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CONTENTS

ARTICLES

CONFLICTING TRENDS: LESSONS FROM
CURRENT EVALUATIVE MECHANISMS IN
INTERNATIONAL AND REGIONAL ANTI-
CORRUPTION SYSTEMS REGARDING
CONFLICTS OF INTEREST*Alexandra R. Harrington* 186

COMPULSORY LICENSING IN THE
EUROPEAN UNION*Jarrold Tudor* 222

NOTES

RATING AGENCIES AND MUNICIPAL
BONDS: HOW A MISUNDERSTOOD
INDUSTRY HAS COST TAXPAYERS.....*Jason Saylor* 259

DOMINATION V. DIPLOMACY:
COMPARING THE EFFECTIVENESS OF THE
UNITED STATES'S JOHN DOE SUMMONS
WITH THE UNITED KINGDOM'S 2011 TAX
TREATY WITH SWITZERLAND*Alfred Bender* 286

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CONFLICTING TRENDS: LESSONS FROM CURRENT EVALUATIVE
MECHANISMS IN INTERNATIONAL AND REGIONAL ANTI-
CORRUPTION SYSTEMS REGARDING CONFLICTS OF INTEREST

*Alexandra R. Harrington**

INTRODUCTION

Corruption is an important topic at the domestic, regional and international levels. The focus on corruption has intensified as it has become widely understood that corruption impacts many facets of law and policy, ranging from finance and development to human rights and environmental concerns, as well as general concepts of good governance. Like the areas that it impacts, corruption itself is not one-dimensional. Rather, it consists of many components that, both individually and collectively, undermine the legal and societal stability of states. One of the most fundamental aspects of corruption is a conflict of interest because, as this article asserts, without the existence of a conflict of interest, the corrupt act in question would likely not qualify as corrupt. Indeed, competition arising from conflicts of interest, particularly in the public sphere, is a theme that runs through the understanding of anti-corruption measures in all jurisdictions.

This article explores the impact of conflict of interest evaluations in international and regional anti-corruption systems—specifically the Inter-American Convention Against Corruption (the “IACAC”), the Group of States Against Corruption (“GRECO”), the Organization for Economic Cooperation and Development (the “OECD”), and the Asian Development Bank/OECD Anti-Corruption Initiative for Asia-Pacific (the “ADB/OECD”)—along with the trends that emerge from these methods of evaluation. Part II of this article establishes the role of conflict of interest prevention within the IACAC and discusses the findings of the Mechanism for Follow-Up on the Implementation of the Inter-American Convention Against Corruption (the “MESICIC”) regarding conflict of interest regulation by state parties. GRECO state parties are similarly evaluated in Part III, the OECD state parties in Part IV, and the ADB/OECD state parties in Part V. Using a comprehensive system that examines the positive and negative aspects of conflict of interest regulation, as demonstrated through the member state evaluations in the studied regimes, Part VI discusses the trends that can be observed from these evaluation systems. Part VII provides basic information on the state party evaluation mechanisms, which have been created under the auspices of the United Nations Convention Against Corruption (the “UNCAC”) and the European Union (the “EU”), but are not yet in force. Part VIII examines the implications of these trends, in terms of

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effectiveness and future development for the existing conflict of interest provisions. Part VIII also uses these observed trends to suggest areas in which the yet-to-be implemented UNCAC and EU evaluation procedures could be better focused to address the member state-based issues that arise in attempting to regulate conflicts of interest through international and regional treaty regimes.

The goal of this article is to gain a more robust understanding of how conflicts of interest are treated in international and regional anti-corruption treaty regimes, as well as the trends that can be discerned from evaluations of regime member practices regarding these conflicts of interest measures. At present, only the IACAC, GRECO, the OECD, and the ADB/OECD have significant member state compliance procedures in place, although, as previously noted, the UNCAC and the EU have created mechanisms to undertake member state compliance procedures in the future. The evaluations used by the IACAC, GRECO, the OECD, and the ADB/OECD have gone through several phases to date, and examination of such existing procedures will help to provide an understanding of the conflict of interest situations in individual member states, as well as the collective situation within each regime overall. As such, the evaluation procedures offer important lessons for each of their respective regimes. Furthermore, the lessons and trends from these existing mechanisms offer additional insights and lessons for those regimes that are in the process of implementing review mechanisms in the future.

I. THE INTER-AMERICAN CONVENTION AGAINST CORRUPTION

A. *The IACAC Conflict of Interest Provisions*

The Organization of American States adopted the IACAC in 1996 as the region's first major attempt to address the issue of corruption at the domestic and regional level.¹ The IACAC is a wide-ranging convention that addresses many issues related to or affecting corruption and underlines the detrimental impact of corruption on law and society.² In particular, the IACAC focuses on corruption in the public sector and the commission of public functions because these forms of corruption are identified as especially detrimental to society and development.³

The IACAC directly addresses the conflict of interest issue by recommending preventative measures for state parties to consider adopting in order to improve the ability of their legal regimes to withstand and avoid corruption.⁴ With that goal in mind, state parties to the IACAC have agreed to consider the implementation and strengthening of codes of conduct and other

¹ Inter-American Convention Against Corruption, Mar. 29, 1996, O.A.S.T.S. No. B-58 [hereinafter IACAC], available at <http://www.oas.org/juridico/english/treaties/b-58.html>; see *Inter-American Convention Against Corruption: Background*, DEP'T OF LEGAL COOPERATION, ORG. OF AM. STATES, http://www.oas.org/juridico/english/corr_bg.htm (last visited Mar. 15, 2013).

² IACAC, *supra* note 1, at pmbl.

³ *Id.*

⁴ *Id.* at art. III.

standards for the “correct, honorable and proper fulfillment of public functions” to prevent conflicts of interest at the governmental level.⁵ Other suggested measures—such as income reporting and new ethics requirements for public officials,⁶ the implementation of reporting systems for conflicts and acts of corruption,⁷ and the creation of oversight bodies to investigate such allegations of corruption⁸—also reinforce the desire to root out conflicts of interest.

In order to assist state parties with the implementation of their IACAC obligations and to evaluate the levels of state party compliance with their obligations over time, the IACAC created the MESICIC.⁹ MESICIC observers periodically compile information on state party implementation of the IACAC and create reports detailing each state party’s compliance with the IACAC recommendations and requirements.¹⁰ These reports are issued in accordance with regularly scheduled rounds, and the MESICIC is currently entering into its fourth round of review and reporting.¹¹ The resulting reports form the basis of the IACAC’s conflict of interest analysis because they reveal the status of each individual state party’s compliance with the recommended conflict of interest measures while also expertly discussing additional measures that it may be necessary for the parties to take.¹² It should be noted that the MESICIC review round reports are by far the most comprehensive of the reviews discussed in this article. Therefore, the MESICIC reports provide the greatest insight into the successes and failures in implementing a conflict of interest regime at the domestic and regional levels.

B. Evaluation Trends

1. General Conflicts of Interest Laws

Among the reviewed IACAC party states, there have been many legislative responses to the conflict of interest requirements set out under the IACAC. Some states have enacted laws targeting conflicts of interest in relation to public ethics,¹³ formal policies addressing administrative and disciplinary concerns,

⁵ *Id.* at art. III(1).

⁶ *Id.* at art. III(3)–(4).

⁷ *Id.* at art. III(8).

⁸ IACAC, *supra* note 1, at art. III(9).

⁹ *What is the MESICIC?*, DEP’T OF LEGAL COOPERATION, ORG. OF AM. STATES, http://www.oas.org/juridico/english/mesicic_intro_en.htm (last visited Mar. 15, 2013).

¹⁰ *Id.* See *Country Reports*, DEP’T OF LEGAL COOPERATION, ORG. OF AM. STATES, http://www.oas.org/juridico/english/mesicic_reports.htm (last visited March 15, 2013) (providing an online compilation of all of the country reports for each round).

¹¹ *Id.* see *Rounds of Review*, DEP’T OF LEGAL COOPERATION, ORG. OF AM. STATES, http://www.oas.org/juridico/english/mesicic_rounds.htm (last visited Mar. 15, 2013).

¹² *What is the MESICIC?*, DEP’T OF LEGAL COOPERATION, ORG. OF AM. STATES, http://www.oas.org/juridico/english/mesicic_intro_en.htm (last visited Mar. 15, 2013).

¹³ See, e.g., Comm. of Experts of the Mechanism for Follow-Up on the Implementation of the Inter-American Convention Against Corruption [Comm. of Experts of the MESICIC], *Report on Implementation in Argentina of the Convention Provisions Selected for Review in the Framework of the First Round*, at 5 (Feb. 13, 2013) [hereinafter *MESICIC Argentina Report I*]; Comm. of Experts of the MESICIC, *Final Report on Implementation in Belize of the Convention Provisions Selected*

and penalties to be imposed in the event of a conflict of interest violation.¹⁴ Several states have further compartmentalized conflict of interest laws based on the function of the targeted public official, thus creating differences in standards and requirements.¹⁵ Overall, a majority of IACAC state parties have updated their laws in some way to include conflicts of interest as a criminal offense.¹⁶

In several states, conflicts of interest have been established as an express bar to police service,¹⁷ service as a member of the judicial branch¹⁸ or the

for Review in the Framework of the First Round, at 20, SG/MESICIC/doc.169/05 Rev. 4 (Mar. 31, 2006) [hereinafter *MESICIC Belize Report 1*]; Comm. of Experts of the MESICIC, *Final Report on Implementation in the Federative Republic of Brazil of the Convention Provisions Selected for Review in the Framework of the First Round*, at 7, SG/MESICIC/doc.168/05 Rev. 4 (Mar. 31, 2006) [hereinafter *MESICIC Brazil Report 1*]; Comm. of Experts of the MESICIC, *Report on its Implementation in Columbia of the Convention Provisions Selected for Review in the Context of the First Round*, at 3 (July 18, 2003) [hereinafter *MESICIC Columbia Report 1*]; Comm. of Experts of the MESICIC, *Report on Implementation in the United States of America of the Convention Provisions Selected for Review in the First Round of the Framework*, at 4, SG/MESICIC/doc.153/05 Rev. 4 (Mar. 31, 2006) [hereinafter *MESICIC USA Report 1*].

