvement Act (FTAIA). In his 2008 opinion, *Boyd v. AWB Limited*, Judge Lynch wrote a nearly 350-word footnote on the debate over the treatment of the FTAIA as either a jurisdictional limitation or as a limitation on the substantive applicability of the statute, even though neither party challenged the characterization of the statute as jurisdictional.[7] He quoted the Supreme Court, calling "the tendency of courts to term the non-existence of a critical fact a 'jurisdictional defect' rather than merely the failure to prove an element of the claim . . . 'drive-by jurisdictional rulings.'"[8]

Like the rest of the country, the Second Circuit currently characterizes the FTAIA as a limitation on the court's jurisdiction,[9] but it appears from his writing in *Boyd* that Judge Lynch favors a move from a jurisdictional view of the FTAIA to a substantive one,[10] and he thinks that this may be delivered through a Supreme Court Decision in a Title VII (Civil Rights Act of 1964) case.[11] In 2006, the Supreme Court held in *Arbaugh* that "when Congress does not rank a statutory limitation on

2. *See* H.R. REP. NO. 97-686, at 2 (1982), *reprinted in* 1982 U.S.C.C.A.N. 2487, 2487 (illustrating that the earliest reports on the FTAIA referred to it in jurisdictional terms).

3. PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW para. 272i2 at 296 (3d ed. 2006).

4. Hartford Fire Ins. Co. v. California, 509 U.S. 764, 813 (1993) (Scalia, J., dissenting).

5. United Phosphorus, Ltd. v. Angus Chem. Co., 322 F.3d 942, 955 (7th Cir. 2003) (Wood, J., dissenting).

6. United States v. Aluminum Co. of Am. (Alcoa), 148 F.2d 416, 444 (2d Cir. 1945).

7. Boyd v. AWB Ltd., 544 F. Supp. 2d 236, 243 n.6 (S.D.N.Y. 2008).

8. *Id.* at 244 (quoting Arbaugh v. Y & H Corp., 546 U.S. 500, 511 (2006)).

9. *See* Filitech S.A. v. France Telecom S.A., 157 F.3d 922, 931 (2d Cir. 1998) (characterizing FTAIA's requirements as jurisdictional).

10. *See Boyd*, 544 F. Supp. 2d at 243 n.6 ("Although the Second Circuit in *Filitech* characterized the FTAIA's limitations as a constraint on courts' 'jurisdiction,' the express language of the FTAIA—*i.e.*, that the Sherman Act 'shall not apply' to certain kinds of foreign conduct—suggests a limitation, not on a courts power to decide the case, but rather, on the substantive applicability of the statute.") (internal citations omitted).

11. *See id.* (discussing *Arbaugh*).

coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character."[12] In concluding his analysis of the treatment of the FTAIA, Judge Lynch wrote, "Because nothing in the statutory language of the FTAIA indicates that its limitations are jurisdictional, *Arbaugh* may require that the Second Circuit review its treatment of that issue."[13] If Judge Lynch is correct, and he almost certainly is, the *Arbaugh* decision will force the lower courts to switch to a substantive view of the FTAIA, which will have serious consequences regarding the way U.S. courts deal with the extraterritoriality of our antitrust laws.

II. A BRIEF HISTORY OF THE FOREIGN TRADE ANTITRUST IMPROVEMENT ACT

A. *Shaky Ground: The Common Law Roots of the FTAIA*

The story of the extraterritorial application of U.S. antitrust laws begins in 1909 with Justice Holmes' opinion in *American Banana Co. v. United Fruit Co.*[14] In this case, Justice Holmes affirmed the lower courts dismissal of an antitrust claim based on "the general and almost universal rule . . . that the character of an act as lawful or unlawful must be determined wholly by the law of the country where the act is done."[15] Justice Holmes further stated that, "[a] conspiracy in this country to do acts in another jurisdiction does not draw to itself those acts and make them unlawful, if they are permitted by the local law."[16] *American Banana* set up what was later referred to as a "strict territorial test."[17] This standard only lasted until 1945, however, when "*American Banana's* strict territorial test was moderated, if not rejected" by Judge Learned Hand's decision in *Alcoa*.[18]

Due to the inability of the Supreme Court to produce a quorum (four Justices were forced to recuse themselves in light of previous involvement with parties to the suit),[19] and pursuant to 15 U.S.C. § 29, which at the time authorized the designation of a court of appeals as a court of last resort for certain antitrust cases, Judge Hand fashioned the "effects test" to define the extraterritorial reach of U.S. antitrust courts.[20] Since the *Alcoa* decision, "it has been relatively clear that it is the situs of the effects as opposed to the conduct, that determines whether United States antitrust law applies."[21] Judge Hand's effects test consisted of two parts. Overseas conspiracies would be subject to U.S. antitrust laws only "if they . . . intended to affect imports *and* did affect them."[22] Confusion over the meaning and application

12. Arbaugh v. Y&H Corp., 546 U.S. 500, 516 (2006).
13. *Boyd*, 544 F. Supp. 2d at 243 n.6.
14. Am. Banana Co. v. United Fruit Co., 213 U.S. 347 (1909).
15. *Id.* at 356.
16. *Id.* at 359.
17. *United Phosphorus*, 322 F.3d at 946.
18. *Id.*
19. Spencer Weber Waller, *The Antitrust Legacy of Thurman Arnold*, ST. JOHN'S L. REV. 569, 591–92 (2004).
20. United States v. Aluminum Co. of Am. (Alcoa), 148 F.2d 416, 444 (2d Cir. 1945).
21. H.R. REP. No. 97-686, at 5 (1982).
22. *Alcoa*, 148 F.2d at 444 (emphasis added).

of the "effects test" in the subsequent four decades led to a call for clarification and eventually to the passing of the FTAIA.[23]

B. The FTAIA: An Improvident Solution

Title IV of the Export Trading Company Act of 1982, the Foreign Trade Antitrust Improvement Act, was signed into law by President Ronald Reagan in 1982.[24] The purpose of this Act was to clarify the extraterritorial reach of the U.S. antitrust laws.[25] Congress was becoming increasingly worried about American courtrooms being inundated with suits brought to satisfy foreign interests and having only nominal effects on domestic commerce.[26] In addition, Congress was concerned about a lack of consistency between courts regarding their role in enforcing U.S. antitrust laws abroad, and the negative impact that this was having on international commerce.[27] The legislative solution to this was the FTAIA. Since being signed into law, the FTAIA has been harshly criticized for being inelegantly worded,[28] "introduc[ing] confusion into a regime that, before its enactment, was . . . modestly successful," and failing in its overall objective.[29]

Despite these criticisms the FTAIA is still an extremely important statute and is intended to serve a number of different functions. First and most importantly, the FTAIA makes it clear that the purpose of U.S. antitrust laws is to protect American economic interests and not foreign interests.[30] This goal was achieved by limiting the Sherman Act to:

> [C]onduct involving trade or commerce (other than import trade or import commerce) with foreign nations unless—
>
> (1) such conduct has a direct, substantial, and reasonably foreseeable effect—
>
> (A) on trade or commerce which is not trade or commerce with foreign nations, or on import trade or import commerce with foreign nations; or
>
> (B) on export trade or export commerce with foreign nations, of a person engaged in such trade or commerce in the United States; and
>
> (2) such effect gives rise to a claim under the provisions of sections 1 to 7 of this title other than this section.[31]

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23. Export Trading Company Act of 1982, Pub. L. No. 97-290, tit. IV, §§ 401–03, 96 Stat. 1233, 1246–47 (codified at 15 U.S.C. § 6a (2000)).

24. *Id.*

25. H.R. REP. NO. 97-686, at 2.

26. AREEDA & HOVENKAMP, *supra* note 3, at 286–87.

27. H.R. REP. NO. 97-686, at 2 (1982).

28. AREEDA & HOVENKAMP, *supra* note 3, at 288.

29. Max Huffman, *A Retrospective on Twenty-Five Years of the Foreign Trade Antitrust Improvements Act*, 44 HOUS. L. REV. 285, 286 (2007).

30. AREEDA & HOVENKAMP, *supra* note 3, at 287.

31. Foreign Trade Antitrust Improvement Act, 15 U.S.C. § 6a (2000).

What this means in plain English is that the Sherman Act does not apply to conduct, foreign or domestic, unless that conduct has a direct, substantial, and reasonably foreseeable effect on domestic markets or on U.S. export opportunities. The FTAIA was also intended to eliminate the perception that "antitrust law prohibits efficiency-enhancing joint export activities" by "encourag[ing] the business community to engage in efficiency producing joint conduct in the export of American goods and services,"[32] as well as "alleviate tension between the United States and its trading partners arising from extraterritorial application of U.S. competition policy in conflict with foreign competition law."[33] Finally, the FTAIA was intended to "serve as a simple and straightforward clarification of existing American Law and the Department of Justice enforcement standards," creating, "[a] clear benchmark . . . for businessmen, attorneys and judges as well as our trading partners."[34]

C. *Cracks in the Foundation: Analysis of the FTAIA*

The FTAIA is a limiting statute; it removes a court's ability to apply the Sherman Act to antitrust claims relating to foreign trade or commerce (other than import trade or import commerce), then it gives some of that power back.[35] U.S. antitrust law only applies to claims when the conduct falls outside the scope of the FTAIA, such as wholly domestic conduct or import trade or import commerce, and if the conduct falls within one of the narrow exceptions set up within the act.[36] To fall within one of the exceptions of the FTAIA, the conduct must meet two requirements. Section 1 requires that the conduct must have "a direct, substantial, and reasonably foreseeable effect" on domestic commerce, import commerce, or the business of U.S. exporters, and Section 2 requires that the conduct "gives rise to a claim" under U.S. antitrust laws.[37]

The "cumbersome, ambiguous, and inelegant language" of the FTAIA[38] has given rise to three major problems in its interpretation. The first problem is understanding what Congress meant by "direct, substantial and reasonably foreseeable." Second is the requirement that conduct "give[] rise to a claim," and finally, there is the use of the language "shall not apply."

The need for a "direct" effect has been the subject of much debate in the courts. *Intel* stated that "but for causation is not the type of direct causation contemplated by the FTAIA"[39] and *Biotechnologies* defined an effect as "direct" under the FTAIA if "it follows as an immediate consequence of the defendant's activity" with no "intervening developments."[40] These interpretations of "direct"

32. H.R. REP. NO. 97-686, at 2, 4 (1982).

33. Huffman, *supra* note 29, at 305.

34. H.R. REP. NO. 97-686, at 2.

35. 15 U.S.C. § 6a.

36. *Id.*

37. *Id.*

38. AREEDA & HOVENKAMP, *supra* note 3, at 288.

39. *In re* Intel Corp. Microprocessor Antitrust Litig., 452 F. Supp. 2d 555, 561 (D. Del. 2006); *see also* Empagran S.A. v. F. Hoffmann-La Roche Ltd., 417 F.3d 1267, 1271 (D.C. Cir. 2006) ("The statutory language—'gives rise to'—indicates a direct causal relationship, that is, proximate causation, and is not satisfied by the mere but-for 'nexus' the appellants advance[] . . . .").

40. United States v. LSL Biotechnologies, 379 F.3d 672, 680–81 (9th Cir. 2004).

seem contradictory to the intent of Congress as discussed in the legislative history, which clearly indicates that spillover effects in the domestic market are enough to meet the "direct" requirement[41]—a much more reasonable interpretation in today's vastly integrated global economy.

Courts have also disagreed over whether the effect has to be *both* "direct" *and* "substantial." In contrast to the majority of post-FTAIA decisions, two cases from the Southern District of New York have stated that both size and directness are not necessary.[42] While the "direct" requirement has made it more difficult for plaintiffs to bring claims than it was under the *Alcoa* effects test, the "reasonably foreseeable" requirement has made it easier. "Reasonably foreseeable" is much less stringent than the "intent" requirement from *Alcoa*. This change in language was meant to eliminate a defense based on ignorance of the effects of one's actions.[43]

The "gives rise to a claim" requirement of section 2 of the FTAIA has been the main factor driving some very important and drawn out litigation in federal courts. This language was a central issue of debate in the Supreme Court's most recent case regarding the FTAIA,[44] a case that has become the "primary source of the modern rules governing extraterritoriality under the FTAIA."[45] This debate caused a serious split within the courts of appeals. The Fifth Circuit in *Den Norske* held that "gives rise to a claim" requires that the domestic effect of the defendant's conduct must have caused *the* injury that the plaintiff is suing over,[46] while the D.C. Circuit held in *Empagran* that there only needed to be the possibility of a claim by a private party in the United States, thus allowing foreign plaintiffs to bring suits based on hypothetical domestic plaintiffs.[47] The Second Circuit took this interpretation even further in *Christie's* by extending this hypothetical domestic claim to claims that could be brought by the U.S. government (which is allowed to bring a claim without having to show demonstrable harm).[48]

On *Empagran's* third trip to the Supreme Court this debate was finally settled. The Court rejected the D.C. Circuit's textualist reading of the FTAIA and held that plaintiffs must demonstrate that the defendant's conduct gives rise to "the claim" that is the basis for the suit rather than "a claim"; the court held that where an adverse foreign effect is independent of any adverse domestic effect, the FTAIA does not apply.[49]

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41. H.R. REP. NO. 97-686, pts. D(4), E(2) (1982) (discussing the sufficiency of spillover in the context of international cartels).

42. *See* Papst Motoren GMbH & Co. v. Kanematsu-Goshu (U.S.A.) Inc., 629 F. Supp. 864, 868 (S.D.N.Y. 1986) (holding that "any demonstrable effect on United States commerce will suffice, so long as it is not de minimus." (citing Dominicus Americana Bohio v. Gulf & W. Indus. Inc., 473 F. Supp. 680, 687 (S.D.N.Y. 1979))); El Cid, Ltd. v. N.J. Zinc Co., 551 F. Supp. 626, 629 (S.D.N.Y. 1982) ("[I]t is probably not necessary for the effect on foreign commerce to be both substantial and direct so long as it is not de minimus." (quoting *Dominicus*, 473 F. Supp. at 687)).

43. H.R. REP. NO. 97-686, at 9.

44. F. Hoffmann-La Roche Ltd. v. Empagran S.A., 542 U.S. 155 (2004).

45. Huffman, *supra* note 29, at 318.

46. Den Norske Stats Oljeselskap v. HeereMac VOF, 241 F.3d 420, 421 (5th Cir. 2001).

47. Empagran S.A. v. Hoffman-LaRoche, Ltd., 315 F.3d 338, 350 (D.C. Cir. 2003), *vacated*, 542 U.S. 155 (2004).

48. Kruman v. Christie's Int'l PLC, 284 F.3d 384, 399–400 (2d Cir. 2002), *abrogated* by F. Hoffmann-La Roche Ltd. v. Empagran, 542 U.S. 155 (2004).

49. *Empagran*, 542 U.S. at 174–75.