¹⁴ See, e.g., Comm. of Experts of the MESICIC, *Final Report on Implementation in the Republic of Costa Rica of the Provisions of the Convention Selected for Review Within the Framework of the First Round*, at 4–5, SG/MESICIC/doc.118/04 Rev. 4 (Mar. 31, 2006) [hereinafter *MESICIC Costa Rica Report 1*]; Comm. of Experts of the MESICIC, *Report on Implementation in the Dominican Republic of the Convention Provisions Selected for Review in the Framework of the First Round*, at 4–5, SG/MESICIC/doc.138/04 Rev. 4 (Mar. 12, 2006) [hereinafter *MESICIC Dominican Republic Report 1*]; Comm. of Experts of the MESICIC, *Final Report on Implementation in the Republic of Honduras of the Provisions of the Convention Selected for Review Within the Framework of the First Round*, at 4–5, SG/MESICIC/doc.141/04 Rev. 4 (Mar. 12, 2006) [hereinafter *MESICIC Honduras Report 1*]; Comm. of Experts of the MESICIC, *Report on Implementation in Nicaragua of the Convention Provisions Selected for Analysis in the Framework of the First Round*, at 2–3 [hereinafter *MESICIC Nicaragua Report 1*]; Comm. of Experts of the MESICIC, *Final Report on Implementation in the Republic of Peru of the Convention Provisions Selected for Review in the Framework of the First Round*, at 4–6, SG/MESICIC/doc.120/04 Rev. 4 (Jul. 29, 2004) [hereinafter *MESICIC Peru Report 1*].

¹⁵ See *MESICIC Brazil Report 1*, *supra* note 13, at 6, 9–10; Comm. of Experts of the MESICIC, *Final Report on Implementation in the Republic of Ecuador of the Provisions of the Convention Selected for Review Within the Framework of the First Round*, at 4–5, SG/MESICIC/doc.75/03 Rev. 4 (Feb. 6, 2004) [hereinafter *MESICIC Ecuador Report 1*]; Comm. of Experts of the MESICIC, *Final Report on the Implementation in the Oriental Republic of Uruguay of the Provisions of the Convention Selected for Review Within the Framework of the First Round*, at 5, SG/MESICIC/doc.86/03 Rev. 4 (Feb. 6, 2004) [hereinafter *MESICIC Uruguay Report 1*]; *MESICIC USA Report 1*, *supra* note 13, at 5.

¹⁶ See Comm. of Experts of the MESICIC, *First Progress Report on Implementation of the Inter-American Convention Against Corruption*, at 14–24, SG/MESICIC/doc.263/10 Rev. 2 (Mar. 24, 2011), available at http://www.oas.org/juridico/english/prog_rep1.pdf (describing 136 actions regarding the implementation of the recommendations related to the prevention of conflicts of interest).

¹⁷ See, e.g., *MESICIC Belize Report 1*, *supra* note 13, at 3–4.

¹⁸ See Comm. of Experts of the MESICIC, *Report on Implementation in the Federative Republic of Brazil of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to That Country in the First Round*, at 7–8, SG/MESICIC/doc.225/08 Rev. 4 (Dec. 12, 2008) [hereinafter *MESICIC Brazil Report 2*] (noting, however, that this is only a limited restriction); *MESICIC Colombia Report 1*, *supra* note 13, at 4; Comm. of Experts of the MESICIC, *Report on Implementation in the Republic of Guatemala of the Convention Provisions Selected for Review in the Framework of the First Round*, at 5, SG/MESICIC/doc.155/05 Rev. 4 (Sept. 30, 2005) [hereinafter *MESICIC Guatemala Report 1*].

executive branch,¹⁹ and/or public service in general. Some states have also established that conflict of interest issues can extend beyond the particular public servant and include the public servant's immediate family members and their interests.²⁰ In some instances, states have enacted laws requiring public servants with conflicts of interest to recuse themselves from the affected position.²¹

Conflicts of interest can be particularly damaging and pervasive in the realm of public contracting. The relationship between corruption and public contracts has resulted in several states creating specific governmental entities that oversee conflicts of interest in the bidding process.²² Certain states have also created publicly accessible databases of those potential bidders who have been debarred from the contracting process as a result of conflict of interest issues.²³

Despite these positive measures, the MESICIC review rounds have highlighted issues with the implementation and effectiveness of conflict of interest laws and regulations. Overall, the reports generated throughout the MESICIC review rounds have recommended that nearly all reviewed states take measures to strengthen their conflict of interest laws and regulations.²⁴ In several instances, a report specifically recommended that the reviewed state create a legal definition of what a conflict of interest is since their legal regimes were operating without such a definition.²⁵ The first three MESICIC review

¹⁹ See, e.g., MESICIC *Guatemala Report 1*, *supra* note 18, at 4.

²⁰ See, e.g., MESICIC *Brazil Report 1*, *supra* note 13, at 26 n.119 (indicating that familial relationships can also cause conflicts of interest).

²¹ See, e.g., Comm. of Experts of the MESICIC, *Final Report on Implementation in Republic of Bolivia of the Convention Provisions Selected for Review in the Framework of the First Round*, at 4, SG/MESICIC/doc.119/04 Rev. 4 (July 29, 2004) [hereinafter *MESICIC Bolivia Report 1*].

²² See MESICIC *Dominican Republic Report 1*, *supra* note 14, at 6; MESICIC *Honduras Report 1*, *supra* note 14, at 9.

²³ See Comm. of Experts of the MESICIC, *Final Report on Implementation in the Republic of Costa Rica of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 11–12, SG/MESICIC/doc.192/07 Rev. 4 (June 28, 2007) [hereinafter *MESICIC Costa Rica Report 2*]; MESICIC *Ecuador Report 1*, *supra* note 15, at 20.

²⁴ See, e.g., Comm. of Experts of the MESICIC, *Report on Implementation in the Commonwealth of the Bahamas of the Convention Provisions Selected for Review in the Framework of the First Round*, at 23, SG/MESICIC/doc.139/04 Rev. 4 (Mar. 12, 2005) [hereinafter *MESICIC Bahamas Report 1*]; MESICIC *Guatemala Report 1*, *supra* note 18, at 39; Comm. of Experts of the MESICIC, *Final Report on Implementation in Guyana of the Convention Provisions Selected for Review in the Framework of the First Round*, at 15, SG/MESICIC/doc.165/05 Rev. 4 (Mar. 31, 2006) [hereinafter *MESICIC Guyana Report 1*]; Comm. of Experts of the MESICIC, *Report on Implementation in Mexico of the Provisions of the Convention Selected for Review in the First Round*, at 38, SG/MESICIC/doc.137/04 Rev. 4 (Mar. 11, 2005) [hereinafter *MESICIC Mexico Report 1*]; Comm. of Experts of the MESICIC, *Report on Implementation in Saint Vincent and the Grenadines of the Convention Provisions Selected for Review in the Framework of the First Round*, at 19, SG/MESICIC/doc.156/05 Rev. 4 (Sept. 30, 2005) [hereinafter *MESICIC St. Vincent Report 1*].

²⁵ See MESICIC *Belize Report 1*, *supra* note 13, at 5; MESICIC *Guatemala Report 1*, *supra* note 18, at 7. See also Comm. of Experts of the MESICIC, *Report on Implementation in Jamaica of the Convention Provisions Selected for Review in the Framework of the First Round*, at 23, SG/MESICIC/doc.139/04 Rev. 4 (Mar. 12, 2005) [hereinafter *MESICIC Jamaica Report 1*] (noting

rounds have also identified issues arising from the implementation of penalties for conflicts of interest violations²⁶ and informed the calculation of the costs of monitoring the application of conflict of interest laws.²⁷

2. Codes of Conduct/Ethics

According to the most recent MESICIC review reports, twenty-one states within the IACAC system currently use codes of conduct or ethics in relationship to conflicts of interest and public authorities.²⁸ Some of these codes are very comprehensive and/or explicit, while others are more limited in scope or narrowly tailored to the branch of government in which a targeted person is employed.²⁹ In some states, such as the Bahamas, this is problematic in that there are no specific codes of conduct or ethics applicable to the legislature, which is historically more corrupt than other areas of government.³⁰ Similarly, in Suriname, codes of conduct are only used in the military, and even in that context the scope of such codes is limited.³¹

In terms of procurement, certain states, including the United States and Canada, have explicit rules and regulations governing the conduct of procuring

that there was no coherent definition of the term “public servant” in Jamaican law and that this hindered the application of the definition of conflicts of interest).

²⁶ See MESICIC *Bahamas Report 1*, *supra* note 24, at 9–10; Comm. of Experts of the MESICIC, *Report on Implementation in Panama of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 29, SG/MESICIC/doc.203/07 Rev. 4 (Dec. 7, 2007) [hereinafter MESICIC *Panama Report 2*]; Comm. of Experts of the MESICIC, *Report on Implementation in Paraguay of the Convention Provisions Selected for Review in the Framework of the First Round*, at 4–5 [hereinafter MESICIC *Paraguay Report 1*]; MESICIC *Peru Report 1*, *supra* note 14, at 6–7; Comm. of Experts of the MESICIC, *Final Report on Implementation in Suriname of the Convention Provisions Selected for Review in the Framework of the First Round*, at 17, SG/MESICIC/doc.167/05 Rev. 4 (Mar. 31, 2006) [hereinafter MESICIC *Suriname Report 1*].

²⁷ See Comm. of Experts of the MESICIC, *Report on Implementation in the Federative Republic of Brazil of the Convention Provisions Selected for Review in the Third Round, and on Follow-Up to the Recommendations Formulated to that Country in Previous Rounds*, at 6–7, SG/MESICIC/doc.285/11 Rev. 4 (Sept. 16, 2011); MESICIC *Costa Rica Report 2*, *supra* note 23, at 37.

²⁸ See Comm. of Experts of the MESICIC, *First Progress Report on Implementation of the Inter-American Convention Against Corruption*, at 15–24, SG/MESICIC/doc.285/11 Rev. 4 (Sept. 16, 2011) (indicating such practices in the following countries: Argentina, Bolivia, Brazil, Canada, Columbia, Costa Rica, Ecuador, Guatemala, Guyana, Mexico, Nicaragua, Panama, Peru, and the United States); MESICIC *Bahamas Report 1*, *supra* note 24, at 5–6; MESICIC *Belize Report 1*, *supra* note 13, at 3; MESICIC *Dominican Republic Report 1*, *supra* note 14, at 4; MESICIC *Jamaica Report 1*, *supra* note 25, at 3–4; MESICIC *Suriname Report 1*, *supra* note 26, at 3–5; MESICIC *St. Vincent Report 1*, *supra* note 24, at 3–5; Comm. of Experts of the MESICIC, *Report on the Implementation in the Republic of Trinidad and Tobago of the Provisions of the Convention Selected for Review Within the Framework of the First Round*, at 4–10, SG/MESICIC/doc.136/04 Rev. 4 (Mar. 11, 2005) [hereinafter MESICIC *Trinidad and Tobago Report 1*].

²⁹ See sources cited *supra* note 28.

³⁰ See MESICIC *Bahamas Report 1*, *supra* note 24, at 10.