Use of the language "shall not apply" has also created debate about the proper interpretation of the FTAIA. Judge Wood wrote that this "straightforward language" indicates that the courts should not construe the FTAIA's tests as going to the subject-matter jurisdiction of the court.[50] This interpretation of the language of the FTAIA is also supported by Judge Lynch in *Boyd*. He wrote that "the express language of the FTAIA—*i.e.*, that the Sherman Act 'shall not apply' to certain kinds of foreign conduct—suggests a limitation not on the court's power to decide the case, but rather, on the substantive applicability of the statute."[51]

III. STATUTORY LIMITATIONS: JURISDICTIONAL OR SUBSTANTIVE

> *Jurisdictional grants empower courts to hear and resolve cases brought before them by parties; substantive causes of action grant parties permission to bring those cases before the court. The substantive cause of action is a ticket permitting individuals to enter the federal judicial process; jurisdiction empowers the court to punch the ticket. Both are necessary for a civil action to be litigated.*[52]

A. *Confusing the Issues*

The failure of a party to meet one of these jurisdictional or substantive elements leads courts to dismiss causes of action for lack of subject-matter jurisdiction rather than properly dismissing them for failure to state a claim.[53] "Federal courts frequently err by treating factual elements of substantive federal causes of action as going to the jurisdiction of the federal court."[54] An error of this nature can have serious consequences for parties by affecting whether their claims are evaluated under Federal Rule of Civil Procedure 12(b)(1), or under Rule 12(b)(6). While some courts have stated that there is little difference between the two rules,[55] there are in fact some extremely important differences.

The most important consequences of determining whether a certain fact goes to jurisdiction or whether it goes to the substantive applicability of a statue is determining when, where, and by whom those facts are resolved.[56] If a certain fact goes to the jurisdiction of the court, judges make findings on those particular facts.[57] "[I]n a 12(b)(6) motion the court looks only at the face of the complaint, but in a challenge to the court's jurisdiction under 12(b)(1) the court may be required to look

50. United Phosphorus, Ltd., v. Angus Chem. Co., 322 F.3d 942, 953–54 (7th Cir. 2003) (Wood, J., dissenting).

51. Boyd v. AWB Ltd., 544 F. Supp. 2d 236, 243 n.6 (S.D.N.Y. 2008).

52. Howard M. Wasserman, *Jurisdiction and Merits*, 80 WASH. L. REV. 643, 676 (2005).

53. *Id.*

54. *Id.* at 643; *see, e.g.*, *United Phosphorus*, 322 F.3d at 953 (Wood, J., dissenting); Hartford Fire Ins. Co. v. California, 509 U.S. 764, 813 (1993) (Scalia, J., dissenting).

55. *See, e.g.*, Hamilton Chapter of Alpha Delta Phi, Inc., v. Hamilton Coll., 128 F.3d 59, 63 (2d Cir. 1997) ("Where, as is the case here with respect to Hamilton's interstate commerce argument, a jurisdictional challenge is addressed to the complaint, the analyses under *Rule 12(b)(1)* and *Rule 12(b)(6)* merge: the critical inquiry is into the adequacy of plaintiffs' allegations that the challenged conduct affects interstate commerce.").

56. Wasserman, *supra* note 52, at 662.

57. *Id.*

beyond the complaint to facts tending to establish or undermine jurisdiction."[58] The Seventh Circuit articulated the distinction between jurisdictional and substantive challenges:

> Normally we do not scrutinize a complaint so closely because under our system of notice pleading, we set a very low threshold to determine whether a complaint states a claim upon which relief can be granted. Such is not the case when a complaint is challenged for want of jurisdiction. On a motion to dismiss under Rule 12(b)(1), the court is not bound to accept the truth of the allegations in the complaint, but may look beyond the complaint and the pleadings to evidence that calls the court's jurisdiction into doubt.[59]

Another consequence is the non-waivability of jurisdiction.[60] Cases dismissed under 12(b)(1) are left open to attack at any time during the proceedings, including during appellate proceedings.

If, rather than going to the jurisdiction of the court, facts are relevant to the substance of the claim, they should be determined at a later phase of the trial. If factual elements of a plaintiff's claim are disputed, this is a determination that should be made by the fact finder rather than the court.[61]

B. Understanding the Confusion

Confusion over the interpretation of factual, substantive elements "derives from misapprehension of the meaning and effect of jurisdictional elements . . . ."[62] Justice Scalia and Judge Wood have both commented on the distinction between "legislative" and "judicial" jurisdiction.[63] A proper understanding of the purpose and effect of jurisdictional elements would alleviate much of this confusion.[64] The purpose that various factual elements serve within a particular statute should guide courts in their decisions over whether or not to treat those elements as jurisdictional. The Sherman Act, for example, is limited to restraints of trade affecting interstate commerce specifically because Congress's power to regulate this activity is derivative of its power to "regulate Commerce with foreign Nations, and among the several States . . . ."[65] Jurisdictional elements are "fact[s] included in a statute that must be pled and proven by the plaintiff in each case, serving as a nexus between a particular

58. AREEDA & HOVENKAMP, *supra* note 3, at 296.

59. Bastien v. AT&T Wireless Services, Inc., 205 F.3d 983, 990 (7th Cir. 2000).

60. *See* Fed. R. Civ. P. 12(h)(3) ("If the court determines at any time that it lacks subject-matter jurisdiction, the court must dismiss the action.").

61. Arthur R. Miller, *The Pretrial Rush to Judgment: Are the "Litigation Explosion," "Liability Crisis," and Efficiency Clichés Eroding Our Day in Court and Jury Trial Commitments?*, 78 N.Y.U. L. Rev. 982, 1083 (2003) ("When there is a dispute as to what acts or events have actually occurred, or what conditions have actually existed, the jury has the task of resolving the conflict." (quoting Stephen A. Weiner, *The Civil Jury Trial and the Law-Fact Distinction*, 54 CAL. L. REV. 1867, 1869–70 (1966))).

62. Wasserman, *supra* note 52, at 684.

63. Hartford Fire Ins. Co. v. California, 509 U.S. 764, 813–20 (1993) (Scalia, J., dissenting); United Phosphorus, Ltd. v. Angus Chem. Co., 322 F.3d 942, 953 (7th Cir. 2003) (Wood, J., dissenting).

64. Wasserman, *supra* note 52, at 684.

65. U.S. CONST. art. I, § 8, cl. 3.

piece of legislation and Congress's constitutional power to enact that legislation and to regulate the conduct at issue."[66] These elements concern Congress's constitutionally granted power to regulate conduct through legislation; they have nothing to do with the subject-matter jurisdiction of the judicial branch.[67] Under this interpretation, the failure of a plaintiff to plead and prove a jurisdictional element of a claim would "mean[] only that the statute by its terms does not reach (or subject to sanction) the real-world actors and conduct at issue."[68] In other words, the plaintiff would not have the necessary ticket to enter the federal judicial process.

C. *Properly Determining Jurisdiction*

Trials are divided up into many different phases: determining the jurisdiction of the court should be done at the outset and should be based on jurisdiction-granting statutory language.[69] If at this point the court finds that it does not have jurisdiction, it is required by law to dismiss the action.[70] Once a court has found that it does have jurisdiction, then, and only then, does the court have the appropriate authority to look into the merits of the case and grant or deny a 12(b)(6) motion.[71]

When looking at the question of whether or not a federal court has jurisdiction over a claim, it is important to remember that Congress granted federal district courts "original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States."[72] Congress further granted the federal courts original jurisdiction in certain types of civil actions, specifically, actions "arising under any Act of Congress regulating commerce or protecting trade and commerce against restraints and monopolies."[73] Jurisdictional granting statutes such as these should be the main focus of the courts when making a 12(b)(1) determination; unless the jurisdiction granted by these statutes is expressly stripped from the courts then a dismissal for lack of subject-matter jurisdiction will be inappropriate.[74]

Before a court can properly determine whether a jurisdiction-granting statute such as those mentioned above applies, they must first determine the meaning of the phrase "arising under." Two recent cases have attempted to clarify this phrase. In *Steel Co. v. Citizens for a Better Environment*, Justice Scalia wrote, "the district court has jurisdiction if 'the right of the petitioners to recover under their complaint will be sustained if the Constitution and laws of the United States are given one

66. Wasserman, *supra* note 52, at 679; *see also* Nesbit v. Gears Unlimited, Inc., 347 F.3d 72, 81–82 (3d Cir. 2003) (explaining jurisdiction elements link to Congressional power under the commerce clause).

67. Wasserman, *supra* note 52, at 684.

68. *Id.* at 687.

69. *Id.* at 693; *see also* Steel Co. v. Citizens for a Better Env't, 523 U.S. 89, 98 (1998) (illustrating the history and the necessity of determining jurisdiction before moving on to the merits).

70. Fed. R. Civ. P. 12(h)(3).

71. Wasserman, *supra* note 52, at 693; *see also* Bell v. Hood, 327 U.S. 678, 682 (1946) ("For it is well settled that the failure to state a proper cause of action calls for a judgment on the merits and not for a dismissal for want of jurisdiction. Whether the complaint states a cause of action on which relief could be granted is a question of law and just as issues of fact it must be decided after and not before the court has assumed jurisdiction over the controversy.").

72. 28 U.S.C. § 1331 (2006).

73. 28 U.S.C. § 1337 (2006).

74. United Phosphorus, Ltd. v. Angus Chem. Co., 322 F.3d 942, 954–55 (7th Cir. 2003) (Wood, J., dissenting).

construction and will be defeated if they are given another.'"[75] In *Jones*, the meaning of "arise under" was modified somewhat further; according to *Jones*, a cause of action arises under an Act in the sense that it is "made possible" by that Act.[76]

D. Limiting Jurisdictional Fact-Finding by the Courts

"Courts should understand that under no circumstances will a factual issue enumerated in a substantive federal cause of action implicate judicial jurisdiction."[77] One reason that courts may be eager to change substantive elemental facts into jurisdictional facts is that they have become accustomed to engaging in jurisdictional fact finding to resolve disputes at the 12(b)(1) phase of litigation.[78] The power for courts to engage in this kind of jurisdictional fact finding is, contrary to the belief of most courts,[79] actually quite limited. The power of courts to make factual determinations regarding subject-matter jurisdiction is generally circumscribed to determinations regarding the parties to a suit, such as findings regarding the domicile of parties in diversity cases and the status of parties, when that status is an issue of jurisdiction, as it is in cases brought under the Foreign Sovereign Immunities Act or the Alien Tort Claims Act.[80]

> These party-based jurisdictional statutes are grounded on issues of fact unrelated to the merits of the claims or the equities of the circumstances giving rise to the action, issues of fact subject to resolution by the court. The jurisdictional facts—party domicile, the defendant's status as a sovereign, or the plaintiff's status as an alien—have nothing to do with the underlying tort or contract claim.[81]

On the other hand, when determining whether a claim "arises under" an act of Congress, the factual questions go directly to the substance of the claim.[82] Wasserman proposes the following inquiry to determine whether or not a court has jurisdiction:

> "[A]rising under" . . . jurisdictional grants . . . ask only for a prediction from the court: Does it appear (based solely on the pleading) that the

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75. Steel Co. v. Citizens for a Better Env't, 523 U.S. 83, 89 (1998) (quoting Bell v. Hood, 327 U.S. 678, 685 (1946)).

76. Jones v. R.R. Donnelly & Sons Co., 541 U.S. 369, 382 (2004).

77. Wasserman, *supra* note 52, at 699.

78. *Id.*; *see also* Bell v. Hood, 327 U.S. 678, 682 (1946) ("The reason for this is that the court must assume jurisdiction to decide whether the allegations state a cause of action on which the court can grant relief as well as to determine issues of fact arising in the controversy."); Lawrence v. Dunbar, 919 F.2d 1525, 1528–29 (11th Cir. 1990) (explaining the difference between facial and factual attacks on subject-matter jurisdiction and the proper role of the court when factual attacks on jurisdiction also go to the merits of the claim).

79. *See* Wasserman, *supra* note 52, at 656 ("When courts confuse jurisdictional facts and law with merits facts and law, issues are adjudicated and resolved at the wrong time and in the wrong manner by the wrong fact finder within the adjudicative process.").

80. *Id.* at 699–700.

81. *Id.* at 701.

82. *See id.* at 694–99 (discussing the definition of "arising under" and the possible factual determinations a federal court may decide to determine whether an action arises under a federal statute).

> plaintiff seeks relief created or made possible by a federal enactment? Does it appear that the outcome of the dispute between the parties will turn on an interpretation, construction, or application of the federal Constitution or federal statute to some set of factual circumstances? If the court predicts an affirmative answer to those questions, it has jurisdiction.
>
> .... The prediction I propose involves even less rigorous inquiry. A court applying an "arising under" jurisdictional grant should look no further—indeed may look no further—than the four corners of the pleadings to discern the origin of the plaintiff's cause of action, with no consideration of the potential or ultimate legal or factual validity of that cause of action.[83]

IV. THE FIGHT OVER THE FTAIA: *HARTFORD FIRE* AND *UNITED PHOSPHORUS*

Although all of the Circuits currently agree that the FTAIA should be interpreted as limiting a court's jurisdiction,[84] there has been some heated debate on this issue.[85] The most prominent critics of this position are Justice Kennedy, Justice Thomas, and Justice Scalia, who wrote a notable dissent that was joined by Justice O'Connor in *Hartford Fire*, and Justice Wood of the Seventh Circuit, who some believe may be "the federal judiciary's foremost thinker on antitrust extraterritoriality issues."[86] In *United Phosphorus*, Judge Wood wrote for the dissent, joined by judges Easterbrook, Manion, and Ilana Diamond Rovner, in a "deeply divided"[87] Seventh Circuit Court en banc decision.[88]

A. *Hartford Fire*

1. Vacillation: The Majority Opinion

Hartford Fire was an antitrust case brought in the Northern District of California by nineteen states and numerous private parties.[89] The claim was that a group of domestic insurers, domestic and foreign reinsurers, and insurance brokers had agreed to boycott general liability insurers that used nonconforming forms.[90] The District Court granted the defendant's motion to dismiss on, among other things, the conclusion that "the principal of international comity barred it from

83. *Id.* at 701.

84. AREEDA & HOVENKAMP, *supra* note 3, at 296.

85. *See* Hartford Fire Ins. Co. v. California, 509 U.S. 746, 796 n.22, 813 (1993) (illustrating the disagreement between Justice Souter and Justice Scalia on whether the FTAIA addresses prescriptive or subject-matter jurisdiction); United Phosphorus, Ltd. v. Angus Chem. Co., 322 F.3d 942, 953 (7th Cir. 2003) (Wood, J., dissenting) (criticizing the majority for failing to "distinguish[] carefully between judicial and legislative jurisdiction").

86. Huffman, *supra* note 29, at 330.

87. Wasserman, *supra* note 52, at 688.

88. *United Phosphorus*, 322 F.3d at 953.

89. *Hartford Fire*, 509 U.S. at 764.

90. *Id.* at 764, 770–71.

exercising Sherman Act jurisdiction."[91] The Court of Appeals disagreed with this analysis and the Supreme Court affirmed this part of the Court of Appeals decision.[92] For the purpose of this article, discussion will be limited to the question presented in No. 91-1128.[93]

a. Jurisdiction and the FTAIA: An Easy Answer

The majority's opinion regarding the reach of U.S. antitrust laws is divided into two parts: first is the jurisdictional question, and second is the role that comity plays in the exercise of jurisdiction. The jurisdictional question was one that the majority felt was easily answered:

> At the outset, we note that the District Court undoubtedly had jurisdiction of these Sherman Act claims, as the London reinsurers apparently concede. Although the proposition was perhaps not always free from doubt, it is well established by now that the Sherman Act applies to foreign conduct that was meant to produce and did in fact produce some substantial effect in the United States. Such is the conduct alleged here: that the London reinsurers engaged in unlawful conspiracies to affect the market for insurance in the United States and that their conduct in fact produced substantial effect.[94]

The majority did not feel the need to take up the jurisdictional debate over the FTAIA. The only references made to this polemic are in footnotes, one of which is directly targeted at Justice Scalia's dissent.[95]

b. No Need to Decide: The Role of Comity

One of the main defenses put forth by the London reinsurers was that jurisdiction should be declined based on the principal of international comity.[96] The District Court agreed and granted their motion to dismiss.[97] The Court of Appeals also agreed that the principal of international comity should play a role in the decision over whether or not to exercise jurisdiction, however, in the end they decided this principal was outweighed by other factors.[98]

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91. *Id.* at 764.

92. *Id.* at 769–70.

93. *Id.* at 779 n.9 ("The question presented in No. 91-1128 is: 'Did the court of appeals properly assess the extraterritorial reach of the U.S. antitrust laws in light of this Court's teachings and contemporary understanding of international law when it held that a U.S. district court may apply U.S. law to the conduct of a foreign insurance market regulated abroad?'").

94. *Id.* at 795–96 (internal citations omitted).

95. *Hartford Fire*, 509 U.S. at 796 n.22.

96. *Id.* at 797.

97. *Id.* at 764.

98. *Id.* at 797–98 ("[T]he Court of Appeals believed that 'application of [American] antitrust laws to the London reinsurance market "would lead to significant conflict with English law and policy,"' and that '[s]uch a conflict, unless outweighed by other factors, would by itself be reason to decline exercise of

The majority determined, in one of its sparse references to the FTAIA, that "Congress expressed no view on the question whether a court with Sherman Act jurisdiction should ever decline to exercise such jurisdiction on grounds of international comity."[99] Once again, as with the jurisdictional debate over the FTAIA, the court decided this was a question that it did not need to address.[100] The majority agreed with the Court of Appeals that the principal of "international comity would not counsel against exercising jurisdiction" in the instant case,[101] however, their decision was based on the notion that there was no "true conflict" between the domestic and foreign law.[102]

2. A Different Set of Questions: The Dissent

a. Jurisdiction: Another Easy Answer

Justice Scalia's dissent in *Hartford Fire* (regarding No. 91-1128) was also divided into two parts. He began by pointing out that the petition raised two distinct questions: the question of whether the District Court had jurisdiction to hear the claim and the question of the extraterritorial reach of the Sherman Act.[103] Justice Scalia answered the first question in the affirmative with only a very cursory analysis. He based his answer to the jurisdictional question on the fact that the Respondents asserted nonfrivolous claims under the Sherman Act and that the District Courts are vested with subject-matter jurisdiction over all cases "arising under" federal statutes under 28 U.S.C. § 1331.[104] Justice Scalia made brief reference to the frequent confusion over barriers to plaintiff's claims due to challenges being inappropriately construed as going to subject-matter jurisdiction but refuted this possibility in the present action by stating simply that "[a] cause of action under our law was asserted here, and the court had power to determine whether it was or was not well founded in law and in fact."[105]

b. Elucidation: The Extraterritorial Reach of the Sherman Act

Justice Scalia conformed to the idea that concerns over the extraterritorial reach of domestic laws have to do with Congress's authority to make substantive law applicable to primary conduct that takes place beyond U.S. borders.[106] He began the second part of his analysis by asserting this belief quite forcefully: "The second question—the extraterritorial reach of the Sherman Act—has nothing to do with the

jurisdiction.' But other factors, in the court's view, including the London reinsurers' express purpose to affect United States commerce and the substantial nature of the effect produced, outweighed the supposed conflict and required the exercise of jurisdiction in this litigation.") (alterations in original) (citations omitted).

99. *Id.* at 798 (citations omitted).

100. *Id.*

101. *Hartford Fire*, 509 U.S. at 798.

102. *Id.* at 798–99.

103. *Id.* at 812 (Scalia, J., dissenting).

104. *Id.*

105. *Id.* at 812 (Scalia, J., dissenting) (quoting Lauritzen v. Larsen, 345 U.S. 571, 575 (1953)).

106. Wasserman, *supra* note 52, at 689.

jurisdiction of the courts. It is a question of substantive law turning on whether, in enacting the Sherman Act, Congress asserted regulatory power over the challenged conduct."[107] Despite the extraterritorial reach of the Sherman Act having nothing to do with the courts, Justice Scalia moved on to explain that "[t]here is, however, a type of 'jurisdiction' relevant to determining the extraterritorial reach of a statute . . . known as 'legislative jurisdiction,' or 'jurisdiction to prescribe,'" that is relevant to determining the extraterritorial reach of a statute.[108] Citing to the Restatement (Third) of Foreign Relations Law, Scalia defined this jurisdiction as "the authority of a state to make its law applicable to persons or activities" and noted that it is quite separate from the "jurisdiction to adjudicate."[109] He asserted, without reservation, that Congress possesses legislative jurisdiction over the acts alleged in the current complaint, and pointed out that "this Court has repeatedly upheld its power to make laws applicable to persons or activities beyond our territorial boundaries where United States interests are affected."[110]

Justice Scalia based the remainder of his analysis on "[t]wo canons of statutory construction": the "presumption against extraterritoriality"[111] and the venerable doctrine handed down by Chief Justice Marshall in *Charming Betsy* that "an act of congress ought never to be construed to violate the law of nations if any other possible construction remains."[112] According to Justice Scalia, the presumption against extraterritoriality has been overcome with respect to U.S. antitrust laws and it is now well established that the Sherman Act applies extraterritoriality, however, courts have frequently recognized that even when this presumption does not apply, "statutes should not be interpreted to regulate foreign persons or conduct if that regulation would conflict with principals of international law."[113] As Justice Scalia puts it, "the practice of using international law to limit the extraterritorial reach of statutes is firmly established in our jurisprudence."[114]

c. The Confusion of Comity

In order to make his final determination regarding the extraterritorial reach of domestic antitrust laws, Justice Scalia relied on the principle of international comity.[115] But as with jurisdiction, he believes that there has been a failure on the part of the courts, including the Court of Appeals in the present case, to distinguish between two distinct types of comity: "prescriptive comity," or "comity of nations," and "comity of the courts."[116] According to Justice Scalia, prescriptive comity is "the respect sovereign nations afford each other by limiting the reach of their laws" and is assumed to be incorporated into our substantive laws having extraterritorial reach.[117] "Considering comity in this way is just part of determining whether the Sherman Act

107. *Hartford Fire*, 509 U.S. at 813 (Scalia, J., dissenting).
108. *Id.*
109. *Id.*
110. *Id.* at 813–14.
111. *Id.* at 814.
112. Murray v. Schooner Charming Betsy, 6 U.S. 64, 118 (1804).
113. *Hartford Fire*, 509 U.S. at 814–15.
114. *Id.* at 818.
115. *Id.* at 817.
116. *Id.* at 817–18.
117. *Id.* at 817.

prohibits the conduct at issue."[118] Based again on the Restatement (Third), Justice Scalia would have let the determination of whether comity limited the extraterritorial reach of domestic law be based on a standard of reasonableness.[119] Based on this standard, Justice Scalia felt that an assertion of legislative jurisdiction in the present case would be considered unreasonable and, in the absence of statutory language to the contrary, it was inappropriate to assume that Congress had made such an assertion.[120] He summarized his critique of the majority opinion as follows:

> It is evident from what I have said that the Court's comity analysis, which proceeds as though the issue is whether the courts should "decline to exercise . . . jurisdiction," rather than whether the Sherman Act covers this conduct, is simply misdirected. I do not at all agree, moreover, with the Court's conclusion that the issue of the substantive scope of the Sherman Act is not in the cases.[121]

B. *United Phosphorus*

1. Falling in Line: The Majority Opinion

In *United Phosphorus*, an Indian company and a U.S. firm involved in a joint venture filed an antitrust claim against another U.S. firm alleging that the defendants "attempted to monopolize, did monopolize, and conspired to monopolize the market for certain chemicals, in violation of § 2 of the Sherman Act."[122] The primary issue in the case was "whether the relevant provision of FTAIA [was] jurisdictional or whether it state[d] an additional element of a Sherman Act claim."[123] The defendants originally raised the issue of subject-matter jurisdiction in 1994, shortly after the case was filed, but their initial 12(b)(1) motion was denied.[124] In 2000, after considerable discovery, the defendants renewed their 12(b)(1) motion to dismiss for lack of subject-matter jurisdiction and for summary judgment; the defendants contended that under FTAIA § 1[125] the court lacked subject-matter jurisdiction.[126] In 2001, Magistrate Judge Ian H. Levin granted the defendants' motion to dismiss.[127]

After lengthy analysis, the court held that "the district court properly treated the issue as one of subject matter jurisdiction."[128] The appellate court's ruling was based on a number of different factors. First and foremost was the Supreme Court's ruling in *Hartford Fire*,[129] as well as the failure of any of the other circuits to adopt

118. *Hartford Fire*, 509 U.S. at 817–18.

119. *Id.* at 818.

120. *Id.* at 819.

121. *Id.* at 820 (internal citations omitted).

122. United Phosphorus, Ltd. v. Angus Chem. Co., 322 F.3d at 944 (2003).

123. *Id.*

124. *Id.*

125. FTAIA § 1 requires a "direct, substantial, and reasonably foreseeable effect on [domestic] commerce." Foreign Trade Antitrust Improvement Act, 15 U.S.C. § 6(a) (2000).

126. *United Phosphorus*, 322 F.3d at 944.

127. *Id.* at 945.

128. *Id.* at 952.

129. *Id.* at 951 ("In *Hartford*, as well, it is not likely that references to jurisdiction are really references

the position that the FTAIA sets out an element of the claim or a basis for legislative jurisdiction.[130] The majority noted that even though there are differences between the circuits concerning the interpretation of the Act and its effect on the previous common law, "all have treated the issue as one of subject matter jurisdiction."[131] The majority also delved into the legislative history of the FTAIA to support its holding, where it determined that "jurisdiction stripping is what Congress had in mind in enacting FTAIA."[132] They based this determination on specific language in the legislative history that refers to the FTAIA as a "predicate for antitrust jurisdiction" as well as "establish[ing] the standards necessary for assertion of United States Antitrust jurisdiction."[133]

Other justifications given by the majority for supporting the jurisdictional interpretation of the FTAIA were the policy considerations:

> There are good policy reasons for the prevailing approach. The extraterritorial scope of our antitrust laws touches our relations with foreign governments, and so, it seems, it is prudent to tread softly in this area. If FTAIA sets out an issue on the merits, resolution of the issue could be delayed until late in the case, and the potential for a lawsuit to have an effect on foreign markets would exist while the case remained pending. In contrast, if this important issue goes to subject matter jurisdiction, it can be resolved early in the litigation .... Treating the matter as one of subject matter jurisdiction reduces the potential for offending the economic policies of other nations. In short, FTAIA limits the power of the United States courts (and private plaintiffs) from nosing about where they do not belong. And the power of the courts is precisely what subject matter jurisdiction is about.[134]

2. A Different Point of View: The Dissent

Judge Wood did not pull any punches in her scathing dissent, nor did she waste any time getting to the point. She referred to what she considered the key language of the statute, "shall not apply," immediately, and made it clear that it is this "straightforward language" that should control the courts analysis.[135] Judge Wood pointed out that the issue before the court is both an issue of first impression for the Seventh Circuit, and an issue that had "never been analyzed thoroughly by any other court."[136] She chastised the majority for adopting the jurisdictional interpretation "largely because the word 'jurisdiction' appears in many prior decisions of lower

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to legislative, rather than subject-matter, jurisdiction. Justice Souter made it clear that he disagreed with Justice Scalia's contention that under FTAIA what is at issue is legislative jurisdiction.").

130. *Id.* at 950.

131. *Id.*

132. *United Phosphorus* 322 F.3d at 951.

133. *Id.* at 952.

134. *Id.*

135. *Id.* at 953 (Wood, J., dissenting).

136. *Id.*

courts and in certain materials published by the government's antitrust enforcement agencies and the American Bar Association."[137]

Judge Wood's complete lack of faith in the ability of any of these institutions to correctly analyze the issue is apparent forthwith. She echoed Justice Scalia's dissent in *Hartford Fire* when she stated:

> [N]either the majority nor those earlier opinions have distinguished carefully between judicial and legislative jurisdiction—or, to put it differently, between jurisdiction to decide a case and jurisdiction to prescribe a rule of law. The central question now before us is whether the FTAIA affects the former or the latter power. Given the fact that "jurisdiction is a word of many, too many, meanings," it is plain that the analysis cannot stop with the observation that the FTAIA somehow affects "jurisdiction."[138]

Judge Wood found four "compelling reasons" why the court should adopt an "elemental" approach rather than construing the FTAIA's test as one going to the subject-matter jurisdiction of the court: the language of the statute, the Supreme Court's decision in *Steel Co.*, the procedural consequences, and the "long history of the application of U.S. antitrust laws to foreign conduct."[139]

a. Yeah It's That Easy: The Language

Under Judge Wood's reading of the FTAIA, one would "search in vain . . . for any hint" of jurisdictional stripping language, which "should be enough to tip the balance toward the 'element' characterization."[140] Judge Wood explained that the Seventh Circuit had recognized that jurisdiction-stripping rules must be expressed clearly,[141] which lends great weight to her earlier contention that the absence of this "express language" is enough by itself to necessitate an "elemental" characterization of the FTAIA.[142] According to Judge Wood, "[l]anguage like that of the FTAIA, stating that a law does not 'apply' in certain circumstances, cannot be equated to language stating that the courts do not have the fundamental competence to consider defined categories of cases."[143]

b. Who Are We to Argue with the Supreme Court: *Steel Co.*

In *Steel Co.*, the Supreme Court held that the district court has jurisdiction "if the right of petitioners to recover under their complaint will be sustained if the Constitution and laws of the United States are given one construction and will be

137. *Id.*

138. *United Phosphorus*, 322 F.3d at 953 (internal citations omitted).

139. *Id.* at 953–4.

140. *Id.* at 954.

141. *Id.*; Czerkies v. U.S. Dep't of Labor, 73 F.3d 1435, 1439 (7th Cir. 1996) (en banc) ("The circuits are in agreement: door-closing statutes do not, unless Congress expressly provides, close the door to constitutional claims.").

142. *United Phosphorus*, 322 F.3d at 954 (Wood, J., dissenting).