³¹ See MESICIC *Suriname Report 1*, *supra* note 26, at 4.

entities and those who obtain procurement agreements with the state.³² As a federal system, many of the states within the US also use codes of conduct to regulate procurement activities.³³

In order to implement the codes of conduct, some states have published guidebooks or other materials that are made available to the general public workforce.³⁴ Further, Guatemala has created a guidebook that explains how supervisors within governmental departments must handle real or potential conflicts of interest,³⁵ and Trinidad has established a requirement that departmental heads report violations of its codes of conduct to their superiors.³⁶

Interestingly—and tellingly, from the perspective of assessing the importance of periodic implementation reviews for anti-corruption regimes—several states were found to have implemented or strengthened their codes of conduct following initial MESICIC reviews which highlighted shortcomings in this area.³⁷ Additionally, several states, such as the Bahamas and Ecuador, indicated during the third review that they were in the process of drafting more comprehensive codes of conduct.³⁸

3. Disclosure and Reporting Requirements

A majority of the states subject to MESICIC review have some form of requirement for the disclosure of assets by state employees, members of the legislature, members of the executive, and other public officials.³⁹ Some of these requirements are targeted at certain groups, such as public servants and high-level members of the executive or the judiciary.⁴⁰ Other requirements are

³² See Comm. of Experts of the MESICIC, *Report on Implementation in Canada of the Convention Provisions Selected for Review in the Second Round of the Framework*, at 14–32, SG/MESICIC/doc.212/08 Rev. 4 (June 27, 2008) [hereinafter *MESICIC Canada Report 2*]; Comm. of Experts of the MESICIC, *Report on Implementation in the United States of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 13–23, SG/MESICIC/doc.213/08 Rev. 4 (June 27, 2008) [hereinafter *MESICIC USA Report 2*].

³³ See *MESICIC USA Report 2*, *supra* note 32, 13–23.

³⁴ See *MESICIC Argentina Report 1*, *supra* note 13, at 11; *MESICIC Canada Report 2*, *supra* note 32, at 41; Comm. of Experts of the MESICIC, *Report on Implementation in the Republic of Columbia of the Convention Provisions Selected for Review in the Third Round, and on Follow-Up to the Recommendations Formulated to that Country in Previous Rounds*, at 6–7, SG/MESICIC/doc.252/09 Rev. 4 (Mar. 25, 2010) [hereinafter *MESICIC Columbia Report 3*]; Comm. of Experts of the MESICIC, *Report on Implementation in the Republic of Guatemala of the Convention Provisions Selected for Review in the Third Round, and on Follow-Up to the Recommendations Formulated to that Country in Previous Rounds*, at 24, SG/MESICIC/doc.275/10 Rev. 4 (Mar. 25, 2011) [hereinafter *MESICIC Guatemala Report 3*].

³⁵ See *MESICIC Guatemala Report 3*, *supra* note 34, at 24.

³⁶ See *MESICIC Trinidad and Tobago Report 1*, *supra* note 28, at 19.

³⁷ See generally *MESICIC reports*, *supra* note 28.

³⁸ See Comm. of Experts of the MESICIC, *Report on Implementation in the Republic of Ecuador of the Convention Provisions Selected for Review in the Third Round, and on Follow-Up to the Recommendations Formulated to that Country in Previous Rounds*, at 23, SG/MESICIC/doc.249/09 Rev. 4 (Mar. 25, 2010) [hereinafter *MESICIC Ecuador Report 3*].

³⁹ See, e.g., *MESICIC USA Report 1*, *supra* note 13, at 25–27.

⁴⁰ See, e.g., *id.* at 25.

the result of specific constitutional provisions that mandate them.⁴¹ Additionally, some states require that those seeking an office make asset disclosures as well.⁴² States such as Bolivia and Guatemala go even further by requiring specific registration of property held by certain public officials.⁴³

A number of state parties have provisions that impose monetary penalties or jail time as punishment for an individual found to have violated the disclosure requirements.⁴⁴ During the MESICIC review rounds, at least one state, Brazil, explained that it had established governmental investigatory powers for potential violations of its disclosure requirements.⁴⁵ Chile and Mexico, on the other hand, noted that they had increased auditing requirements for disclosures during the MESICIC review rounds.⁴⁶ Both Chile and Ecuador, however, expressly noted that there were issues with societal acceptance of the disclosure requirements and their implementation.⁴⁷ Further, during the MESICIC review rounds, particularly the second and third rounds, a number of states noted that they had implemented increased disclosure requirements.⁴⁸

Despite these advances and improvements in implementation of the IACAC requirements by means of asset disclosure by public officials, the MESICIC review rounds revealed consistent areas of identified weaknesses in implementation. Overall, it was recommended that many states—representing all forms of development status—needed to make their disclosure requirements

⁴¹ See MESICIC *Ecuador Report 1*, *supra* note 15, at 13–14; MESICIC *Nicaragua Report 1*, *supra* note 14, at 8–9.

⁴² See, e.g., MESICIC *Bahamas Report 1*, *supra* note 24, at 14–16; MESICIC *Brazil Report 1*, *supra* note 13, at 25–26.

⁴³ See MESICIC *Bolivia Report 1*, *supra* note 21, at 17; MESICIC *Guatemala Report 1*, *supra* note 18, at 18.

⁴⁴ See, e.g., MESICIC *Bahamas Report 1*, *supra* note 24, at 15 (noting that the penalties include monetary aspects and/or jail time); MESICIC *Guyana Report 1*, *supra* note 24, at 8 (noting that the penalties include monetary aspects but not jail time); MESICIC *Nicaragua Report 1*, *supra* note 14, at 8 (explaining that there is a penalty but its true extent is unknown); Comm. of Experts of the MESICIC, *Final Report on Implementation in the Bolivarian Republic of Venezuela of the Convention Provisions Selected for Analysis in the Framework of the First Round*, at 18, SG/MESICIC/doc.117/04 Rev. 4 (June 30, 2004) [hereinafter *MESICIC Venezuela Report 1*] (explaining that there are monetary penalties only).

⁴⁵ MESICIC *Brazil Report 1*, *supra* note 13, at 30–31.

⁴⁶ See Comm. of Experts of the MESICIC, *Final Report on Implementation in the Republic of Chile of the Convention Provisions Selected for Analysis Within the Framework of the First Round*, at 12, SG/MESICIC/doc.89/03 Rev. 4 (Feb. 6, 2004) [hereinafter *MESICIC Chile Report 1*]; MESICIC *Mexico Report 1*, *supra* note 24, at 16.

⁴⁷ See MESICIC *Chile Report 1*, *supra* note 46, at 50; Comm. of Experts of the MESICIC, *Final Report on Implementation in the Republic of Ecuador of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 13–23, SG/MESICIC/doc.185/06 Rev. 4 (Dec. 15, 2006) [hereinafter *MESICIC Ecuador Report 2*].

⁴⁸ See, e.g., Comm. of Experts of the MESICIC, *Report on Implementation in the Republic of Chile of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 49, SG/MESICIC/doc.204/07 Rev. 4 (Dec. 7, 2007) [hereinafter *MESICIC Chile Report 2*]; MESICIC *Columbia Report 3*, *supra* note 34, at 30; MESICIC *Costa Rica Report 1*, *supra* note 23, at 41–42; MESICIC *Ecuador Report 3*, *supra* note 38, at 26–27; MESICIC *Guatemala Report 3*, *supra* note 34, at 29–30.

and processes more transparent.⁴⁹ The majority of states received recommendations to increase their reporting requirements in general,⁵⁰ and some were subject to specific recommendations to increase their income reporting requirements,⁵¹ as well as the oversight mechanisms used in the disclosure reporting process.⁵²

4. Constitutional Provisions Relating to Conflicts of Interest

Constitutions are essential to law and society for many reasons, not the least of which being that they express the mores and principles of a society. While all laws necessarily have power, constitutional law has a different and typically more hallowed place in law and society, in both civil legal systems and common law legal systems. With the exception of the United States and Canada, there has been a concerted trend among MESICIC states of incorporating anti-corruption provisions into their constitutional framework, particularly in the form of conflict of interest provisions.

Most states have coalesced around the inclusion of provisions that create public service ineligibilities in certain instances where a conflict of interest would otherwise exist.⁵³ A majority of applicable states have otherwise coalesced by including express constitutional prohibitions regarding conflicts of interest,⁵⁴ thus constitutionally requiring that public servants act only for the

⁴⁹ See, e.g., MESICIC *Bahamas Report 1*, *supra* note 24, at 25; Comm. of Experts of the MESICIC, Report on Implementation in Canada of the Convention Provisions Selected for Review in the Framework of the First Round, at 47, SG/MESICIC/doc.152/05 Rev. 4 (Sept. 30, 2005) [hereinafter MESICIC *Canada Report 1*]; MESICIC *Colombia Report 1*, *supra* note 13, at 32.

⁵⁰ See, e.g., MESICIC *Guyana Report 1*, *supra* note 24, at 21; MESICIC *Ecuador Report 1*, *supra* note 15, at 33; MESICIC *Bolivia Report 1*, *supra* note 21, at 42–43; MESICIC *Costa Rica Report 1*, *supra* note 14, at 44–45; MESICIC *Guatemala Report 1*, *supra* note 18, at 41.

⁵¹ See MESICIC *Dominican Republic Report 1*, *supra* note 14, at 43; Comm. of Experts of the MESICIC, Report on the Implementation in the Republic of El Salvador of the Convention Provisions Selected for Review in the Framework of the First Round, at 34, SG/MESICIC/doc.104/04 Rev. 4 (Mar. 12, 2005) [hereinafter MESICIC *El Salvador Report 1*].

⁵² See MESICIC *Belize Report 1*, *supra* note 13, at 22; MESICIC *Dominican Republic Report 1*, *supra* note 14, at 44.

⁵³ See, e.g., MESICIC *Bahamas Report 1*, *supra* note 24, at 3–4; MESICIC *Jamaica Report 1*, *supra* note 25, at 3; Comm. of Experts of the MESICIC, Final Report on Implementation in the Republic of Panama of the Convention Provisions Selected for Review in the Framework of the First Round, at 4, SG/MESICIC/doc.88/03 Rev. 4 (Feb. 6, 2004) [hereinafter MESICIC *Panama Report 1*]; MESICIC *Paraguay Report 1*, *supra* note 26, at 3; MESICIC *Peru Report 1*, *supra* note 14, at 4.