143. *Id.* at 955.

defeated if they are given another."[144] This holding was delivered despite the fact that the statute at issue uses the word "jurisdiction" to describe the permitted actions.[145] Applying this holding to *United Phosphorus*, Judge Wood contended that "the plaintiffs will have a right to recover if defendants' activities have the requisite effect on either U.S. domestic or import commerce (and they can prove the remainder of their federal antitrust claim), and they will lose if those effects are lacking."[146]

Judge Wood opined that in enacting the FTAIA, Congress "established the 'direct, substantial, and reasonably foreseeable' effect on commerce test as an element of the plaintiff's claim."[147] Pointing out that the Supreme Court, in *Hartford Fire*, did not address the FTAIA's effect on the case,[148] Judge Wood averred that the majority was wrong in suggesting that *Hartford Fire* held to the contrary.[149] In addition, she declared that the legal principals put forth by Justice Scalia in his dissent[150] were adopted by the Supreme Court in *Steel Co.*, and *United States v. Cotton*[151] and thus the approach that she advocates is "entirely consistent" with Supreme Court doctrine.[152]

c. Ludicrous Speed: The Procedural Consequences

Judge Wood wrote about the potential waste of judicial resources if the FTAIA is treated as a jurisdictional inquiry. She stated that jurisdictional inquiries such as those needed to evaluate diversity or whether a claim "arises under" federal law are "well-defined and do not normally consume enormous judicial resources,"[153] however:

> In contrast, an inquiry into whether a particular course of conduct has a "direct, substantial, and reasonably foreseeable effect" on either the domestic commerce of the United States or its import commerce threatens to become a preliminary trial on the merits. Indeed, the record in one famous international antitrust case, *Timberlane Lumber Co. v. Bank of America, N.T. & S.A.*, should give advocates of the "subject-matter jurisdiction" approach pause. That case was originally filed in the district court in 1973. In 1974, the district court dismissed for want of "subject-

144. Steel Co. v. Citizens for a Better Env't, 523 U.S. 83, 89 (1998) (citing Bell v. Hood, 327 U.S. 678, 685 (1946)).

145. 42 U.S.C. §§ 11046(a)(1), 2(c), (2009).

146. *United Phosphorus*, 322 F.3d at 955 (Wood, J., dissenting).

147. *Id.*

148. Hartford Fire Ins. Co. v. Cal., 509 U.S. 764, 796 n.23 (1993).

149. *United Phosphorus*, 322 F.3d at 956 (Wood, J., dissenting).

150. *See Hartford Fire*, 509 U.S. at 812 ("I believe that the District Court had subject-matter jurisdiction over the Sherman Act claims against all the defendants .... Respondents asserted nonfrivolous claims under the Sherman Act, and 28 U.S.C. § 1331 vests district courts with subject-matter jurisdiction over cases 'arising under' federal statutes.").

151. *See* United States v. Cotton, 535 U.S. 625, 630 (2002) ("*Bain's* [121 U.S. 1 (1887)] elastic concept of jurisdiction is not what the term 'jurisdiction' means today, *i.e.*, the courts' statutory or constitutional power to adjudicate the case." (citing Steel Co. v. Citizens for a Better Env't, 523 U.S. 83, 89 (1998))).

152. *United Phosphorus*, 322 F.3d at 956 (Wood, J., dissenting).

153. *Id.* at 957.

> matter jurisdiction." The Ninth Circuit reversed in 1976. Six years of discovery then took place, in which the parties explored the effects of the alleged conspiracy on U.S. commerce. In 1983, the district court again dismissed the action for want of jurisdiction. Up on appeal again to the Ninth Circuit, the case was affirmed, though on somewhat different grounds. In 1985, the Supreme Court denied certiorari, with a note indicating that Justice White and Blackmun would have granted review. Thus, at least 12 years after the case was filed, the "jurisdictional" issue was finally resolved. Had it been resolved in the affirmative, there is no telling how many more years would have passed before the litigation was over. This is no way to decide whether the federal courts are competent to hear a case.[154]

In an only slightly better display of judicial efficiency, *United Phosphorus* itself took eight years, twenty-four depositions, and 8,000 pages of exhibits to resolve the jurisdictional issue.[155]

Judge Wood ended her discussion of the procedural implications with a rather blunt synopsis:

> The subject-matter jurisdiction characterization makes no sense, either from the point of view of the policies being furthered by the FTAIA, or from the standpoint of judicial administration. We should not adopt a perverse decision just because parties have chosen to file motions under Rule 12(b)(1) instead of Rule 12(b)(6) or Rule 56, or because courts have unquestioningly adopted the diction of 'subject-matter jurisdiction' without careful examination.[156]

d. History Lesson: Application of U.S. Antitrust Laws to Foreign Conduct

Judge Wood ended her defense of an "elemental" approach to the FTAIA with a review of the history of the application of U.S. antitrust laws to foreign conduct.[157] She began, of course, with *American Banana*, maintaining that nothing in the language of the decision suggested that the court thought that it was dealing with an issue of subject-matter jurisdiction in the sense of the court's power to adjudicate.[158] "It was the legislative branch, in short, which the Court thought had not reached out to cover an intergovernmental dispute affecting international trade in bananas. There was not a hint that the federal courts had no competence to decide that the Sherman Act did not reach that far."[159]

Judge Wood then turned to *Alcoa* and its generation of voluminous scholarly writing on the subject of prescriptive jurisdiction, culminating in the Restatement

154. *Id.* (internal citations omitted).
155. *Id.* at 944.
156. *Id.* at 959 (Wood, J., dissenting).
157. *Id.*
158. *United Phosphorus*, 322 F.3d at 959 (Wood, J., dissenting).
159. *Id.*

(Third) of Foreign Relations Law of the United States.[160] Judge Wood concluded that "the domestic concept of subject-matter jurisdiction has no bearing on the question whether the United States validly prescribed a certain rule of law."[161] Relying on section 415, which covers the prescriptive jurisdiction in cases dealing with anticompetitive activities, specifically comment b,[162] Judge Wood attempted to nullify the majority's reliance on the language found in House Report No. 97-686 to support their position that Congress intended the FTAIA to be a jurisdictional limitation:

> It is this topic of prescriptive jurisdiction, and how far the U.S. antitrust laws were actually reaching, that was before Congress when it enacted the FTAIA. (While it is true that the House Report on the FTAIA uses the word "jurisdiction" with some regularity, it also speaks repeatedly about whether U.S. antitrust law should be applied to particular transactions. It is therefore impossible to draw any firm conclusions from that brief document that will assist us in resolving the issue presented before us.)[163]

Finally, Judge Wood discussed how the FTAIA is being handled in modern day federal courts. She concluded that with respect to modern decisions such as *Empagran*, *Kruman*, and *Den Norske*, there is a discrepancy between "what the court said in passing" and what the court did.[164] Judge Wood saw *Empagran* "as a case acknowledging that a dismissal for failure to meet the standards of the FTAIA is one for failure to state a claim" instead of lack of subject-matter jurisdiction.[165] Discussing the *Kruman* case, Judge Wood pointed out that "the court paid no attention to the issue now before us; it was concerned instead about the type of effect on domestic (or import) commerce the FTAIA requires before conduct could be 'regulated by the Sherman Act'" which severely undercuts the majority's reasoning.[166]

C. *Don't Call it a Comeback: The Rise of Comity in Empagran*

In 2004 the U.S. Supreme Court sat to hear its second case regarding the FTAIA.[167] While the main issue in this case was the nexus of effects required between domestic and foreign injury,[168] another important impact that it had was

160. *Id.* at 960.

161. *Id.* at 961.

162. Comment b states that "Congress apparently believed that activity whose anti-competitive effects are felt only in foreign states should not be a concern of United States antitrust regulation, but that activities carried out abroad that have 'direct, substantial, and reasonably foreseeable' effect in the United States or on the import trade of the United States (as by limiting imports or fixing the price of imported products) should be subject to the Sherman and FTC Acts." RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 415 cmt. b (1987).

163. *United Phosphorus*, 322 F.3d at 961–62 (Wood, J., dissenting) (internal citations omitted).

164. *Id.* at 963.

165. *Id.*

166. *Id.* at 963–64.

167. F. Hoffmann-La Roche Ltd. v. Empagran S.A., 542 U.S. 155 (2004).

168. *Id.*

settling one of the major unresolved issues from *Hartford Fire*,[169] namely that of the role of comity. In a unanimous decision, the Supreme Court reversed the D.C. Circuit holding that the FTAIA "significantly limited the ability of foreign firms to invoke the United States antitrust laws to remedy foreign injuries," [170] and they did it based on principals of prescriptive comity.

> We conclude that principles of prescriptive comity counsel against the Court of Appeals' interpretation of the FTAIA. Where foreign anticompetitive conduct plays a significant role and where foreign injury is independent of domestic effects, Congress might have hoped that America's antitrust laws, so fundamental a component of our own economic system, would commend themselves to other nations as well. But, if America's antitrust policies could not win their own way in the international marketplace for such ideas, Congress, we must assume, would not have tried to impose them, in an act of legal imperialism, through legislative fiat.[171]

Not only did the court base this decision on the principals of prescriptive comity, but in doing so it also favorably cited to Justice Scalia's dissent from *Hartford Fire*,[172] eliminating any doubt as to whether, when referring to prescriptive comity, it was referring to the interpretation that Justice Scalia put forward in that case. The Supreme Court's overt acceptance of the principal of prescriptive comity when analyzing the FTAIA will have significant impact if and when the FTAIA is interpreted as a limitation on the extraterritorial applicability of the Sherman Act.

V. LAYING DOWN THE LAW: *ARBAUGH* AND ITS EFFECTS

A. What Does Fifteen Mean: The Case

On February 22, 2006 the United States Supreme Court handed down a decision in a Title VII[173] case that may have significant impact on the future of the FTAIA.[174] The central issue in this case was the very same issue that caused such consternation for Judge Wood in *United Phosphorus*:[175] "the distinction between two sometimes confused or conflated concepts: federal-courts 'subject-matter' jurisdiction over a controversy; and the essential ingredients of a federal claim for

169. *See* Hartford Fire Ins. Co. v. California, 509 U.S. 765, 798 n.24 (1993) ("Justice Scalia contends that comity concerns figure into the prior analysis whether jurisdiction exists under the Sherman Act. This contention is inconsistent with the general understanding that the Sherman Act covers foreign conduct producing a substantial intended effect in the United States, and that *concerns of comity come into play, if at all*, only after a court has determined that the acts complained of are subject to Sherman Act jurisdiction") (internal citations omitted and emphasis added).

170. AREEDA & HOVENKAMP, *supra* note 3, at 307.

171. *Empagran*, 542 U.S. at 169.

172. *Id.* at 164.

173. Civil Rights Act of 1964, 42 U.S.C. § 2000e-2 (2009) (prohibiting employment discrimination based on race, color, religion, sex and national origin).

174. Arbaugh v. Y & H Corp., 546 U.S. 500 (2006).

175. *See United Phosphorus*, 322 F.3d at 953 (Judge Wood criticizing the majority for their failure to distinguish "carefully between judicial and legislative jurisdiction").

relief."[176] It seems that just over three years after that decision, the Supreme Court was finally ready to rise to her challenge to "distinguish[] carefully between judicial and legislative jurisdiction."[177]

Jennifer Arbaugh brought a Title VII action in federal court against her former employer, Y & H Corporation, charging sexual harassment.[178] Two weeks after the court entered judgment for Arbaugh, Y & H moved to dismiss the entire action for lack of subject-matter jurisdiction.[179] The defendants based their 12(b)(1) motion to dismiss on an assertion that they had fewer than fifteen employees and were therefore not amenable to suit under Title VII.[180] The trial court, believing that the fifteen or more employee requirement was a jurisdictional element, considered itself obligated to grant the motion to dismiss and vacated its prior judgment and dismissed Arbaugh's Title VII claim with prejudice.[181] The Fifth Circuit affirmed, but in a unanimous decision, the Supreme Court rejected this categorization and held that "the numerical threshold does not circumscribe federal-court subject-matter jurisdiction. Instead, the employee-numerosity requirement relates to the substantive adequacy of Arbaugh's Title VII claim."[182]

The Supreme Court noted the confusion that often arises in the federal courts over the distinction between jurisdictional and substantive elements:

> On the subject matter jurisdiction/ingredient-of-claim-for-relief dichotomy, this Court and others have been less than meticulous. "Subject matter jurisdiction in federal-question cases is sometimes erroneously conflated with a plaintiff's need and ability to prove the defendant bound by the federal law asserted as the predicate for relief—a merits related determination." Judicial opinions, the Second Circuit incisively observed, "often obscure the issue by stating that the court is dismissing 'for lack of jurisdiction' when some threshold fact has not been established, without explicitly considering whether the dismissal should be for lack of subject matter jurisdiction or for failure to state a claim." We have described such unrefined dispositions as "drive-by jurisdictional rulings" that should be accorded "no precedential effect" on the question whether the federal court had authority to adjudicate the claim in suit.[183]

The Court explained that Congress does have the power to make certain statutory elements "jurisdictional," but, "neither § 1331, nor Title VII's jurisdictional provision specifies any threshold ingredient akin to 28 U.S.C. § 1332's monetary floor. Instead, the fifteen employee threshold appears in a separate provision that does not speak in jurisdictional terms or refer in any way to the jurisdiction of the district courts."[184]

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176. *Arbaugh*, 546 U.S. at 503.
177. *United Phosphorus*, 322 F.3d at 953.
178. *Arbaugh*, 546 U.S. at 504.
179. *Id.* at 503–04.
180. *Id.* at 504.
181. *Id.*
182. *Id.*
183. *Id.* at 511 (citations omitted).
184. *Arbaugh*, 546 U.S. at 515. (citations omitted).

In an attempt to clear up the confusion over this issue once and for all, the Supreme Court fashioned a "readily administrable bright line" rule.[185] "If the Legislature clearly states that a threshold limitation on a statute's scope shall count as jurisdictional, then courts and litigants will be duly instructed and will not be left to wrestle with the issue. But when Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character."[186]

B. *Delayed Reaction: The Effects of Arbaugh*

This new rule seems to be almost directly derived from Judge Wood's dissent in *United Phosphorus* and one must surely give her credit for anticipating this shift. However, having argued this point from the beginning, and having been one of its most eloquent champions, I can only imagine that Judge Wood is now feeling the terrible pangs of frustration at the conspicuous lack of an impact that the *Arbaugh* ruling has had regarding the FTAIA. Granted, there have been fewer than twenty cases concerning the FTAIA heard in federal courts since *Arbaugh's* new "bright line" rule was handed down,[187] and only two of those have made it to courts of appeals.[188] Both of those cases however, have continued to treat the FTAIA as a jurisdictional limitation and neither case made any reference to the *Arbaugh* decision.[189] Both were dismissed for lack of subject-matter jurisdiction.[190] As the only two cases that have made it to the appellate level post-*Arbaugh*, the most bothersome aspect is that each of these cases had glaringly obvious opportunities to apply *Arbaugh's* rule.

In *MSG*, the defendants filed a motion at the district court level to dismiss the claim for both lack of subject-matter jurisdiction and for failure to state a claim.[191] The district court initially denied the motion, but after reconsideration it was granted.[192]

> [T]he appellees moved to dismiss the complaint for lack of subject matter jurisdiction and for failure to state a claim, alleging that the FTAIA precluded the claim from being brought under the Sherman Act. The district court denied the appellees' motion. Following the D.C. Circuit's decision in Empagran S.A. v. F. Hoffmann-LaRoche, Ltd., (*Empagran II*),

185. *Id.* at 502.

186. *Id.* at 515–16. (citations omitted).

187. *See, e.g.*, Animal Sci. Prod., Inc. v. China Nat'l Metals & Minerals Imp. & Exp. Corp., 596 F. Supp. 2d 842, 842 (D.N.J., December 30, 2008); Commercial St. Express, LLC v. Sara Lee Corp., No. 08 C 1179, 2008 WL 5377815, at *3 (N.D. Ill. Dec. 18, 2008); Emerson Elec. Co. v. Le Carbone Lorraine, No. 05-6042, 2008 WL 4126602, at *1 (D.N.J. Aug. 27, 2008); *In re* TFT-LCD (Flat Panel) Antitrust Litig., No. M 07-1827 SI, 2008 WL 2219837, at *1 (N.D. Cal. May 27, 2008); Sun Microsystems, Inc. v. Hynix Semiconductor, Inc., 608 F. Supp. 2d 1166, 1174 (N.D. Cal. 2009).

188. *In re* Dynamic Random Access Memory (DRAM) Antitrust Litig., 546 F.3d 981, 981 (9th Cir. 2008); *In re* Monosodium Glutamate (MSG) Antitrust Litig., 477 F.3d 535 (8th Cir. 2007).

189. *DRAM*, 546 F.3d at 985; *MSG*, 477 F.3d at 537.

190. *See DRAM* at 985 n.3 ("Accordingly, we assume without deciding that the district court correctly dismissed under Rule 12(b)(1)."); *MSG*, 477 F.3d at 536 ("Appellants appeal from the district court's dismissal of their complaint for lack of subject matter jurisdiction. We affirm.").

191. *MSG*, 477 F.3d at 537.

192. *Id.*

> the appellees filed a motion for reconsideration of the district court's order denying their motion to dismiss. The district court, relying on Empagran II, granted the motion and dismissed the complaint with prejudice, holding that the appellants had not stated a claim under the Sherman Act because they had not shown that the domestic effect of the global price-fixing cartel proximately caused their injuries.[193]

The Eighth Circuit reviewed the district court's dismissal for lack of subject-matter jurisdiction *de novo*.[194] In conducting their review of subject-matter jurisdiction, the Eighth Circuit made repeated reference to the appellant's failure to satisfy the causation standard that had recently been set up in *Empagran* and quoted the district courts holding that "the appellants therefore failed to state a claim under the Sherman Act."[195] Unfortunately, the appellate court equated this failure to state a claim with a failure to meet the second requirement of the FTAIA (giving rise to a claim) and used this as its basis for upholding the dismissal for lack of subject-matter jurisdiction.[196] It is difficult to understand why the Eighth Circuit did not take this opportunity to apply *Arbaugh* to the FTAIA, but instead perpetuated the confusion between subject-matter jurisdiction and the merits of a claim distinction that *Arbaugh* was intended to clear up.

Even more troubling is the Ninth Circuit's failure in this capacity, especially since they went so far as to recognize the confusion between the jurisdiction and the merits:

> The district court granted defendants' motion to dismiss, which was premised solely on jurisdictional grounds. It is unclear, however, whether the FTAIA is more appropriately viewed as withdrawing jurisdiction from the federal courts when a plaintiff fails to establish proximate cause or as simply establishing a limited cause of action requiring plaintiffs to prove proximate cause as an element of the claim. *Compare Empagran S.A. v. F. Hoffmann-LaRoche*, (affirming dismissal under Rule 12(b)(1) for lack of subject matter jurisdiction), with *In re Elevator Antitrust Litigation*, (affirming dismissal on 12(b)(6) grounds). The Supreme Court's decision in Empagran I provides little guidance because, although the district court had dismissed under Rule 12(b)(1), the Court did not explicitly address whether the issue was properly viewed as one of federal question subject matter jurisdiction or of a failure to state a claim under federal law. We decline to resolve the question, because it was not argued by the parties and in this case the result and analysis are the same. Accordingly, we assume without deciding that the district court correctly dismissed under Rule 12(b)(1).[197]

193. *Id.* (citations omitted).

194. *Id.*

195. *Id.* at 538–39.

196. *Id.*

197. *In re* Dynamic Random Access Memory (DRAM) Antitrust Litig., 546 F.3d 981, 985 n.3 (9th Cir. 2008).

While it is true that the Court in *Empagran I* didn't decide the issue regarding the appropriate application of the FTAIA, the *Arbaugh* decision did.[198] It is even more disheartening in my view that the Court believes it is unnecessary to "resolve the question" because the "result and analysis are the same."[199] Under a 12(b)(1) motion, the Court may look beyond the face of the complaint to determine if it has jurisdiction,[200] while under a 12(b)(6) motion, the Court must take the allegations in the complaint as true.[201] If there is a genuine issue regarding facts, that is an issue for the fact finder, usually a jury, rather than for the Court.[202] And as has already been discussed, the resulting procedural implications of dismissal under these two rules are dramatically different.[203]

It seems that the *Arbaugh* decision has had little to no precedential effect on the treatment of the FTAIA as of yet. The "readily administrable bright line rule," while certainly bright, has yet to be administered to the FTAIA. It leaves one to ask the question, why? There are a number of possibilities ranging from the sheer lack of FTAIA cases to the general recalcitrance of federal courts to make drastic changes. Whatever the reason, the fact of the matter is that since this rule was delivered in a Title VII case rather than in an FTAIA case, it has had a hard time making an impact on the extraterritoriality of our antitrust laws.

VI. THE TIMES THEY ARE A CHANGING: THE FUTURE OF THE FTAIA

Despite an unfortunately slow start, the FTAIA now exists in a post-*Arbaugh* world. So the question really is not one of *if Arbaugh* will bring about a change, but rather *when* that change will occur, and more importantly what that change will mean. Businessmen, attorneys, judges, U.S. trading partners, and members of Congress should start thinking now about how this almost inevitable shift in the interpretation of the FTAIA will affect them. How will the application of the FTAIA be modified if its elements are treated as substantive limitations rather than jurisdictional limitations?

First, there will be procedural implications. It will be much harder for defendants to have FTAIA claims dismissed for lack of subject-matter jurisdiction. This will be an important consideration in light of the significant differences between 12(b)(1) and 12(b)(6) motions. The question of when, where, and who will decide the issues will be altered; and the "irresistible invitation to the losing party in an international antitrust case to invite the Supreme Court to revisit the complex

198. *Id.* at 983 ("The Supreme Court's decision in *Empagran I* provides little guidance because, although the district court had dismissed under Rule 12(b)(1), the Court did not explicitly address whether the issue was properly viewed as one of federal question subject matter jurisdiction or of a failure to state a claim under federal law."); Arbaugh v. Y&H Corp., 546 U.S. 500, 516 (2006) ("[W]hen Congress does not rank a statutory limitation on coverage as jurisdictional, courts should treat the restriction as nonjurisdictional in character. Applying that readily administrable bright line to this case, we hold that the threshold number of employees for application of Title VII is an element of a plaintiff's claim for relief, not a jurisdictional issue.").

199. *DRAM*, 546 F.3d at 983.

200. Bastien v. AT&T Wireless Services, Inc., 205 F.3d 983, 990 (7th Cir. 2000).

201. Tellabs v. Makor Issues & Rights, Ltd., 551 U.S. 308, 322 (2007).

202. Miller, *supra* note 61, at 1083.

203. *See* pt. 3(A), *supra*.

question"[204] will no longer be so readily available. Another procedural change is that the requirements of the FTAIA will become an additional element needing to be properly pled and proved as an element of certain Sherman Act claims.[205]

While procedure is an important aspect of the interpretation of the FTAIA and is the vehicle through which the courts are currently analyzing this statute, the procedural effects are best understood in light of their substantive implications. Procedural changes are well and good, but the heart of the matter really goes to how such a paradigmatic shift will eventually influence the underlying policy concerns of both the courts and the legislature. The debate in *United Phosphorus* illustrates the tension over these concerns. The majority claims that there are "good policy reasons for the prevailing (jurisdictional) approach" including timely resolution of issues in FTAIA cases and reduction of "the potential for offending the economic policies of foreign nations."[206] Judge Wood counters this argument by illustrating the waste of judicial resources that can occur when the FTAIA is treated as a limit on jurisdiction[207] as well as asserting that a substantive approach will actually be more helpful in avoiding diplomatic tensions than a jurisdictional one.[208]

> Although the defendants argued that the policies behind the FTAIA—particularly the avoidance of diplomatic tensions with other countries—are better served by the jurisdictional characterization, that assumes that district courts will systematically reject jurisdiction. There is no reason at all to make such an assumption. If district courts find the FTAIA test satisfied, foreign parties will be stuck with deferential appellate review of those facts. This also means that appellate courts will not be free to give plenary consideration to the sensitive issues of international comity that can arise in these cases—issues better resolved at the level of the court of appeals or the Supreme Court than by a solitary district judge.[209]

This brings us to a discussion of the second major consideration: what role comity will play in the future.

It is apparent that the Supreme Court does not want the FTAIA to be used as a vehicle to expand the extraterritorial reach of the Sherman Act.[210] If lack of subject-matter jurisdiction is no longer a viable option to rein in the extraterritorial reach of the Sherman Act, then prescriptive comity may be the answer that they turn to.

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204. United Phosphorus, Ltd. v. Angus Chem. Co., 322 F.3d 942, 958 (7th Cir. 2003) (Wood, J., dissenting).

205. *See id.* at 944 ("Today, for the first time in this court, we encounter the Foreign Trade Antitrust Improvements Act, a 1982 amendment to the Sherman Act, which affects its reach in foreign commerce. The primary issue involves whether the relevant provision of FTAIA is jurisdictional or whether it states an additional element of a Sherman Act claim. This in turn affects how a court deals with it and, in this case, what the outcome will be.") (citations omitted).

206. *Id.* at 952.

207. *Id.* at 957 (Wood, J. dissenting).

208. *Id.* at 958.

209. *Id.* at 958–59.

210. *See* F. Hoffmann-La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 169 (2004) ("[T]he FTAIA's language and history suggest that Congress designed the FTAIA to clarify, perhaps to limit, but not to *expand* in any significant way, the Sherman Act's scope as applied to foreign commerce.").

Unfortunately, adoption of this approach will leave the Supreme Court in a very awkward position.

In the Supreme Court's latest decision on the FTAIA[211] it referred frequently to notions of prescriptive comity,[212] the same kind of comity that Justice Scalia referred to in his dissent in *Hartford Fire*.[213] Judge Wood also made references to prescriptive comity in her *United Phosphorus* dissent.[214]

On the one hand, if the court adopts Justice Scalia's interpretation of the role of comity in determining the extraterritorial reach of the Sherman Act, then the Court will effectively limit the application of domestic antitrust laws to foreign conduct.[215] There is a problem though; under this approach, prescriptive comity is used as a threshold test to limit the legislative jurisdiction of the Sherman Act.[216] In deciding whether the Act even applies to certain conduct, the court would be required to conduct a reasonability test at the beginning of every claim.[217] This is exactly the kind of "case by case comity analysis" that the Court declared unworkable in *Empagran*.[218]

On the other hand, if the Court declines to adopt Scalia's prescriptive comity threshold analysis then the extraterritorial reach of U.S. antitrust laws will be greatly expanded, which the Supreme Court previously declared was not the intent of the FTAIA.[219] It is possible that the Supreme Court may try to distinguish the next FTAIA case that it hears from its holding in *Arbaugh*, yet, in my personal opinion, the close tie between Title VII and the Sherman Act created by their link to 28 U.S.C. § 1331 would make this a seemingly impossible feat. It would require a deft pen and no small amount of judicial chicanery for the Supreme Court to convincingly distinguish the two.

In recognizing the waste of judicial resources that can result from misconstruing statutory elements as going to the subject-matter jurisdiction of federal courts, the Supreme Court has made it clear that in order for a threshold limitation on a statute's scope to be considered jurisdictional Congress must state this explicitly.[220] When it comes to this question, it has decided that the wisest course of action is to "leave the ball in Congress's court."[221] It is with only the slightest hint of reservation

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211. *Id.*

212. *See id.* at 169 ("We conclude that principles of prescriptive comity counsel against the Court of Appeals' interpretation of the FTAIA.").

213. Hartford Fire Ins. Co. v. California, 509 U.S. 746, 817 (1993).

214. *United Phosphorus*, 322 F.3d at 959.

215. *See Hartford Fire*, 509 U.S. at 818 ("Some antitrust courts, including the Court of Appeals in the present cases, have mistaken the comity at issue for the 'comity of courts,' which has led them to characterize the question presented as one of 'abstention,' that is, whether they should 'exercise or decline jurisdiction.' As I shall discuss, that seems to be the error the Court has fallen into today. Because courts are generally reluctant to refuse the exercise of conferred jurisdiction, confusion on this seemingly theoretical point can have the very practical consequence of greatly expanding the extraterritorial reach of the Sherman Act.") (citations omitted).

216. *Id.*

217. *Id.*

218. F. Hoffmann-La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 156 (2004).

219. *See id.*, ("[T]he FTAIA's language and history suggest that Congress designed the FTAIA to clarify, perhaps to limit, but not to expand in any significant way, the Sherman Act's scope as applied to foreign commerce.").

220. Arbaugh v. Y&H Corp., 546 U.S. 500, 502 (2006).

221. *Id.*

that I say, *when* the FTAIA is determined to be a substantive limitation rather than a jurisdictional one by the courts, that the ball will be squarely back in Congress's court. If the legislature intended or has subsequently come to intend that the FTAIA be treated as a limit on subject-matter jurisdiction then it will be up to them to rewrite the FTAIA and state this intent explicitly. Until that time, I would urge the lower courts to take the initiative, heed the advice of the Supreme Court, and begin properly interpreting the FTAIA as a substantive test, giving "'drive-by jurisdictional rulings' . . . 'no precedential effect . . . .'"[222]

222. *Id.* at 511.

Sotomayor and the Future of International Law

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SUMMARY

I. INTRODUCTION

Supreme Court nominations are usually accompanied by a flurry of speculation regarding the nominee's position on various legal issues. In this respect, the nomination of Justice Sotomayor was not exceptional. A significant question presented by commentators at that time was how she would use, interpret, and apply international law if confirmed.

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This paper continues the discussion by examining Sotomayor's record on international legal issues. First, it examines the extent to which she has treated international law as binding authority within the domestic sphere. Second, it evaluates her view of the role of foreign jurisprudence in the interpretation of international agreements. Third, it explores cases in which she has looked to foreign jurisprudence in interpreting domestic legal provisions concerning foreign-nationals and in which she has dealt with customary international legal issues. Fourth, it analyzes her speeches, writings, and confirmation-hearing responses in order to shed light on the question of her potential future use of foreign law in deciding domestic legal issues.

After examining her decisions, speeches, and writings, this paper concludes that she is receptive to the use of international law, although she will not always prioritize international law over domestic law. There is especially strong evidence that she favors the use of foreign jurisprudence when interpreting treaties and when defining certain legal terms in order to apply domestic law to foreign nationals. There is further evidence that she favors the use of foreign law to aid in the interpretation of domestic law under certain circumstances.

This paper also notes that the infrequency with which she has dealt with international law and the narrowness of her holdings make it difficult to predict her future treatment of international law. Ultimately, Sotomayor's treatment of international law is not internally consistent; that is, she does not always subrogate domestic law to international law, nor does she consistently treat domestic law as a superior source of legal authority to international law. Rather, her cases demonstrate that, depending on the legal issues and the fact pattern at hand, either international law or domestic law may prevail. The only consistencies across all of her jurisprudence concerning international legal issues are: (1) her reliance on precedent; and (2) her tendency to craft narrow holdings which do no more than answer the question at hand. Her new post on the nation's highest court may lead her to either broaden her holdings or break from precedent. If either change should occur, we may glean a clearer view of Sotomayor's position on the proper place of international law in the American legal order.