⁵⁴ See, e.g., MESICIC *Colombia Report 1*, *supra* note 13, at 3 (prohibiting appointments based on kinship); MESICIC *Ecuador Report 1*, *supra* note 15, at 4 (prohibiting nepotism); Committee of Experts of the MESICIC, Report on Implementation in Grenada of the Convention Provisions Selected for Review in the First Round of the Framework, at 3, SG/MESICIC/doc.166/05 Rev. 4 (Mar. 31, 2006) [hereinafter MESICIC *Grenada Report 1*] (prohibiting certain appointments); MESICIC *Honduras Report 1*, *supra* note 14, at 4 (prohibiting most public servants from holding two offices); MESICIC *Nicaragua Report 1*, *supra* note 14, at 2 (prohibiting officials from acting on behalf of a party other than the State when making contract with the State).

good of the nation⁵⁵ and constitutionally mandating that public officials register assets with a designated entity upon taking public office.⁵⁶

Additional relevant constitutional provisions in some MESICIC states include overall governmental transparency requirements,⁵⁷ required codes of conduct for public officials,⁵⁸ the creation of a state duty to combat corruption,⁵⁹ and the requirement that the state create a corruption oversight body.⁶⁰

5. Existence and Creation of Oversight Bodies

A constant theme throughout the MESICIC review process has been that it is necessary to strengthen or create oversight bodies for conflict of interest laws and regulations and anti-corruption measures in general. In the wake of the IACAC's adoption, a number of state parties created national oversight bodies to police conflicts of interest, often under the rubric of the oversight of public ethics. Many state parties designated an ombudsman to address these issues, particularly in terms of conflicts of interest in legislative activities.⁶¹ Other entities that have been established include anti-corruption offices,⁶² police service commissions,⁶³ judicial and legal service commissions,⁶⁴ and oversight bodies for government contracting and related contractors.⁶⁵ Additionally, several state parties have created programs, which assist state employees in seeking guidance regarding the potential existence of conflicts of interest.⁶⁶

Coordination—or the lack thereof—between oversight bodies within the governmental structure is an identified problem in regard to oversight bodies

⁵⁵ See, e.g., MESICIC *Bolivia Report 1*, *supra* note 21, at 4; MESICIC *Guatemala Report 1*, *supra* note 18, at 3; MESICIC *Peru Report 1*, *supra* note 14, at 4; MESICIC *Uruguay Report 1*, *supra* note 15, at 3.

⁵⁶ See, e.g., MESICIC *Bolivia Report 1*, *supra* note 21, at 17; MESICIC *Costa Rica Report 1*, *supra* note 14, at 19 (applying only certain public servants); MESICIC *Paraguay Report 1*, *supra* note 26, at 9; MESICIC *Peru Report 1*, *supra* note 14, at 18–19 (applying only to certain public officials); MESICIC *Trinidad and Tobago Report 1*, *supra* note 28, at 21.

⁵⁷ See, e.g., MESICIC *Chile Report 1*, *supra* note 46, at 22.

⁵⁸ See MESICIC *Belize Report 1*, *supra* note 13, at 3.

⁵⁹ See MESICIC *Ecuador Report 1*, *supra* note 15, at 5.

⁶⁰ See, e.g., MESICIC *Ecuador Report 1*, *supra* note 15, at 5; MESICIC *Peru Report 1*, *supra* note 14, at 6; MESICIC *Trinidad and Tobago Report 1*, *supra* note 28, at 5 (applying only to judges and other limited officials).

⁶¹ See, e.g., MESICIC *Belize Report 1*, *supra* note 15, at 5; MESICIC *Costa Rica Report 1*, *supra* note 14, at 6; MESICIC *Dominican Republic Report 1*, *supra* note 14, at 2; MESICIC *Ecuador Report 1*, *supra* note 15, at 3; MESICIC *Trinidad and Tobago Report 1*, *supra* note 28, at 5.

⁶² See MESICIC *Argentina Report 1*, *supra* note 13, at 9; MESICIC *Bolivia Report 1*, *supra* note 21, at 37.

⁶³ See MESICIC *Bahamas Report 1*, *supra* note 24, at 7; MESICIC *St. Vincent Report 1*, *supra* note 24, at 4; MESICIC *Trinidad and Tobago Report 1*, *supra* note 28, at 7.

⁶⁴ See, e.g., MESICIC *Bahamas Report 1*, *supra* note 24, at 7; MESICIC *Grenada Report 1*, *supra* note 2454, at 5; MESICIC *Jamaica Report 1*, *supra* note 25, at 8; MESICIC *St. Vincent Report 1*, *supra* note 24, at 5; MESICIC *Trinidad and Tobago Report 1*, *supra* note 28, at 3.

⁶⁵ See MESICIC *Belize Report 1*, *supra* note 13, at 5; MESICIC *Dominican Republic Report 1*, *supra* note 14, at 10; MESICIC *Jamaica Report 1*, *supra* note 25, at 12.

⁶⁶ See, e.g., MESICIC *Honduras Report 1*, *supra* note 14, at 9.

and conflicts of interest. A number of state parties have experienced issues with this type of splintered oversight, which can often undermine the efficacy of the conflicts of interest laws and rules that they are charged with overseeing.⁶⁷ In response, some state parties have taken measures to establish a coordinating body⁶⁸ or to generally facilitate such coordination efforts.⁶⁹ Despite all of these efforts, throughout the MESICIC review rounds there has been a consistent finding that all IACAC state parties need to strengthen conflicts of interest oversight.⁷⁰

6. Incompatibilities for Governmental Service

As a general matter, the majority of IACAC state parties have legal restrictions that render a person ineligible for public service under certain conditions, such as holding another office at the same time or prior governmental service.⁷¹ In addition, some state parties have created position-

⁶⁷ See, e.g., MESICIC *Panama Report 1*, *supra* note 53, at 8; MESICIC *Paraguay Report 1*, *supra* note 26, at 18; MESICIC *Peru Report 1*, *supra* note 14, at 23; MESICIC *St. Vincent Report 1*, *supra* note 24, at 21; MESICIC *Uruguay Report 1*, *supra* note 15, at 16–17.

⁶⁸ See, e.g., Comm. of Experts of the MESICIC, *Final Report on Implementation in the Republic of Argentina of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 45, SG/MESICIC/doc.181/06 Rev. 4 (Dec. 15, 2006) [hereinafter *MESICIC Argentina Report 2*].

⁶⁹ See e.g., Comm. of Experts of the MESICIC, *Report on Implementation in the Republic of Columbia of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 51, SG/MESICIC/doc.202/07 Rev. 4 (Dec. 7, 2007); Comm. of Experts of the MESICIC, *Report on Implementation in the Republic of Guatemala of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 47–48, SG/MESICIC/doc.217/08 Rev. 4 (June 27, 2008); Comm. of Experts of the MESICIC, *Final Report on Implementation in the Republic of Honduras of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 33, SG/MESICIC/doc.186/06 Rev. 4 (Dec. 15, 2006) [hereinafter *MESICIC Honduras Report 2*]; Comm. of Experts of the MESICIC, *Final Report on Implementation in the Republic of Nicaragua of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 30–31, SG/MESICIC/doc.183/06 Rev. 4 (Dec. 15, 2006) [hereinafter *MESICIC Nicaragua Report 2*]; Comm. of Experts of the MESICIC, *Final Report on Implementation in the Republic of Paraguay of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 26–27, SG/MESICIC/doc.182/06 Rev. 4 (Dec. 15, 2006) [hereinafter *MESICIC Paraguay Report 2*].

⁷⁰ See, e.g., MESICIC *Argentina Report 2*, *supra* note 68, at 45; MESICIC *Brazil Report 2*, *supra* note 18, at 51–52; MESICIC *Colombia Report 3*, *supra* note 34, at 51; MESICIC *Nicaragua Report 2*, *supra* note 69, at 30–31; MESICIC *Paraguay Report 2*, *supra* note 69, at 26–27; Comm. of Experts of the MESICIC, *Final Report on Implementation in the Oriental Republic of Uruguay of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 27, SG/MESICIC/doc.184/06 Rev. 4 (Dec. 15, 2006).

⁷¹ See, e.g., MESICIC *Ecuador Report 1*, *supra* note 15, at 4; MESICIC *El Salvador Report 1*, *supra* note 51, at 4; MESICIC *Grenada Report 1*, *supra* note 54, at 6; MESICIC *Guatemala Report 1*, *supra* note 18, at 3; MESICIC *Honduras Report 1*, *supra* note 14, at 4.

specific disqualifying incompatibilities, such as those for office seekers,⁷² legislative servants,⁷³ judicial officials,⁷⁴ senior members of the government,⁷⁵ other officials in general,⁷⁶ labor-related positions,⁷⁷ and certain individuals involved in the procurement process.⁷⁸ Several state parties have also extended their regulations to address incompatibilities at the local government level.⁷⁹

7. Training in Conflicts of Interest

The establishment of a meaningful conflict of interest regime cannot be fully achieved until the members of the government and the public generally understand what such regulations mean and how they apply. In recognition of this, a number of state parties have enacted publicity requirements for conflict of interest laws and regulations.⁸⁰ The MESICIC review rounds, however, have continually stressed the need for training in conflicts of interest and ethics requirements in the state party system.⁸¹

8. Regulation of Post-Governmental Service Conflicts of Interest

The ability of former civil and government servants to enter the private sector is rife with potential conflict of interest situations. In recognition of this, many IACAC state parties have enacted laws and regulations that restrict—at

⁷² See, e.g., MESICIC *Chile Report 1*, *supra* note 46, at 6; MESICIC *Colombia Report 1*, *supra* note 13, at 5; MESICIC *Ecuador Report 1*, *supra* note 15, at 4.

⁷³ See, e.g., MESICIC *Bahamas Report 1*, *supra* note 24, at 9.

⁷⁴ See, e.g., MESICIC *Bolivia Report 1*, *supra* note 21, at 5; MESICIC *Colombia Report 1*, *supra* note 13, at 4; MESICIC *El Salvador Report 1*, *supra* note 51, at 3; MESICIC *USA Report 1*, *supra* note 13, at 8.

⁷⁵ See, e.g., MESICIC *Guatemala Report 1*, *supra* note 18, at 3; MESICIC *Peru Report 1*, *supra* note 14, at 4; MESICIC *Suriname Report 1*, *supra* note 26, at 3.

⁷⁶ See, e.g., MESICIC *Bolivia Report 1*, *supra* note 21, at 4.

⁷⁷ See, e.g., MESICIC *Chile Report 1*, *supra* note 46, at 7.

⁷⁸ See, e.g., MESICIC *El Salvador Report 1*, *supra* note 51, at 5; MESICIC *Nicaragua Report 1*, *supra* note 14, at 3.

⁷⁹ See MESICIC *Panama Report 1*, *supra* note 53, at 7–8; MESICIC *Paraguay Report 1*, *supra* note 26, at 1–2.

⁸⁰ See, e.g., MESICIC *Nicaragua Report 1*, *supra* note 14, at 3; MESICIC *Trinidad and Tobago Report 1*, *supra* note 28, at 13; MESICIC *Uruguay Report 1*, *supra* note 15, at 7; MESICIC *USA Report 1*, *supra* note 13, at 10–11.