II. INTERNATIONAL AGREEMENTS AS BINDING DOMESTIC LAW

The relationship between international treaties and domestic law has long been disputed. The President has the power to make treaties with the advice and consent of two-thirds of the Senate.[1] Once made, the Supremacy Clause declares these treaties "the supreme law of the land,"[2] but the analysis of their effect in the domestic sphere does not end there.[3] In consequence, while all treaties may be the supreme law of the land for the purpose of creating international legal obligations, the precise domestic legal effect of their provisions is anything but uniform.[4]

1. U.S. CONST. art. II, § 2, cl. 2.

2. *Id.* art. VI, cl. 2.

3. Foster v. Neilson, 27 U.S. 253, 314 (1829).

4. *See* Medellin v. Texas, 552 U.S. 491 (2008) (noting that there was a presumption against self-executing treaty provisions, concluding that only if a "treaty contains stipulations which are self-executing . . . [will] they have the force and effect of a legislative enactment"). In *Medellin*, the court considered whether the Vienna Convention—which gives foreign nationals accused of crime a right to meet with diplomats from their home country—could be enforced as U.S. law and whether an International Court of

Sotomayor's opinion in *United States v. Ni Fa Yi* shows that, although she respects Congress's role in making treaty provisions binding by passing legislation, equal protection concerns might affect her determination of when these provisions are binding.[5] In contrast, her decision in *European Community v. RJR Nabisco* demonstrates a willingness to defer to the executive branch when her decision will have foreign policy implications.[6]

A. Congressional Enactments of Treaty Provisions are Subject to Judicial Scrutiny

Sotomayor's opinion in *Ni Fa Yi* indicates that she does not consider treaty obligations as a source of law that is separate from Congressional legislation. In *Ni Fa Yi*, she held that treaty provisions that required Congressional enactment before taking effect as domestic law would not automatically meet the requirements of judicial scrutiny.[7] As these treaty provisions only become binding domestic law after a Congressional enactment, as opposed to self-executing treaty provisions, they are subject to the same judicial scrutiny as any other Congressional enactment.[8]

In *Ni Fa Yi,* Judge Sotomayor was concerned that "... the [Hostage Taking] Act reache[d] a significant amount of conduct unrelated to" the government's goal and "that [her] holding could support some other provision ... which ... effect[ed] no sounder purpose than to discriminate against persons on the basis of their alienage."[9] This suggests that equal protection concerns may temper her decisions regarding the binding authority of international treaties on U.S. courts and, ultimately, limit the nature of the provisions that may be implemented by Congress. However, when a decision will have foreign policy implications, Sotomayor has exhibited deference to the wishes of the executive branch.

Justice's ruling that stated the treaty was binding inside the United States was binding on the United States. The Supreme Court ruled 6-3 that the Vienna Convention was not enforceable as a matter of U.S. law because it did not contain explicit provisions that made it self-executing. It also held that that the World Court decision did not bind the United States and therefore did not preempt state law restrictions on challenges to convictions. Chief Justice John G. Robert's opinion was supported in full by Justices Samuel A. Alito, Jr., Anthony M. Kennedy, Antonin Scalia, and Clarence Thomas. Justice John Paul Stevens supported the result only, saying he found the issue to be a closer one than the Roberts opinion allowed, but said that he was persuaded "in the end" that the treaty did not authorize the Supreme Court to enforce the International Court of Justice's ruling. *See id.* (noting that there was a presumption against self-executing treaty provisions, concluding that only if a "treaty contains stipulations which are self-executing ... will they have the force and effect of a legislative enactment").

5. *See* 951 F. Supp. 42, 45 (S.D.N.Y. 1997) (stating that treaties with foreign nations must pass Constitutional muster).

6. *See generally* 355 F.3d 123 (2d Cir. 2004), *vacated and remanded*, 544 U.S. 1012 (2005).

7. *Ni Fa Yi*, 951 F. Supp. at 43. Finding for the government, Sotomayor held the Hostage Taking Act (enacted to ratify the International Convention against the Taking of Hostages) constitutional when a defendant charged with hostage-taking argued that it deprived him of equal protection by differentiating between U.S. nationals and non-citizens.

8. *Id.* at 45–46 ("[R]ules of international law and provisions of international agreements of the United States are subject to the Bill or Rights and other prohibitions, restrictions and requirements of the Constitution and cannot be given effect in violation of them.").

9. *Id.*

B. *Deference to the Executive Branch May Affect the Binding Nature of Judgments by Foreign Courts*

In *Nabisco*, Judge Sotomayor deferred to the executive in determining whether the common law "revenue rule" was binding on domestic courts.[10] This rule holds that courts of one country will not enforce tax judgments by foreign courts.[11] Specifically, *Nabisco* examined the rule as it applied to a civil Racketeer Influenced and Corrupt Organizations (RICO) suit brought by the European Community and its member states against a variety of tobacco companies.[12] Sotomayor was reluctant to involve the judiciary in resolving this dispute. Furthermore, she paid great attention to the role that the other political branches could play in this type of civil suit and required clear evidence that they had declined to participate before she would allow the litigation to proceed.[13] Finding such evidence lacking, she barred the RICO suit on the basis of earlier Second Circuit precedent.[14]

An earlier Second Circuit decision, *Attorney General of Canada v. R.J. Reynolds Tobacco Holdings, Inc.*, had held that the rule applied to a civil RICO suit filed by the government of Canada against various Canadian and American tobacco firms.[15] Writing for the court in *Nabisco*, Judge Sotomayor held that *R.J. Reynolds* was controlling and that, in the absence of mitigating factors, the revenue rule applied, barring the plaintiff's claims.[16] She noted two concerns behind the revenue rule explained in *R.J. Reynolds*: sovereignty and separation of powers.[17] Further, she acknowledged that the rule need not be applied when these concerns are not present.[18] As the abrogation of the revenue rule in any one case would necessarily impact foreign relations, Sotomayor found that such an abrogation required a showing that Congress had directly spoken on the matter.[19] She rejected the plaintiff's attempts to show the absence of foreign policy concerns by finding that the

10. 355 F.3d at 132.

11. *Id.*

12. *Id.*

13. *Id.*

14. *See id.*

15. 268 F.3d 103 (2d Cir. 2001), *cert. denied*, 537 U.S. 1000 (2002). Both cases involved allegations that the defendants had participated in schemes to smuggle contraband cigarettes into the plaintiff's territories and thereby committed RICO violations—e.g., conspiracies to commit mail and wire fraud—that resulted in the governments' loss of revenue from tobacco duties and taxes and law enforcement costs.

16. The Supreme Court later vacated the judgment and remanded the decision for further consideration in light of the Court's ruling in *Pasquantino v. United States* that the revenue rule did not bar a government prosecution of wire fraud under 18 U.S.C. § 1343 connected to a scheme to smuggle liquor into Canada to avoid heavy import taxes. 544 U.S. 349 (2005). On remand, Judge Sotomayor concluded that *Pasquantino* did not "cast doubt" on the prior Second Circuit ruling—the court standard that would have permitted a different outcome on remand—and reinstated the earlier opinion. European Community v. RJR Nabisco Inc., 424 F.3d 175, 178 (2d Cir. 2005). As it had in *R.J. Reynolds*, the Supreme Court denied review. European Cmmty. v. RJR Nabisco Inc., 546 U.S. 1092 (2006) (denying cert.).

17. *Nabisco*, 355 F.3d at 131 (citing *R.J. Reynolds*, 268 F.3d at 126).

18. *Id.* at 132 (explaining that under the holding in *R.J. Reynolds*, the rule would not have to be applied if the executive branch expressed its consent to the suit or, absent such consent, if the plaintiffs "establish that superior law, such as the federal statute that provides that applicable right of action, abrogates the rule in the context in which the plaintiffs seek to enforce their tax laws").

19. *Id.* ("Because the revenue rule is a longstanding common law rule, and its abrogation in any one situation necessarily impacts foreign relations, a statute or treaty 'must speak directly to the matter' in order to abrogate it.").

Executive Branch's decision not to intervene in the suit, despite being aware of it, did not constitute consent to the action.[20]

The Second Circuit stated that where the executive branch had "expressed its consent to adjudication by the courts," the institutional and separation of power concerns behind the rule would be mitigated.[21] As in *R.J. Reynolds*, the court suggested that executive consent may be found where the United States itself institutes a prosecution designed to punish those who have defrauded foreign governments of tax revenues, or where the treaties between the United States and the sovereigns at issue provide for broad, reciprocal tax enforcement assistance.[22] The executive also might indicate its consent to the suit by other means, such as by submitting a statement from the State Department or filing an amicus brief.[23] The court stated that "[a]bsent such indication that the executive branch consents to the suit, a claim that triggers the revenue rule is barred unless the plaintiffs establish that superior law, such as the federal statute that provides the applicable right of action, abrogates the rule in the context in which the plaintiffs seek to enforce their tax laws."[24] Thus, she showed an inclination to defer to the executive branch in a case with foreign-policy implications in two ways: first, by respecting executive branch silence and second, by indicating that deference would likely be accorded to its views once expressed.

Sotomayor's positions in *Ni Fa Yi* and *Nabisco* show that, as a Second Circuit judge, she followed precedent in determining issues surrounding the binding nature of treaty provisions as domestic law. To date, she has not decided a case that calls into question the process by which a treaty becomes domestic law. Given the divided court in *Medellin v. Texas*,[25] the Supreme Court is likely to hear another case on the issue. In *Ni Fa Yi*, Sotomayor noted that equal protection concerns may allow courts to overturn treaty provisions made into law by Congress. Justice Sotomayor may then be swayed by the argument that equal protection concerns similarly weigh against self-executing treaty provisions, because requiring Congressional legislation provides an added layer of protection against the violation of equal protection rights. However, both self-executing treaties and treaties made binding by Congressional action may be subject to judicial scrutiny,[26] so the method by which the treaty becomes effective domestically may not weigh into Sotomayor's decision. As Sotomayor's opinion in *Nabisco* demonstrated that she believes the court may need to defer to the executive on some international matters, she may be more inclined to allow some treaty provisions to be self-executing because of executive branch involvement in entering into the treaty.

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20. *Id.* at 137.

21. *Id.* at 132.

22. *Id.*

23. *Nabisco*, 355 F.3d at 132.

24. *Id.*

25. Medellin v. Texas, 552 U.S. 491 (2008). *See supra* discussion at note 4.

26. *See* United States v. Ni Fa Yi, 951 F. Supp. 42 (S.D.N.Y. 1997) (involving a treaty approved by Congress which was subjected to judicial scrutiny).

III. USING FOREIGN JURISPRUDENCE TO INTERPRET INTERNATIONAL AGREEMENTS

Given that treaty provisions can become binding domestic law, enforced by the U.S. judicial system, one must ask how a court should interpret and apply those provisions. The Supreme Court has held that "the opinions of our sister signatories [are] entitled to considerable weight."[27] However, it remains unclear how much deference American courts should give to foreign jurisprudence when it does not unanimously support one interpretation over all others.[28] The circuit-split over the proper application of foreign jurisprudence in defining a parent's "right of custody" under the Hague Convention on the Civil Aspects of International Child Abduction exemplifies this difficulty.[29] Justice Sotomayor wrote the dissent in *Croll v. Croll*,[30] and she will soon face the question yet again in *Abbott v. Abbott*.[31] *Abbott* may provide the court with the opportunity to more thoroughly define the proper role of foreign jurisprudence in treaty interpretation.

Croll was the first case on the matter to be decided by a U.S. Court of Appeals. Mrs. Croll had custody of her daughter, Christina while Mr. Croll had only "rights of access."[32] There was also a *ne exeat* provision preventing both parties from removing Christina from Hong Kong without the other parent's permission or authorization of the court.[33] Violating that order, Mrs. Croll brought Christina to the United States.[34] Arguing that the violation of the *ne exeat* clause rendered Christina's removal from Hong Kong wrongful under the Convention, Mr. Croll brought suit in a federal

27. Air France v. Saks, 470 U.S. 392, 404 (1985).

28. *See* Croll v. Croll, 229 F.3d 133, 143 (2d Cir. 2000), *cert. denied*, 534 U.S. 949 (2001) (acknowledging that there is no doctrine requiring the court's deference to foreign jurisprudence that is inconsistent in its interpretation of a treaty).

29. *Compare* Furnes v. Reeves, 362 F.3d 702, 716–17 (11th Cir. 2004) (holding that the *ne exeat* right as defined by the Hague Convention provided a father with a right of custody over the child and noting that its "reasoning and conclusions are in harmony with the majority of the courts of our sister signatories that have addressed this treaty issue"), *and* Fawcett v. McRoberts, 326 F.3d 491, 500 (4th Cir. 2003) (holding that the court will "accept the holding of *In re* H, [[1999] 2 A.C. 291 (H.L.) (appeal taken from N. Ir.) (U.K.),] and assume, without deciding, that if an 'application to the court . . . raise[s] matters of custody within the meaning of the [Hague] Convention' the court may have 'rights of custody,' and further that a third party (such as a parent) may assert those rights in a petition for return of child"), *with* Abbott v. Abbott, 542 F.3d 1081, 1086 (5th Cir. 2008) (adopting the district court reasoning that although "[t]he opinions of courts in other signatory states to the Hague Convention are also 'entitled to considerable weight'" according to *Air France*, the "cases from other signatory states addressing the rights conferred on a parent by a *ne exeat* order are 'few, scattered, [and] conflicting" and thus do not guide this Court in its consideration of the issue"), *cert. granted*, 129 S. Ct. 2859 (June 29, 2009) (No. 08-645), Gonzalez v. Gutierrez, 311 F.3d 942, 952, 954 (9th Cir. 2002) (holding that "a *ne exeat* clause intended to benefit a non-custodial parent who possesses access or visitation rights does not afford 'rights of custody' to that parent under the Hague Convention," noting that "as the Second Circuit has observed, the cases of other signatory states on this question are 'few, scattered, conflicting, and sometimes, conclusory and unreasoned'" (quoting *Croll,* 229 F.3d at 143)), *and Croll*, 229 F.3d 133, 143 ("[T]hough the 'opinions of our sister signatories [are] entitled to considerable weight,' . . . we are aware of no doctrine requiring our deference to a series of conflicting cases from foreign signatories." . . . "[W]e hold that a *ne exeat* clause does not transmute access rights into rights of custody under the Convention." (quoting *Air France*, 470 U.S. at 404)).

30. 229 F.3d at 144.

31. 129 S.Ct. 2859 (2009) (granting cert.)

32. *Croll*, 229 F. 3d at 134.

33. *Id.* at 134–35.

34. *Id.* at 135

district court.[35] The court ordered Christina's return to Hong Kong.[36] It reasoned that because the *ne exeat* clause bestowed a joint right to determine her place of residence upon both parents, Mr. Croll had a "corresponding right of custody within the meaning of the Convention."[37]

Overturning the district court, the Second Circuit held that the *ne exeat* clause did not provide Mr. Croll with a right of custody.[38] In coming to its conclusion, the Court privileged the conventional meaning of "custody"[39] and the intentions of the treaty's drafters[40] over the jurisprudence of other signatory nations.[41] The majority justified this decision by emphasizing the split in the foreign jurisprudence.[42] It noted that no doctrine required it to follow such jurisprudence when there is not a single interpretation of a treaty.[43] Sotomayor's dissent suggests that the relevant foreign jurisprudence should have played a greater role in informing the majority's interpretation of the treaty.[44] She argued that the foreign cases seemingly supporting the majority are not strong authority.[45] In her view, the majority overstated the divided nature of the foreign jurisprudence.[46] While there was not one prevailing view as to whether a *ne exeat* clause conferred a right of custody under the

35. *Id.* Only people or entities holding "rights of custody" can seek the return of children wrongly removed from the child's habitual country of residence. Convention on the Civil Aspects of International Child Abduction, art. 5, para.1, Oct. 25, 1980, T.I.A.S. No. 11,670, 1983 U.N.T.S. 98.

36. *Croll*, 229 F.3d at 136.

37. *Id.* (quoting Croll v. Croll, 66 F. Supp. 2d at 559 (1999)).

38. *Id.* at 143.

39. *Id.* at 138–39 (defining custody by looking at dictionaries and American case law).

40. *Id.* at 141–43 (citing sources suggesting that the drafters did not intend for a *ne exeat* clause to confer rights of custody onto a parent).

41. *Id.* at 143–45 (demonstrating that the foreign case law was not as heavily weighed in coming to a decision as were these other factors).

42. *Croll*, 229 F.3d at 138–45.

43. *Id.* at 143. The court described "the cases worldwide [as] few, scattered, conflicting, and sometimes conclusory and unreasoned." *Id.* Further justifying its position, the majority claimed that "most of the cases rest on distinguishable facts, such as (a) orders of *temporary* custody awarded in the course of an ongoing custody battle . . . or (b) consent decrees expressly granting custody rights to both parents." *Id.* (internal citations omitted).

44. *Id.* at 150–53 (summarizing foreign cases interpreting rights of custody in light of the Hague Convention).

45. *Id.* While the majority argues that the "joint guardian" status of the parents distinguishes an English case in which both parents were granted "joint guardianship" of the child and a *ne exeat* order was in place, from *Croll*, Sotomayor points out that "the court explicitly relied on the language of the *ne exeat* provision and not the joint guardianship clause in determining that the father possessed 'rights of custody' under the Convention." *Croll*, 229 F.3d at 150 n.6 (citing C v. C, [1989] 1 W.L.R. 654 (C.A. (appeal taken from Eng.) (U.K.)). The court also cited a French case, in which that Court declined to order the return of a child in England and Wales, not because the order did not confer custodial rights on the father, but because an order preventing the defendant from moving would violate the mother's expatriation rights under the European Convention for the Protection of Human Rights and Fundamental Freedoms. *Id.* at 152 (citing Ministere Public v. Mme Y., Tribunaux de grande instance [T.G.I.] [ordinary court of original jurisdiction] Periguez, Mar. 17, 1992, D.S. Jur. 1992 (Fr.)). Finally, the court recalled that the Canadian Supreme Court only noted in dicta that where there is a final non-removal order, ordering the return of a child would be inappropriate. *Id.* at 152 (citing Thomson v. Thomson, [1994] 119 D.L.R. 253 (Can.)).

46. *See id.* at 150 (explaining that "[m]ost foreign courts addressing this question have interpreted the notion of rights of custody broadly in light of the Convention's purpose and structure"; that is, the majority's interpretation is contrary to the majority of foreign jurisprudence). *See also id.* at 151–53 (arguing that the cases which seemingly support the majority's interpretation are not strong authority).

Convention, she claimed that only Canadian courts had interpreted *ne exeat* clauses as not constituting a right of custody and that this was only done in dictum.[47]

Following the Second Circuit's decision in *Croll*, other U.S. Courts of Appeal were confronted with this question, and there is now a split in the jurisprudence.[48] This split may explain the Supreme Court's recent decision to grant a writ of certiorari in *Abbott v. Abbott*.[49]

The fact pattern in *Abbott* is similar to *Croll*: Mr. Abbot had a right to regular visitation with his son, and Mrs. Abbott had custody rights.[50] Mrs. Abbott then violated a *ne exeat* order.[51] Requesting the return of his son, Mr. Abbott filed suit in a Federal District Court.[52]

The court followed *Croll* in holding that a *ne exeat* order does not grant a "right of custody" under the Convention.[53] The court also distinguished this case from *Furnes v. Reeves*, on the grounds that the two parties in *Furnes* had joint parental responsibility for the child.[54] On appeal, the Fifth Circuit affirmed the district court's decision and explicitly adopted the reasoning in *Croll*.[55]

Renewing the argument that the Convention confers rights of custody upon a parent when a *ne exeat* order is in place, Mr. Abbott petitioned the Supreme Court for review.[56] His petition echoes Sotomayor's argument that the majority in *Croll* misinterpreted the foreign cases.[57] It also points out that, subsequent to *Croll*, at least two foreign courts have rejected the Second Circuit's interpretation of the treaty.[58]

The contention that the Supreme Court should review the decision in order to ensure both national and international uniformity in treaty-interpretation is one of the petitioner's more provocative arguments. He argues that the split in both the national and the international jurisprudence allows a custodial parent who wrongfully removes a child from another country to circumvent the Convention through forum-shopping.[59]

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47. *Id.* at 152.

48. Petition for Writ of Certiorari at 7, Abbott v. Abbott, 542 F.3d 1081, *cert. granted*, 77 U.S.L.W. 3308, 3702, 3708 (U.S. Jun. 29, 2009) (No. 08-645).

49. *Abbott,* 542 F.3d 1081.

50. *Id.* at 1082.

51. *Id.*

52. *Id.*

53. *Id.* at 1082–83.

54. *Id.* at 1085–86. *See also supra*, note 28 (discussing the American jurisprudence).

55. *Abbott*, 542 F.3d at 1087–88.

56. Petition for Writ of Certiorari at 2–6, *Abbott*, 542 F.3d 1081 (No. 08-645) (petitioning the U.S. Supreme Court for review).

57. *Id.* at 21–24 (summarizing and elaborating upon Sotomayor's discussion of the foreign cases which are considered to support the notion that a *ne exeat* clause does not confer rights of custody upon a parent).

58. *See id.* at 21 (explaining that opinions in at least two cases explicitly rejected the *Croll* majority's reasoning and supported Sotomayor's dissent) (citing Sonderup v. Tondelli, 2000 (1) SA 1171 (CC) (S. Afr.), *available at* http://www.saflii.org/za/cases/ZACC/2000/26.pdf; *Re P (A Child) (Abduction: Acquiescence)* [2004] EWCA (Civ) 971, paras. 57–60 (Eng.), *available at* http://www.incadat.com/index.cfm?fuseaction=convtext.showFull&code=591&lng=1 (INCADAT summary)).

59. *See id.* at 14–16 (outlining the petitioner's arguments regarding the necessity of national uniformity in treaty-interpretation). In order to avoid a *ne exeat* order, one need only remain in a circuit which has held that a *ne exeat* order does not confer a "right of custody" under the Convention. *Id.* at 15. Furthermore, the petitioner argues that review is necessary because: (1) the court ignored the fact that the

In *Croll*, Sotomayor briefly cited a Second Circuit decision for the proposition that uniformity among signatories in treaty-interpretation is desirable.[60] Otherwise, her dissent does not provide much guidance on how to handle a situation in which a majority of foreign courts have interpreted an international agreement in one manner and a minority in another. For example, she did not specify how much consensus is required before a majority view becomes persuasive. *Abbott* may be the vehicle through which we learn her views on the matter.

Abbott, which is currently awaiting oral argument, may cause the Supreme Court to further address the issue of how courts should treat foreign jurisprudence when interpreting treaties. Sotomayor will not only have the opportunity to stand by her view that the majority's decision in *Croll* was wrong on the merits,[61] but she may also have the opportunity to elaborate on the proper role of foreign jurisprudence. Given that *Croll* is not the only example of Sotomayor's willingness to consider the decisions of foreign courts, it is likely that any view she would express on the matter would evidence an open-mindedness toward the reasoning employed by the courts of other nations.

IV. JUSTICE SOTOMAYOR'S VARIED OPINIONS ON INTERNATIONAL LAW

Sotomayor's dissent in *Croll* displayed her willingness to consider international jurisprudence in the interpretation of international obligations. Similarly, her dissent from the Second Circuit's denial of a rehearing en banc in *Koehler v. Bank of Bermuda* displayed a willingness to look to foreign jurisprudence, but here it was applied to the interpretation of domestic law that applies to foreign-nationals.[62] However, Justice Sotomayor is not consistently open to the use of international law. When confronted with questions concerning customary international law, she has shown a tendency to subordinate it to domestic law.

In *Koehler*, she argued that the court should reconsider its understanding of relationships between the United Kingdom and its territories in considering alienage jurisdiction under 28 U.S.C. §1332(a), which grants federal courts diversity jurisdiction in cases between "citizens of a State and citizens or subjects of a foreign state."[63] Relying on a previous case, *Matimak Trading Co. v. Khalily*,[64] the Second Circuit had held that alienage jurisdiction was lacking in a case involving a U.S.

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majority of international cases have interpreted Article 5 of the Convention to include *ne exeat* provisions as sources of rights of custody; and (2) the legislative history makes clear that both Congress and the Executive understood that national uniformity is a necessary condition for uniform international interpretation. *Id.* at 17–24.

60. Croll v. Croll, 229 F.3d 133, 150 (2d Cir. 2000), *cert. denied*, 534 U.S. 949 (2001) (citing Denby v. Seaboard World Airlines, Inc., 737 F.2d 172, 176 n.5 (2d Cir. 1984)).

61. *See id.* at 145–50 (explaining why a *ne exeat* clause should be considered to grant rights of custody under the Convention).

62. *See* Koehler v. Bank of Bermuda (Koehler II), 229 F.3d 187 (2d Cir. 2000); *see also* Senator Linni Gmbh & Co. Kg. v. Sunway Line, Inc., 291 F.3d 145, 158–65 (2d Cir. 2002) (looking at the international forces leading to the enactment of the Carriage of Goods at Sea Act of 1936 to help her make sense of that statute, which potentially shows a willingness on her part to consider the international environment when applying statutes).

63. *Koehler II*, 229 F.3d at 187.

64. 118 F.3d 76 (2d Cir. 1997).

plaintiff and defendants that were residents of Bermuda on the ground that Bermuda defendants were not "citizens or subjects of a foreign state."[65] Judge Sotomayor dissented from the court's denial of a rehearing en banc, arguing that a rehearing "would provide a much-needed opportunity for the full Court to reexamine the flawed and internationally troublesome position that corporations and individuals from territories of the United Kingdom do not fall within the alienage jurisdiction of the federal courts."[66] In arguing for the rehearing, Judge Sotomayor cited factors that may evidence her willingness to employ international jurisprudence of the alienage issue: (1) the strong negative reaction to the cases by the United Kingdom, specifically citing that government's request to reconsider *Matimak*; (2) the misapplication of the terms "citizens or subjects of a foreign state" in *Matimak*, which rendered those terms "inconsistent with both the historical understanding of these terms; and (3) the need for a contemporary understanding of the relationship between the United Kingdom and its Overseas Territories."[67]

However, when she has been confronted with questions of customary international law, Justice Sotomayor has tended to subordinate it to domestic law.[68] For example, in *Center for Reproductive Law and Policy v. Bush*, she rejected a lawsuit challenging the ban on funding for overseas abortions under constitutional and customary international law.[69] In doing so, she disposed of the customary international law claim in a single footnote stating that since the "plaintiffs' claims based on customary international law [were] substantively indistinguishable from their First Amendment claims, they are dismissed on the same ground. We express no view as to whether those claims are otherwise viable."[70]

As Sotomayor does not consistently defer to international law, it is difficult to predict if and how she will employ international law in any single case that comes before her. However, her track record suggests that she is not dogmatic and analyzes the appropriateness of international law in each case. Arguably, her views on the use of foreign jurisprudence in the interpretation and application of domestic law are more accessible than her views on other international law issues.

V. THE ROLE OF FOREIGN LAW IN THE DETERMINATION OF DOMESTIC LAW ISSUES

In her speeches, writings, and confirmation-hearing responses, Justice Sotomayor has demonstrated that, at least within certain constraints, she accepts the consideration of foreign law and jurisprudence in the interpretation of domestic law as a valid one. Furthermore, these records suggest that she approves of the Supreme

65. Koehler v. Bank of Bermuda (Koehler I), 209 F.3d 130, 139 (2d Cir. 2000). The Supreme Court later rejected the majority's approach in its reversal of another Second Circuit ruling. JP Morgan Bank v. Traffic Stream (BVI) Infrastructure Ltd., 536 U.S. 88 (2002).

66. *Koehler II*, 229 F.2d at 187.

67. *Id.* at 188, 190–93.

68. *See* Beharry v. Ashcroft, 339 F.3d 51, 55 (2d Cir. 2003) (rejecting the lower court's assertion that customary international law was accorded the same status as federal legislation under the Supremacy Clause).

69. *See generally* 304 F.3d 183, 195 (2d Cir. 2002) (disposing of the case on the merits because the challenged governmental provision was entertained and a controlling decision issued in Planned Parenthood Fed'n of Am., Inc. v. Agency for Int'l Dev., 915 F.2d 59 (2d Cir. 1990).

70. *Ctr. for Reprod. Law & Policy*, 304 F.3d at 195 n.6.

Court's use of foreign law in both *Roper v. Simmons* and *Lawrence v. Texas*—two cases that critics argue subordinated domestic law to foreign domestic law.

A. *Roper v. Simmons and the Debate over the Use of Foreign Law*

The Court's use of foreign jurisprudence in *Roper v. Simmons* sparked a debate over the proper role of foreign law in the interpretation and application of domestic law. In *Roper*, the Court held that it is cruel and unusual punishment to execute an individual for crimes committed while a juvenile[71] after concluding that there was a consensus against the practice.[72]

Using foreign law to define constitutional terms[73] and surveying foreign jurisprudence to delineate acceptable practices are particularly contentious uses of foreign law.[74] Justice Scalia's dissent in *Roper* represents one side of the debate. He noted that the Eighth Amendment jurisprudence asks whether there is a "national consensus" opposing a disputed practice and only allows the Court to ban the practice if one exists.[75] Arguing that the practice of executing individuals who had committed crimes as juveniles was not obsolete, Justice Scalia concluded in his dissent that there was not a *national* consensus against the practice.[76] To bolster its argument, the majority looked outside the borders of the United States to determine whether an *international* consensus on the matter existed.[77] Finding that very few foreign states allowed the practice, the Court condemned it.[78]

The use of foreign law is more contentious when the Court is perceived as using it as grounds for deciding a domestic legal issue (as was the case in both *Roper* and *Lawrence*) than it is when the Court is perceived as using it in a demonstrative manner.[79] Examples of the latter include using it to define American law by showing

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71. Roper v. Simmons, 543 U.S. 551 (2005).

72. *Id.* at 575.