⁸¹ See MESICIC *Colombia Report 2*, *supra* note 69, at 45–46; MESICIC *Ecuador Report 2*, *supra* note 48, at 34; Comm. of Experts of the MESICIC, *Report on Implementation in El Salvador of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 31, SG/MESICIC/doc.205/07 Rev. 4 (Dec. 7, 2007); MESICIC *Honduras Report 2*, *supra* note 69, at 27; Comm. of Experts of the MESICIC, *Final Report on Implementation in the Republic of Trinidad and Tobago of the Convention Provisions Selected for Review in the Second Round, and on Follow-Up to the Recommendations Formulated to that Country in the First Round*, at 23, SG/MESICIC/doc.195/07 Rev. 4 (June 29, 2007).

least temporarily—the ability of these former public officials to enter into negotiations or contracts with governmental entities.⁸²

Government contracting and procurement is the most commonly referenced area where these types of conflicts of interest occur. As a result, several state parties have created conflict of interest-based restrictions for government contracts.⁸³ Other state parties have created restrictions that bar former state officials and employees from the contracting process,⁸⁴ and El Salvador has created a specific procurement oversight body to handle the issue.⁸⁵

During the MESICIC review rounds, Chile has noted that it is attempting to strengthen its restrictions on this form of conflict of interest regulations.⁸⁶ Overall, the MESICIC reviewers have noted that there are additional possibilities for strengthening these suggestions for certain state parties.⁸⁷

9. Relationship Between Federal/National Implementation and Municipal/Local Implementation

Conflict of interest laws and regulations that stem from the IACAC are often not implemented beyond the national or federal level.⁸⁸ This limitation, however, can stand in the way of fully realizing the purpose of the conflict of interest provisions, as identified in the Argentinean review round reports.⁸⁹ As a result, the MESICIC review rounds have continually stressed the need to ensure that the appropriate conflict of interest provisions extend to the local and municipal level.⁹⁰

Overall, while the MESICIC review rounds have highlighted many areas in which progress needs to be made for the terms of the IACAC to be fully implemented, these findings are beneficial in that they demonstrate the power of the review entity. Rather than serving as a rubber stamp, the MESICIC process is able to function as a meaningful entity that assists the IACAC state parties in realizing the full reform potentials of their convention commitments.

⁸² See, e.g., MESICIC *Belize Report 1*, *supra* note 13, at 4; MESICIC *Bolivia Report 1*, *supra* note 21, at 5; MESICIC *Canada Report 1*, *supra* note 49, at 4; MESICIC *Colombia Report 1*, *supra* note 13, at 4; MESICIC *Venezuela Report 1*, *supra* note 44, at 43.

⁸³ See, e.g., MESICIC *Colombia Report 1*, *supra* note 13, at 3.

⁸⁴ See, e.g., MESICIC *Panama Report 2*, *supra* note 26, at 12.

⁸⁵ See MESICIC *El Salvador Report 1*, *supra* note 51, at 5.

⁸⁶ MESICIC *Chile Report 2*, *supra* note 48, at 46–48.

⁸⁷ See, e.g., MESICIC *Belize Report 1*, *supra* note 13, at 20; MESICIC *El Salvador Report 1*, *supra* note 51, at 31; MESICIC *Honduras Report 1*, *supra* note 14, at 36; MESICIC *Nicaragua Report 1*, *supra* note 14, 16–17; MESICIC *Panama Report 1*, *supra* note 53, at 32–33.

⁸⁸ See MESICIC *Bolivia Report 1*, *supra* note 21, at 2; MESICIC *Brazil Report 1*, *supra* note 13, at 4; MESICIC *Canada Report 1*, *supra* note 49, at 2–3 (noting however that although the treaty is at a federal level, all levels of government participate where necessary); MESICIC *USA Report 1*, *supra* note 13, at 3–4; MESICIC *Venezuela Report 1*, *supra* note 44, at 6–7, 42.

⁸⁹ See MESICIC *Argentina Report 1*, *supra* note 13, at 4.

⁹⁰ See *id.* at 5; MESICIC *Brazil Report 1*, *supra* note 13, at 4; MESICIC *Venezuela Report 1*, *supra* note 44, at 12.

II. GRECO

A. *GRECO Conflicts of Interest Provisions*

GRECO was established in 1999 under the auspices of the Council of Europe.⁹¹ GRECO was formed in response to the Programme of Action against Corruption, which was adopted by the Council's Committee of Ministers in 1996, as well as various joint and individual policy statements against corruption made by the governments of European Union member states.⁹² Notably, all EU member states are also members of GRECO, along with several non-EU member states, such as Switzerland and the United States.⁹³ While there have been other EU action plans regarding corruption, and the European Commission even created the European Anti-Fraud Office ("OLAF") after GRECO was established, GRECO is currently the predominant provider of reports and analysis regarding member state actions effecting corruption.⁹⁴ As discussed below, it is expected that an EU-specific anti-corruption reporting mechanism will be in effect in 2013.⁹⁵ This mechanism, however, has not yet been implemented, and the lack of available information has prompted even the European Commission to acknowledge the need for member states to cooperate with the GRECO review mechanism in order to determine the levels of compliance with anti-corruption measures.⁹⁶

The recognition of the social and economic ills that corruption brings and the need for a concerted domestic and regional effort to combat them is a key justification for GRECO's founding.⁹⁷ In order to identify and address such issues, the GRECO states empowered GRECO as an entity to advise member states on the suitability of their anti-corruption practices and on potential corrective efforts that could be taken by member states to eradicate corruption.⁹⁸ The requirements that review reports be generated for all GRECO states—

⁹¹ See Comm. of Ministers, *Agreement Establishing the Group of States Against Corruption - GRECO-*, 102d Sess., Res. 98(7), at 5 (1998), Res. 99(5), at 6–7 (1999).

⁹² Comm. of Ministers, *Agreement Establishing the Group of States Against Corruption*, 102d Sess., Res. 98(7), at 5 (1998).

⁹³ See *GRECO: Members and Observers*, GRP. OF STATES AGAINST CORRUPTION, COUNCIL OF EUR., http://www.coe.int/t/dghl/monitoring/greco/general/members_en.asp (last visited Mar. 15, 2013).

⁹⁴ Commission Decision 1999/352, of 28 April 1999 establishing the European Anti-Fraud Office (OLAF), pmbL., art. 1, 1999 O.J. (L 136) 20 (EC).

⁹⁵ See Commission Decision, of 6.6.2011 Establishing an EU Anti-corruption reporting mechanism for periodic assessment ("EU Anti-Corruption Report"), arts. 1–2(a), 4, C (2011) 3673 final [hereinafter Commission Decision *EU Anti-Corruption Report*].

⁹⁶ *Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee, Fighting Corruption in the EU*, at 8, COM (2011) 308 final (June 6, 2011); see *Corruption*, DIRECTORATE GEN., EUROPEAN COMMISSION, http://ec.europa.eu/dgs/home-affairs/what-we-do/policies/organized-crime-and-human-trafficking/corruption/index_en.htm (last updated Oct. 26, 2012).

⁹⁷ See Comm. of Ministers, *Agreement Establishing the Group of States Against Corruption - GRECO-*, 102d Sess., Res. (99)5, at 6 (1999).

⁹⁸ *Id.* at 9.

similar to the MESICIC review reports⁹⁹—and that GRECO monitor the overall activities of member states in areas that effect anti-corruption efforts are essential aspects of this function.¹⁰⁰ Conflicts of interest, along with associated policy areas which lead to or perpetuate them, have been evaluated and discussed throughout the GRECO review reports and have yielded telling information.

B. *Evaluation Trends*

1. General Conflicts of Interests Laws

The GRECO review mechanism evaluates the conflict of interest laws, rules and regulations promulgated by member states, as well as any relevant draft laws, in order to determine their overall strength and efficacy.¹⁰¹ Interestingly, unlike the MESICIC mechanism discussed earlier, GRECO evaluations extend to the implementation of conflicts of interest protections at the local or municipal level, as well as at the national or federal level.¹⁰²

A significant number of member states were identified as having passable laws, rules and regulations at the federal or national level,¹⁰³ while a far smaller number of member states were identified as having passable laws, rules and regulations at the local or municipal level.¹⁰⁴ Some member states were identified as having limited or weak conflict of interest laws, rules and regulations,¹⁰⁵ and a handful were identified as having limited or weak conflict of interest laws, rules and regulations at the local or municipal level.¹⁰⁶

⁹⁹ *Id.* at 10, 13–14.

¹⁰⁰ *Id.* at 6.

¹⁰¹ GRECO *Evaluations*, GRP. OF STATES AGAINST CORRUPTION, COUNCIL OF EUR., http://www.coe.int/t/dghl/monitoring/greco/evaluations/index_en.asp (last visited Mar. 15, 2013).

¹⁰² *See id.* (containing links to electronic copies of all rounds of evaluation reports).

¹⁰³ *See, e.g.*, GRECO, *First Evaluation Round, Evaluation Report on Belgium*, at 3, Greco Eval I Rep (2000) 1E Final (Dec. 15, 2000); GRECO, *First Evaluation Round, Evaluation Report on the Czech Republic*, at 4–5, Greco Eval I Rep (2002) 11E Final (Mar. 28, 2003); GRECO, *First Evaluation Round, Evaluation Report on Denmark*, at 21, Greco Eval I Rep (2002) 6E Final (July 11, 2002) [hereinafter GRECO *Denmark Report 1*]; GRECO, *First Evaluation Round, Evaluation Report on France*, at 5, Greco Eval I Rep (2001) 4E Final (Sept. 14, 2001) [hereinafter GRECO *France Report 1*]; GRECO, *First Evaluation Round, Evaluation Report on Georgia*, at 3, Greco Eval I Rep (2001) 5E Final (June 15, 2001) [GRECO *Georgia Report 1*]. The countries identified also include: Greece, Hungary, Iceland, Italy, Latvia, Monaco, Poland, Serbia, Slovakia, Spain, Switzerland, the Ukraine, the United Kingdom, and the United States.

¹⁰⁴ *See* GRECO, *Second Evaluation Round, Evaluation Report on the Czech Republic*, at 14, 18, Greco Eval II Rep (2005) 7E (May 12, 2006) [hereinafter GRECO *Czech Republic Report 2*]; GRECO, *Third Evaluation Round, Evaluation Report on Georgia on Incriminations*, at 21, Greco Eval III Rep (2010) 12E (May 27, 2011); GRECO, *Second Evaluation Round, Evaluation Report on Hungary*, at 15, Greco Eval II Rep (2005) 5E (Mar. 10, 2006) [hereinafter GRECO *Hungary Report 2*]; GRECO, *Second Evaluation Round, Evaluation Report on Spain*, at 14, Greco Eval II Rep (2004) 7E (May 20, 2005) [hereinafter GRECO *Spain Report 2*].