73. *See* J. Antonin Scalia & J. Stephen Breyer, *A Conversation Between U.S. Supreme Court Justices: The Relevance of Foreign Legal Materials in U.S. Constitutional Cases*, 3 INT'L J. CONST. L. 519, 521 (2005) (Scalia arguing it would be inappropriate to use foreign law to determine constitutional terms because the United States does not "have the same legal and moral framework as the rest of the world").

74. *Compare* Steven G. Calabresi & Stephanie Dotson Zimdahl, *The Supreme Court and Foreign Sources of Law: Two Hundred Years of Practice and the Juvenile Death Penalty Decision*, 47 WM. & MARY L. REV. 743, 755 (2005) (examining the use of foreign law in U.S. case decisions), *with* Vicki C. Jackson, *Transnational Discourse, Relational Authority, and the U.S. Court: Gender Equality*, 37 LOY. L.A. L. REV. 271, 281–82 (2003) (praising the Court's transnational turn), *and* Harold Hongju Koh, *International Law as Part of Our Law*, 98 AM. J. INT'L L. 43, 56 (2004) (arguing enthusiastically that "*Lawrence* and *Atkins* may signal that the nationalists' heyday has finally passed").

75. *Roper*, 543 U.S. at 608 (Scalia, J., dissenting). The Court has developed objective criteria by which it can determine whether a consensus exists, which includes surveying "statutes passed by society's elected representatives." Stanford v. Kentucky, 492 U.S. 361, 370 (1989). If very few state legislatures allow a practice, then the Court "will condemn the practice as an outlier." Ernest A. Young, *The Supreme Court, 2004 Term—Comment: Foreign Law and the Denominator Problem*, 119 HARV. L. REV. 148, 148 (2005).

76. *Roper*, 543 U.S. at 609 (Scalia, J., dissenting) ("Words have no meaning if the views of less than 50% of death penalty States can constitute a national consensus.").

77. *Id.* at 575.

78. *Id.*

79. JEFF SESSIONS, LEGISLATIVE BRANCH APPROPRIATIONS ACT 2010: TEXT FROM THE CONGRESSIONAL RECORD (2009), *available at* http://www.c-spanarchives.org/congress/?q=node/77531&id=9004211.

what it is *not*,[80] and citing foreign experience to illustrate possible consequences of a proposed holding.[81]

B. *Sotomayor's Speeches and Writings*

While on the Second Circuit, Sotomayor had few opportunities "to look to international sources."[82] Thus, one may need to examine her speeches and writings in order to determine her views regarding the proper uses of foreign law in the consideration of domestic legal issues.

In her foreword to *The International Judge*,[83] Sotomayor claimed that "the question of how much we have to learn from foreign law and the international community when interpreting our Constitution is . . . worth posing."[84] During her confirmation hearings, Sotomayor argued that she was referring to the purely academic question posed by the book, pointing out that she is not "a comparative law scholar . . . [who] spend[s] [her] time studying these questions."[85] As she does not appear to have published anything else on the topic, many have turned to her speeches in order to assess her views.

Sotomayor's speech to the ACLU of Puerto Rico[86] indicates that she views foreign law as a rich source of legal ideas.[87] She explained that judges "don't *use* foreign or international law; [they] *consider* the ideas that are suggested by an international court of law."[88] This statement indicates that while she would not defer to the judgments of foreign courts, she would willingly consider the strength of their arguments when facing questions of domestic law.[89] "Ideas are ideas," she said, "and whatever their source, whether they come from foreign law, or international law, or a trial judge in Alabama . . . if it persuades you . . . then you're going to adopt its reasoning. If it doesn't fit, then you won't use it."[90]

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80. *See* Joan L. Larsen, *Importing Constitutional Norms from a "Wider Civilization": Lawrence and the Rehnquist Court's Use of Foreign and International Law in Domestic Constitutional Interpretation*, 65 OHIO ST. L.J. 1283, 1288 (2004) ("A court uses comparative or international law in this [expository] sense when it uses the foreign law rule to contrast and thereby explain a domestic constitutional rule.").

81. *Id.* at 1289 ("[T]he Court looks abroad to see what the effect of the proposed rule might be in the context of a particular legal system.").

82. Collin Levy, *Sotomayor and International Law*, WALL ST. J., July 14, 2009, *available at* http://online.wsj.com/article/SB124753085258335815.html.

83. SONIA SOTOMAYOR, *Foreword* to DANIEL TERRIS, CESARE P. R. ROMANO, AND LEIGH SWIGART, THE INTERNATIONAL JUDGE: AN INTRODUCTION TO THE MEN AND WOMEN WHO DECIDE THE WORLD'S CASES (2007).

84. *Id.*

85. SONIA SOTOMAYOR, RESPONSES OF JUDGE SONIA SOTOMAYOR TO THE WRITTEN QUESTIONS OF SENATOR JEFF SESSIONS (21) (July 20, 2009), *available at* http://judiciary.senate.gov/nominations/SupremeCourt/Sotomayor/upload/QFRsSessions.pdf [hereinafter RESPONSES TO SESSIONS].

86. Sonia Sotomayor, Speech to the ACLU of Puerto Rico (April 2009), *available at* http://www.heritage.org/research/legalissues/wm2525.cfm#_ftn12 [hereinafter ACLU SPEECH].

87. *Id.*

88. *Id.*

89. *Id.* ("American analytical principles do not permit us to use that law to decide our cases. But nothing in the American legal system stops us from considering the ideas that that law can give us.").

90. *Id.*

Her speech did not express disapproval of the use of foreign law in *Roper* and *Lawrence*. Rather, she said that using foreign law could help judges discover "whether [their] understanding of our own constitutional rights [falls] into the mainstream of human thinking."[91] This serves to make sure the decision "will be more informed" as judges "look at the ideas of everyone, consider them, and . . . test the force of their persuasiveness."[92]

In Sotomayor's view, objections to the Supreme Court's citations to foreign law in cases like *Lawrence* and *Roper* reflect a "misunderstanding of the American use of . . . foreign law."[93] While acknowledging that Justices Scalia and Thomas are right to worry that "a judge can look to the law of any country to support his or her own conclusion, because they'll find someone who will agree with them," she ultimately agrees with Justice Ginsburg's view that foreign opinions "add to the story of knowledge relevant to the solution of a question."[94]

In short, both Sotomayor's foreword and her speech express her opinion that foreign law is a good source of ideas but it is not binding law which judges should blindly follow.[95] Her responses to questions posed at her confirmation hearings appear to be consistent with this view.[96]

C. *The Hearings*

As expected, many of the questions posed to Sotomayor concerning the proper use of foreign law were phrased generally.[97] Furthermore, her responses on the appropriate use of foreign law referenced treaty and contract-interpretation but disavowed the use of foreign law in constitutional interpretation.[98]

While acknowledging that foreign decisions are not "binding precedent," she appears to support their use as a persuasive source.[99] In a post-hearing questionnaire, she stated that she accepted the Supreme Court's Eighth Amendment

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91. *Id.*

92. *Id.*; *see* Frederick Schauer, *Authority and Authorities*, 94 VA. L. REV. 1931, 1944 (2008) (stating that this reason-borrowing argument should be distinguished from the opinions in *Roper*, *Lawrence*, and similar cases, which do not analyze the reasons why other countries allow a disputed practice, only whether or not they do allow it).

93. ACLU speech, *supra* note 86.

94. *Id.*

95. RESPONSES TO SESSIONS, *supra* note 85.

96. SONIA SOTOMAYOR, SOTOMAYOR HEARINGS: THE COMPLETE TRANSCRIPT (July 14, 2009), *available at* http://latimesblogs.latimes.com/washington/2009/07/sotomayor-hearings-complete-transcript-4.html (saying that "American law does not permit the use of foreign law or international law to interpret the Constitution" but that "there are some situations in which courts are commanded by American law to look at what others are doing [such as treaties and contracts]").

97. *See, e.g.*, *id.* (quoting Senator Schumer as asking "what do you believe is the appropriate role of any foreign law in the U.S. courts?").

98. *Id.* (stating that "American law does not permit the use of foreign law or international law to interpret the Constitution" but that "there are some situations in which courts are commanded by American law to look at what others are doing," including treaties and contracts).

99. RESPONSES TO SESSIONS, *supra* note 85, at 1–2.

jurisprudence.[100] She also stated that *Roper* and *Lawrence* did not treat the decisions of foreign courts as "controlling authority."[101]

Although she answered questions concerning the Court's past use of foreign law, she avoided answering the question of how *she* would use it. For example, she avoided the question of whether it would be appropriate to consider the practices of other countries when interpreting the Second Amendment by responding that she could not address that issue as relevant cases "are currently pending before the Court."[102]

Although Sotomayor has not had many opportunities to rely upon foreign or international law in interpreting domestic law, the cases and other materials discussed above demonstrate that she tends to rely on precedent. In a broad sense, there is precedent, though troubled and divisive precedent, of the Supreme Court using the jurisprudence of foreign courts to aid in its task of constitutional interpretation.[103] Sotomayor's article in *The International Judge* indicates that she has at the least considered what effect such jurisprudence should have. Perhaps consistent with her demonstrated adherence to the principle of stare decisis, her speech to the ACLU of Puerto Rico suggests that she would not fail to consider a possible legal argument for the simple reason that its basis lies in lessons learned from cases outside of the United States.

However, the following questions remain open: 1) how much weight she will grant foreign legal arguments; and 2) whether she will extend the practice of looking to foreign jurisprudence to aid her in her interpretation of constitutional issues beyond the contexts of the Eighth and Fourteenth Amendments.

She indicated in her hearings that neither she nor the majority opinions in *Roper* and *Lawrence* considered decisions of foreign courts to be "controlling authority."[104] She also did not join Justices Scalia and Thomas in renouncing the consideration of foreign court decisions.[105] Indeed, her speeches and writings suggest that she will at least consider arguments rooted in foreign jurisprudence to guide her interpretation of domestic law. Furthermore, her acceptance of *Roper* and *Lawrence*, as well as her general adherence to precedent, suggest that her use of foreign jurisprudence will accord foreign legal ideas the same weight as they were accorded in those cases. She may argue that she is only looking to such decisions for ideas. However, those who see the use of foreign law in *Roper* and *Lawrence* as elevating the status of foreign court decisions to that of controlling authority will likely see this as the subrogation of domestic law to foreign law.

Sotomayor's view of *Roper* and *Lawrence* as having used foreign law as a source of ideas and her general adherence to precedent may suggest that she will extend this use of foreign jurisprudence beyond the interpretation of Eighth and Fourteenth Amendment issues. Both cases may be seen as standing for the general principle that when there is not a national consensus on a morally charged legal

100. *Id.* at 13.

101. *Id.* at 16.

102. *Id.* at 2.

103. Roper v. Simmons, 543 U.S. 551, 561 (2005).

104. RESPONSES TO SESSIONS, *supra* note 85, at 16.

105. *Id.* at 17 ("[Their] criticism does not support the conclusion that American judges should ignore entirely the decisions of foreign courts. In some limited circumstances, decisions of foreign courts can be a source of ideas, just as law review articles or treatises can be sources of ideas.").

issue, one may look to the views of foreign courts in search of an international consensus. If these cases are seen in this light, it becomes increasingly likely that Sotomayor will extend this use of foreign law to other legal issues when there is a risk that the law in question contradicts the international consensus on the matter and no national consensus exists.

VI. CONCLUSION

The picture that emerges of Sotomayor is that of a judge who varies in her use of international law depending on the circumstances of the case and the legal issues at hand. If her past treatment of international law is indicative of how she will treat international legal issues in the future, one may expect that she will: (1) hold Congressional enactments of treaty provisions to the same rigors of judicial scrutiny as she would with any other law; (2) show deference to decisions of other branches when enforcing laws which are motivated in part by concerns over the separation of powers and sovereignty; (3) show deference to the decisions of the executive by requiring clear evidence that the executive has chosen not to participate in the enforcement of foreign-tax judgments by other countries in American courts before enforcing such judgments; (4) grant considerable weight to the interpretations of foreign courts when interpreting treaties; (5) consider international factors considered by the legislature in enacting a statute when she is faced with applying it; and (6) subordinate foreign customary law to domestic law.

However, many questions follow from her jurisprudence that cannot be answered easily. For example, will she recognize claims arising out of customary international law that are not substantively indistinguishable from claims existing in domestic law? Generally, her holdings have been so narrow in addressing only the case in front of her that it is difficult to predict how she will treat new international legal issues that come before her.

The one feature shared by her disposition of international legal issues is that they had a strong basis in precedent. Does this mean we can expect her to be consistent with her past work when disposing of these same issues anew on the Supreme Court? If she truly is devoted to the principle of stare decisis, and if the fact-patterns are substantially similar to those in the cases she has already disposed of, one may reasonably expect that her application and interpretation of the law would not differ to the extent that there is already Supreme Court precedent for the same outcome and reasoning. However, one must bear in mind that she is no longer a circuit court judge; she is now a Supreme Court Justice. So, if she believes a case is wrongly decided, she can overturn it without facing the consequence of being overturned by a higher court. Whether she will seize this newly-found freedom,[106] or whether she will continue to show a strong adherence to the principle of stare decisis remains unclear.

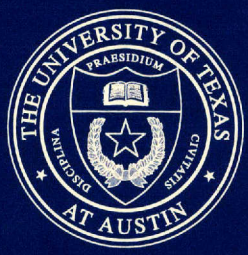
As this paper has already pointed out, Sotomayor has not had much of an opportunity to consider foreign domestic law in interpreting the U.S. Constitution. However, she has expressed a willingness to look to it as a source of ideas in both

106. RICHARD A. POSNER, HOW JUDGES THINK 9–11 (2008) (arguing that this freedom is bounded by political factors, personal factors, background experience, strategic concerns, institutional factors, and preconceptions, in addition to several other considerations).

her speeches and her writings. Furthermore, she claims that the use of international law in *Roper* and *Lawrence* falls into her category of accepted use. Given her past adherence to the principle of stare decisis, it is unlikely that she would routinely use this method of interpreting domestic law. However, the views expressed in her speeches suggest that, if she believes it to be beneficial in a given circumstance, she may, on occasion, look to foreign law. She may even extend its use beyond the contexts of the Eighth and Fourteenth Amendments—the two contexts in which this method has already been employed.

Abbott will be one of our first indications of whether Sotomayor will continue to treat international legal issues in same manner as she did while on the Second Circuit. Both the facts and the legal issues presented in *Abbott* are nearly identical to those of *Croll*. Thus, *Abbott* serves as a near perfect vehicle through which to see whether Sotomayor will stand by her previous treatment of questions of international law and whether she will continue to bring her open-minded view regarding the use of foreign jurisprudence. Will she continue to value the interpretation of international agreements by "our sister signatories"? Will she once again claim that there is a clear majority consensus among the decisions of foreign courts on the question of whether a *ne exeat* clause confers "rights to custody" upon a parent under the Hague Convention? Perhaps even more interesting is the question of whether she will define what constitutes a sufficient majority-consensus among signatory nations to compel American courts to follow a specific interpretation of a treaty provision. Fortunately, we will not have to wait long to catch a glimpse of how Sotomayor's new position will affect her treatment of international law.[107]

107. Abbott v. Abbott, 129 S.Ct. 2859 (June 29, 2009) (No. 08-645) (granting certiorari).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