¹⁰⁵ *See, e.g.*, GRECO, *Joint First and Second Evaluation Rounds, Evaluation Report on Andorra*, at 31, Greco Eval I-II Rep (2006) 1E (Dec. 8, 2006) [hereinafter GRECO *Andorra Report 1/2*]; GRECO, *Joint First and Second Round, Evaluation Report on Armenia*, at 30, Greco Eval I-II Rep (2005) 2E (Mar. 10, 2006) [hereinafter GRECO *Armenia Report 1/2*]; GRECO, *Joint First and*

During the periods of GRECO review evaluations, the GRECO review body consistently recommended that states strengthen their conflict of interest laws, rules and regulations.¹⁰⁷ At the same time, several member states also enacted new conflict of interest laws that were intended to further compliance with the GRECO standards,¹⁰⁸ and several other member states were considering draft laws that would strengthen the conflicts of interest protections in these states.¹⁰⁹

2. Conflict of Interest Definitions

When evaluating conflicts of interest provisions it is, perhaps obviously, important to understand how the legal system being evaluated defines conflicts of interest. The GRECO review evaluations found that a majority of the member states had passable or well-defined conflict of interest laws.¹¹⁰ Interestingly, most of these states had defined “conflict of interest” through relatively new laws and rules.¹¹¹ Several member states, however, were

Second Evaluation Rounds, Evaluation Report on Azerbaijan, at 32–33, Greco Eval I-II Rep (2005) 5E (June 23, 2006) [hereinafter *GRECO Azerbaijan Report 1/2*]; GRECO, *First Evaluation Round, Evaluation Report on Bosnia and Herzegovina*, at 25, Greco Eval I Rep (2002) 10E (July 11, 2003); GRECO, *First Evaluation Round, Evaluation Report on Croatia*, at 32, Greco Eval I Rep (2002) 4E Final (May 17, 2002) [hereinafter *GRECO Croatia Report 1*]. The countries identified also include Georgia, Luxembourg, Monaco, Poland, Romania, and Russia. See *GRECO Evaluations*, *supra* note 101 for the remaining reports.

¹⁰⁶ See GRECO, *Joint First and Second Evaluation Round, Evaluation Report on Austria*, at 37, Greco Eval I-II Rep (2007) 2E (June 13, 2008) [hereinafter *GRECO Austria Report 1/2*]; GRECO, *Joint First and Second Evaluation Rounds, Evaluation Report on Switzerland*, at 33–34, Greco Eval I-II Rep (2007) 1E (Apr. 4, 2008) [hereinafter *GRECO Switzerland Report 1/2*].

¹⁰⁷ See, e.g., GRECO *Andorra Report 1/2*, *supra* note 105, at 32, 39; GRECO *Croatia Report 1*, *supra* note 105, at 16, 32; GRECO, *First Evaluation Round, Evaluation Report on Romania*, at 19–20, 26, Greco Eval I Rep (2001) 13E Final (Mar. 8, 2002); GRECO, *Joint First and Second Evaluation Rounds, Evaluation Report on the Russian Federation*, at 64, 78, Greco Eval I-II (2008) 2E (Dec. 5, 2008) [hereinafter *GRECO Russia Report 1/2*]; GRECO *Switzerland Report 1/2*, *supra* note 106, at 43.

¹⁰⁸ See, e.g., GRECO, *First Evaluation Round, Evaluation Report on Bulgaria*, at 5, 18, Greco Eval I Rep (2001) 14E Final (May 17, 2002) [hereinafter *GRECO Bulgaria Report 1*]; GRECO *Georgia Report 1*, *supra* note 103, at 3; GRECO, *Second Evaluation Round, Evaluation Report on Greece*, at 12–13, 17, Greco Eval II Rep (2005) 6E (Dec. 9, 2005) [hereinafter *GRECO Greece Report 2*]; GRECO *Hungary Report 2*, *supra* note 104, at 13–15; GRECO, *Joint First and Second Round, Evaluation Report on Italy*, at 33–36, Greco Eval I/II Rep (2008) 2E (July 2, 2009) [hereinafter *GRECO Italy Report 1/2*].

¹⁰⁹ See GRECO *Azerbaijan Report 1/2*, *supra* note 105, at 31, 33–34; GRECO *Croatia Report 1*, *supra* note 105, at 30; GRECO, *Second Evaluation Round, Evaluation Report on Luxembourg*, at 23, Greco Eval II Rep (2003) 5E (May 14, 2004) [hereinafter *GRECO Luxembourg Report 2*]; GRECO, *Joint First and Second Evaluation Rounds, Evaluation Report on Ukraine*, at 35, Greco Eval I-II Rep (2006) 2E (Mar. 21, 2007) [hereinafter *GRECO Ukraine Report 1*].

¹¹⁰ See, e.g., GRECO *Austria Report 1/2*, *supra* note 106, at 32, 37; GRECO *Croatia Report 1*, *supra* note 105, at 26; GRECO *Czech Republic Report 2*, *supra* note 104, at 14–17; GRECO, *Second Evaluation Round, Evaluation Report on Georgia*, at 15–16, 18, Greco Eval II Rep (2006) 2E (Dec. 8, 2008) [hereinafter *GRECO Georgia Report 2*]; GRECO *Greece Report 2*, at 12–13, 17.

¹¹¹ See, e.g., GRECO *Austria Report 1/2*, *supra* note 106, at 32; GRECO *Czech Republic Report 2*, *supra* note 104, at 14; GRECO *Greece Report 2*, *supra* note 108, at 12–13.

identified as having weak or insufficient conflict of interest definitions.¹¹² Further, the GRECO review reports noted that several states were working on draft legislation which would enact or expand their definition of conflicts of interest as a matter of law.¹¹³

3. Codes of Conduct/Ethics

Several GRECO member states have indicated that they have enacted national codes of conduct with wide-ranging impacts on their governments and society.¹¹⁴ Some of these codes, however, although in existence, have limited effects because they are based on extremely broad definitions or are discretionary in terms of certain applications.¹¹⁵ Several codes were identified as being generally weak,¹¹⁶ and others have been created but are not yet fully implemented.¹¹⁷

¹¹² See GRECO *Armenia Report 1/2*, *supra* note 105, at 13–14; GRECO, *Second Evaluation Round, Evaluation Report on Belgium*, at 15–16, Greco Eval II Rep (2004) 1E (Dec. 2, 2004) [hereinafter GRECO *Belgium Report 2*]; GRECO, *Second Evaluation Round, Compliance Report on Bosnia and Herzegovina*, at 7–8, Greco RC-II (2008) 7E (Feb. 19, 2009) [hereinafter GRECO *Bosnia and Herzegovina Report 2*]; GRECO, *Joint First and Second Evaluation Rounds, Compliance Report on Monaco*, at 24, Greco RC-I/II (2010) 3E (Oct. 1, 2010) [hereinafter GRECO *Monaco Report 1/2*]; GRECO, *Joint First and Second Evaluation Rounds, Compliance Report on Montenegro*, at 13–14, Greco RC-I/II (2008) SE (Dec. 5, 2008) [hereinafter GRECO *Montenegro Report 1/2*].

¹¹³ See GRECO *Hungary Report 2*, *supra* note 104, at 7–8; GRECO *Montenegro Report 1/2*, *supra* note 102, at 13–15; GRECO, *Joint First and Second Evaluation Rounds, Compliance Report on the Republic of Serbia*, at 14, Greco RC-I/II (2008) 1E (June 13, 2008).

¹¹⁴ See, e.g., GRECO *Austria Report 1/2*, *supra* note 106, at 16; GRECO, *First Evaluation Round, Evaluation Report on “the Former Yugoslav Republic of Macedonia,”* at 23, Greco Eval I Rep (2002) 7E Final (Dec. 10, 2002) [GRECO *Macedonia Report 1*]; GRECO, *First Evaluation Round, Evaluation Report on Malta*, at 4, Greco Eval I Rep (2002) 8E Final (Dec. 13, 2002) [hereinafter GRECO *Malta Report 1*]; GRECO, *Second Evaluation Round, Compliance Report on Romania*, at 9–10, Greco RC-II (2007) 9E (Dec. 7, 2007) [hereinafter GRECO *Romania Report 2*]; GRECO, *First Evaluation Round, Evaluation Report on the United Kingdom*, at 6–7, Greco Eval I Rep (2001) 8E Final (Sept. 14, 2001) [hereinafter GRECO *UK Report 1*].

¹¹⁵ See GRECO *Czech Republic Report 2*, *supra* note 104, at 15; GRECO, *Second Evaluation Round, Evaluation Report on Estonia*, at 14, Greco Eval II Rep (2003) 4E (July 2, 2004) [hereinafter GRECO *Estonia Report 2*]; GRECO *Georgia Report 1*, *supra* note 103, at 7 (explaining that the code excludes certain high level actors); GRECO *Malta Report 1*, *supra* note 114, at 7 (explaining that the applicable code is weak in terms of application to customs officials); GRECO *UK Report 1*, *supra* note 114, at 6 (explaining that the applicable code is weak in terms of punishments for violations).

¹¹⁶ See, e.g., GRECO *Second Evaluation Round, Evaluation Report on Finland*, at 14, Greco Eval II Rep (2003) 3E (July 2, 2004) [hereinafter GRECO *Finland Report 2*]; GRECO *Second Evaluation Round, Evaluation Report on Slovenia*, at 12, Greco Eval II Rep (2003) 1E (Dec. 12, 2003).

¹¹⁷ See, e.g., GRECO *Italy Report 1/2*, *supra* note 108, at 33; GRECO *Second Evaluation Round, Compliance Report on Portugal*, at 9–10, Greco RC-II (2008) 2E (Oct. 10, 2008) [hereinafter GRECO *Portugal Report 2*].

While some member states have opted for national codes of conduct or ethics, other member states have opted for codes that apply to certain entities and areas, such as administrative agencies¹¹⁸ and quasi-governmental entities.¹¹⁹

4. Disclosure and Reporting Requirements

The GRECO reviews found that a majority of member states have passable reporting requirements for conflict of interest violations or potential violations.¹²⁰ Other member states were found to have limited reporting requirements with identified flaws,¹²¹ and Iceland was found not to have an express reporting requirement.¹²² Further, the Czech Republic was found to have problems applying the reporting requirements at both the local and national levels.¹²³

5. Existence and Creation of Oversight Bodies

A majority of the member states that were identified as having central anti-corruption oversight bodies used either a universal ombudsman or a corruption committee framework.¹²⁴ For example, France reported using an ethics committee,¹²⁵ and Estonia reported using a parliamentary committee for

¹¹⁸ See GRECO *Bulgaria Report 1*, *supra* note 108, at 8; GRECO *Ukraine Report 1*, *supra* note 109, at 18.

¹¹⁹ See GRECO, *First Evaluation Round, Evaluation Report on Iceland*, at 11, Greco Eval I Rep (2001) 10E Final (Sept. 14, 2001) [hereinafter GRECO *Iceland Report 1*].

¹²⁰ See, e.g., GRECO *Austria Report 1/2*, *supra* note 106, at 15; GRECO *Czech Republic Report 2*, *supra* note 104, at 14 n.27; GRECO *Estonia Report 2*, *supra* note 115, at 11; GRECO *Finland Report 2*, *supra* note 116, 13–15; GRECO *Georgia Report 1*, *supra* note 103, at 10. Other states with passable reporting requirements include: Italy, Latvia, Moldova, the Netherlands, Portugal, Slovenia, Sweden, the Ukraine, the United Kingdom, and the United States. See GRECO *Evaluations*, *supra* note 101 for the remaining reports.

¹²¹ See GRECO *Armenia Report 1/2*, *supra* note 105, at 17, 31–32 (explaining that reporting requirements are for tax purposes rather than strictly COI and there were limited punishments for failure to report); GRECO *Belgium Report 2*, *supra* note 112, at 13 (explaining that reporting requirement applies to only some public servants); GRECO *Croatia Report 1*, *supra* note 105, at 11 (explaining that reporting requirements identified as weak); GRECO *Luxembourg Report 2*, *supra* note 109, at 12 (finding that there were many loopholes in the reporting requirements); GRECO *Montenegro Report 1/2*, *supra* note 112, at 23 (explaining that reporting requirements identified as weak); GRECO *Romania Report 2*, *supra* note 114, at 16–17, 23 (finding that there were many loopholes and that the reporting requirements were essentially limited in scope); GRECO *Switzerland Report 1/2*, *supra* note 106, at 29 (finding that there were limited reporting requirements).

¹²² See GRECO, *Second Evaluation Round, Evaluation Report on Iceland*, at 10, Greco Eval II Rep (2003) 7E (July 2, 2004) [hereinafter GRECO *Iceland Report 2*].

¹²³ See GRECO *Czech Republic Report 2*, *supra* note 104, at 17.

¹²⁴ See GRECO, *First Evaluation Round, Evaluation Report on Greece*, at 13, Greco Eval I Rep (2001) 15E (May 17, 2002) [hereinafter *Greece Report 1*]; GRECO, *First Evaluation Round, Evaluation Report on Latvia*, at 4–5, Greco Eval I Rep (2002) 2E (May 17, 2002) [hereinafter GRECO *Latvia Report 1*]; GRECO *Montenegro Report 1/2*, *supra* note 112, at 11–12; GRECO *Romania Report 2*, *supra* note 107, at 8.

¹²⁵ See GRECO, *Second Evaluation Round, Evaluation Report on France*, at 10, Greco Eval II Rep (2004) 5E (Dec. 2, 2004) [hereinafter GRECO *France Report 2*].

oversight issues.¹²⁶ Bosnia and Herzegovina, on the other hand, has created an oversight body mechanism.¹²⁷

6. Incompatibilities

A number of GRECO member states have anti-corruption laws that apply to public servants, in general, with the purpose of distinguishing which forms of conflicts of interest or incompatibilities are passable.¹²⁸ GRECO review reports, on the other hand, have identified several member states with weak incompatibilities laws.¹²⁹ Some of the specialized restrictions that have been enacted target incompatibilities that arise in contract solicitations and negotiations,¹³⁰ in the concurrent holding of multiple offices,¹³¹ in potentially conflicting business interests,¹³² in judicial situations,¹³³ and in relation to membership of and certain activities in political parties and associations.¹³⁴ France was found to have established a committee to determine whether an incompatibility might exist prior to it actually occurring.¹³⁵

7. Conflicts of Interest in the Procurement Process

In general, GRECO review reports have identified conflicts of interest in the procurement process as an area of particular concern. The reports have revealed that only a few members have laws that are overall passable¹³⁶ and that

¹²⁶ See GRECO, *First Evaluation Round, Evaluation Report on Estonia*, at 14–15, Greco Eval I Rep (2001) 7E (Sept. 14, 2001).

¹²⁷ See GRECO *Bosnia and Herzegovina Report 2*, *supra* note 112, at 8.

¹²⁸ See, e.g., GRECO *Austria Report 1/2*, *supra* note 106, at 118; GRECO *Second Evaluation Round, Evaluation Report on Denmark*, at 7, Greco Eval II Rep (2004) 6E (Mar. 18, 2005) [hereinafter GRECO *Denmark Report 2*]; GRECO *Estonia Report 2*, *supra* note 115, at 10–11; GRECO *France Report 1*, *supra* note 103, at 17; GRECO *Italy Report 1/2*, *supra* note 108, at 45.

¹²⁹ See GRECO *Luxembourg Report 2*, *supra* note 109, at 12; GRECO *Monaco Report 1/2*, *supra* note 112, at 22.

¹³⁰ See GRECO *Austria Report 1/2*, *supra* note 106, at 30–31.

¹³¹ See GRECO *Czech Republic Report 2*, *supra* note 104, at 14; GRECO *Monaco Report 1/2*, *supra* note 112, at 22.

¹³² See GRECO *Czech Republic Report 2*, *supra* note 104, at 14; GRECO *Estonia Report 2*, *supra* note 115, at 10–11; GRECO *Monaco Report 1/2*, *supra* note 112.

¹³³ See GRECO *Monaco Report 1/2*, *supra* note 112, at 22; GRECO *Switzerland Report 1*, *supra* note 106, at 28; GRECO, *First Evaluation Round, Evaluation Report on the United States of America*, at 7, Greco Eval I Rep (2003) 2E (Mar. 25, 2004) [hereinafter GRECO *United States Report 1*].

¹³⁴ See GRECO *Estonia Report 2*, *supra* note 115, at 7–8; GRECO, *Joint First and Second Evaluation Round, Evaluation Report on the Republic of Serbia*, at 10, Greco Eval I-II Rep (2005) 1E Revised (June 23, 2006).

¹³⁵ See GRECO *France Report 1*, *supra* note 103, at 17.

¹³⁶ See GRECO, *Second Round Evaluation, Evaluation Report on “the former Yugoslav Republic of Macedonia”*, at 10, Greco Eval II Rep (2004) 11E (Oct. 14, 2005) [hereinafter GRECO *Macedonia Report 2*]; GRECO, *Second Evaluation Report, Evaluation of the United States*, at 32–33, Greco Eval II Rep (2005) 10E (Oct. 13, 2006).

other states need to rework their laws in this area.¹³⁷ Some states, however, were identified as having effective conflict of interest provisions for procurement in certain agencies¹³⁸ and the ability to annul contracts when there are issues with the procurement process.¹³⁹

8. Conflicts of Interest and Gifts

Giving gifts to public officials and employees can carry implicit and/or explicit expectations that amount to issues of conflicts of interest. Accordingly, the GRECO review reports have found that some member states have gift regulations in order to address and prevent the potential for conflicts of interest.¹⁴⁰ Other states, however, have weak laws on this topic.¹⁴¹

9. Conflicts of Interest in the Electoral Sector

The issue of conflicts of interest is highly associated with the electoral sector, perhaps because of the role that campaign contributions and other methods of support can superficially or actually have on the actions of an elected candidate. The GRECO review reports have identified that, under the terms of the GRECO review standards, some states had passable conflict of interest election laws,¹⁴² some states had limited or weak conflict of interest election laws,¹⁴³ and a few states had no conflict of interest election laws.¹⁴⁴

¹³⁷ See GRECO *Latvia Report 1*, *supra* note 124, at 16–18; GRECO *Romania Report 2*, *supra* note 114, at 16–17; GRECO, *First Evaluation Round, Evaluation Report on Sweden*, at 16–17, Greco Eval I Rep (2001) 3E Final (June 15, 2001).

¹³⁸ See GRECO, *First Evaluation Round, Evaluation Report on Germany*, at 14, Greco Eval I Rep (2001) 12E Final (Mar. 8, 2002) (relating to the Defense Ministry).

¹³⁹ See GRECO *Croatia Report 1*, *supra* note 105, at 22.

¹⁴⁰ See, e.g., GRECO *Czech Republic Report 2*, *supra* note 104, at 15; GRECO *Georgia Report 2*, *supra* note 110, at 16–17; GRECO *Third Evaluation Round, Evaluation Report on Iceland, Incriminations (ETS 173 and 191, GPC 2)*, at 3–9, Greco Eval III Rep (2007) 7E (Apr. 4, 2008); GRECO *Portugal Report 2*, *supra* note 117, at 12; GRECO *Third Evaluation Round, Evaluation Report on “the former Yugoslav Republic of Macedonia,” Incriminations (ETS 173 and 191, GPC 2)*, at 3–8, Greco Eval III Rep (2009) 6E (Mar. 26, 2010).

¹⁴¹ See GRECO *Montenegro Report 1/2*, *supra* note 112, at 23.

¹⁴² See GRECO *Third Evaluation Round, Evaluation Report on Hungary, Transparency of Party Funding*, at 13, Greco Eval III Rep (2009) 8E (June 11, 2010); GRECO *Third Evaluation Round, Evaluation Report on Iceland, Transparency of Party Funding*, at 4, Greco Eval III Rep (2007) 7E (Apr. 4, 2008); GRECO *Third Evaluation Round, Evaluation Report on Portugal, Transparency of Party Funding*, at 14, Greco Eval III (2010) 6E (Dec. 3, 2010); GRECO *Third Evaluation Round, Evaluation Report on Slovenia on Transparency of Party Funding*, at 17, Greco Eval III Rep (2007) 1E (Dec. 7, 2007).

¹⁴³ See, e.g., GRECO, *Third Evaluation Round, Evaluation report on Andorra, Transparency of Political Party Funding*, at 18, Greco Eval III Rep (2010) 11E (May 27, 2011); GRECO, *Third Evaluation Round, Evaluation Report on Georgia on Transparency of party funding*, at 23, Greco Eval III Rep (2010) 12E (May 27, 2011); GRECO, *Third Evaluation Round, Evaluation Report on Latvia on Transparency of Party Funding*, at 20–21, Greco Eval III Rep (2008) 1E (Oct. 10, 2008); GRECO, *Third Evaluation Round, Evaluation Report on Montenegro, Transparency of Party Funding*, at 25, Greco Eval III Rep (2010) 7E (Dec. 3, 2010); GRECO, *Third Evaluation Round, Evaluation Report on the Netherlands on “Transparency of Party Funding,”* at 25, Greco Eval III Rep (2007) 8E (June 13, 2008).

10. Training in Conflicts of Interest

As noted in previous sections, training government officials and employees, as well as society in general, in conflicts of interest laws and rules and their applicability is essential to combatting conflicts of interest as a whole. The GRECO review reports found that some state parties use training exercises within governmental departments to raise awareness of their conflict of interest provisions,¹⁴⁵ while others use guidelines and pamphlets,¹⁴⁶ public awareness campaigns,¹⁴⁷ and/or programs to educate administrators on how to identify and handle conflicts of interest.¹⁴⁸ Still, GRECO review reports have suggested that some state parties could improve their training systems for addressing conflicts of interests.¹⁴⁹

In addition to governmental training *per se*, the GRECO review reports have highlighted the importance of enacting rules related to conflicts of interest and auditing in the corporate sphere.¹⁵⁰

11. Pantouflage Issues¹⁵¹

Several state parties were identified in GRECO review reports as having decent or passable pantouflage laws.¹⁵² Almost as many state parties, however, have no pantouflage laws at all.¹⁵³ Between these extremes, the GRECO review

¹⁴⁴ See GRECO, *Third Evaluation Round, Evaluation Report on Armenia on Transparency of party funding*, at 12, 18, Greco Eval III Rep (2010) 4E (Dec. 3, 2010); GRECO, *Third Evaluation Round, Evaluation Report on Denmark on Transparency of Party Funding*, at 10, 15, Greco Eval III Rep (2008) 9E (July 2, 2009).

¹⁴⁵ See GRECO *Azerbaijan Report 1/2*, *supra* note 105, at 8; GRECO, *Second Evaluation Round, Evaluation Report on Bulgaria*, at 11, GrecoEval II Rep (2004) 13E (July 1, 2005) [hereinafter GRECO *Bulgaria Report 2*]; GRECO *Hungary Report 2*, *supra* note 104, at 12; GRECO *Romania Report 2*, *supra* note 107, at 10–15; GRECO *Ukraine Report 1*, *supra* note 109, at 20.

¹⁴⁶ See GRECO *Belgium Report 2*, *supra* note 112, at 11; GRECO, *Second Evaluation Round, Evaluation Report on Sweden*, at 11, Greco Eval II Rep (2004) 9E (Mar. 18, 2005) [hereinafter GRECO *Sweden Report 2*].

¹⁴⁷ See GRECO *Latvia Report 1*, *supra* note 124, at 26.

¹⁴⁸ See GRECO *Sweden Report 2*, *supra* note 146, at 11.

¹⁴⁹ See GRECO *Schweiz Report 1/2*, *supra* note 106, at 34; GRECO *Ukraine Report 1/2*, *supra* note 109, at 41.

¹⁵⁰ See GRECO *Belgium Report 2*, *supra* note 112, at 23–24; GRECO *Denmark Report 1*, *supra* note 103, at 19–20; GRECO *Iceland Report 1*, *supra* note 119, at 11; GRECO *Luxembourg Report 2*, *supra* note 109, at 22; GRECO *Macedonia Report 2*, *supra* note 136, at 20–21.

¹⁵¹ As used in the GRECO context, pantouflage refers to instances where public officers/employees leave public service, enter the private sector and attempt to use their previously existing governmental relationships for private gain.

¹⁵² See, e.g., GRECO *Bulgaria Report 2*, *supra* note 145, at 12; GRECO *France Report 2*, *supra* note 125, at 11–12; GRECO, *Second Evaluation Round, Evaluation Report on Malta*, at 9–10, Greco Eval II Rep (2004) 14E (July 1, 2005); GRECO, *Second Evaluation Round, Evaluation Report on Moldova*, at 15–16, Greco Eval II Rep (2006) [hereinafter GRECO *Moldova Report 2*].

¹⁵³ See GRECO *Belgium Report 2*, *supra* note 112, at 12–13; GRECO *Finland Report 2*, *supra* note 114, at 11; GRECO, *Second Evaluation Round, Evaluation Report on Germany*, at 11, Greco

reports have identified other states with limited pantouflage laws.¹⁵⁴ Furthermore, at the time of the last GRECO review, some state parties had proposed pantouflage laws that were in the process of being considered or enacted.¹⁵⁵

In some contexts, limiting the pantouflage opportunities of some state parties is actually quite controversial. There is an argument that, in some societies, pantouflage is an accepted practice that is necessary given the small size of the particular state and the expertise of the individuals in question.¹⁵⁶ Despite this view, the GRECO review reports have continually offered suggestions on how these states, and other states, might strengthen their pantouflage laws.¹⁵⁷

The GRECO review reports have also found that there are related issues regarding privatization and conflicts of interest that often implicate pantouflage.¹⁵⁸ Another pantouflage issue, which the GRECO review reports have further addressed, is whether family members have interests which would be implicated under standard pantouflage laws.¹⁵⁹

12. Local and Municipal Powers Regarding Conflicts of Interest

Since conflicts of interest are important issues at the local level, as well as at the national level, the GRECO review reports have paid special attention to applicable municipal laws. These review reports have found that many state parties have passable laws and rules regarding conflicts of interest at the local level,¹⁶⁰ although there have been some issues with implementation.¹⁶¹ Other

Eval II Rep (2004) 10E (July 1, 2005); GRECO *Iceland Report 2*, *supra* note 122, at 9; GRECO *Switzerland Report 1/2*, *supra* note 106, at 28.

¹⁵⁴ See, e.g., GRECO *Austria Report 1/2*, *supra* note 106, at 31–32; GRECO *Bosnia & Herzegovina Report 2*, *supra* note 112, at 14; GRECO *Czech Republic Report 2*, *supra* note 104, at 15; GRECO *Hungary Report 2*, *supra* note 104, at 12; GRECO *Luxembourg Report 2*, *supra* note 109, at 11.

¹⁵⁵ See GRECO *Azerbaijan Report 1/2*, *supra* note 105, at 4; GRECO *Monaco Report 1/2*, *supra* note 112, at 26.

¹⁵⁶ See GRECO *Andorra Report 1/2*, *supra* note 105, at 3; GRECO *Denmark Report 2*, *supra* note 128, at 11; GRECO *Sweden Report 2*, *supra* note 146, at 12.

¹⁵⁷ See, e.g., GRECO *Austria Report 1/2*, *supra* note 106, at 45; GRECO *Belgium Report 2*, *supra* note 112, at 16; GRECO *Czech Republic Report 2*, *supra* note 104, at 27; GRECO *Italy Report 1/2*, *supra* note 108, at 57; GRECO *Switzerland Report 1/2*, *supra* note 106, at 43.

¹⁵⁸ See GRECO, *First Evaluation Round, Evaluation Report on Slovenia*, at 13, Greco Eval I Rep (2000) 3E Final (Dec. 15, 2000).

¹⁵⁹ See GRECO *Luxembourg Report 2*, *supra* note 109, at 6.

¹⁶⁰ See, e.g., GRECO *Finland Report 2*, *supra* note 116, at 11; GRECO *Georgia Report 2*, *supra* note 110, at 15; GRECO, *First Evaluation Round, Evaluation Report on Lithuania*, at 15, Greco Eval I Rep (2002) 1E Final (Mar. 8, 2002) (noting that Lithuania has developed special courts to determine whether there is a conflict in state officer serving at the local and national level); GRECO, *Second Evaluation Round, Evaluation Report on Norway*, at 9, Greco Eval II Rep (2004) 3E (Sept. 30, 2004); GRECO *United States Report 1*, *supra* note 133, at 31.

¹⁶¹ See, e.g., GRECO *Austria Report 1/2*, *supra* note 106, at 37; GRECO *Bosnia and Herzegovina Report 2*, *supra* note 112, at 14.

state parties, however, only have conflict of interest laws at the national level.¹⁶² The GRECO review reports have suggested that such state parties enact laws to strengthen their local-level conflict of interest regimes.¹⁶³

III. OECD

A. *OECD Conflicts of Interest Provisions*

The primary OECD legal instrument addressing corruption is the Convention on Combatting Bribery of Foreign Public Officials in International Business Transactions (the "Convention").¹⁶⁴ While the text of the Convention itself does not directly regulate conflicts of interest,¹⁶⁵ the issue is discussed within the evaluative reports that the OECD has generated throughout several review rounds conducted in accordance with the Convention. As with the other evaluative reports discussed in this article, the OECD conducts reviews of member state practices in relation to the Convention's terms.¹⁶⁶

B. Evaluation Trends

1. General Conflict of Interest Laws

OECD reviews do not contain as much information regarding conflicts of interest laws and practices used by state parties as the other reporting mechanisms discussed in this article. The information provided, however, does establish that some state parties have passable conflicts of interest regimes under the OECD standards,¹⁶⁷ while others have limited or weak regimes. Within the regimes identified as limited or weak,¹⁶⁸ the OECD reviews have established

¹⁶² See GRECO *Belgium Report 2*, *supra* note 112, at 14; GRECO *Estonia Report 2*, *supra* note 115, at 13; GRECO *Russia Report 1/2*, *supra* note 107, at 59; GRECO *Spain Report 2*, *supra* note 104, at 17.

¹⁶³ See, e.g., GRECO *Austria Report 1/2*, *supra* note 106, at 37; GRECO *Czech Republic Report 2*, *supra* note 104, at 17-18; GRECO *Estonia Report 2*, *supra* note 115, at 13; GRECO *Spain Report 2*, *supra* note 104, at 14; GRECO *Switzerland Report 1/2*, *supra* note 106, at 42.

¹⁶⁴ The Organisation for Economic Co-operation and Development [OECD], Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, Dec. 17, 1997 (entered into force Feb. 15, 1999), available at <http://www.oecd.org/corruption/oecdantibriberyconvention.htm>.

¹⁶⁵ See generally *id.*

¹⁶⁶ *Country report on the implementation of the OECD Anti-Bribery Convention*, OECD, http://www.oecd.org/document/24/0,3746,en_2649_34859_1933144_1_1_1_1,00.html (last visited Mar. 15, 2013) (providing online access to each country's reports).

¹⁶⁷ See OECD, *Mexico: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 8 (Sept. 2, 2004) [hereinafter *OECD Mexico Report 2*]; OECD, *Steps taken to implement and enforce the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, Slovenia*, at 2 (Oct. 1, 2012).

¹⁶⁸ See, e.g., OECD, *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Bulgaria*, at 6 (Mar. 18, 2011); OECD, *Luxembourg: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business*

that state parties are continuing to work toward strengthening those regimes. In some instances, however, balancing the interests of the state party with the implementation of robust conflict of interest regimes is an issue.¹⁶⁹ It should be noted that at least one state party, Italy, has reported taking measures to control conflicts of interest during the privatization of certain government-held entities.¹⁷⁰

2. Codes of Conduct and Guidelines

Many individual state parties subject to the OECD review and reporting system use national codes of conduct and/or guidelines to address issues related to conflicts of interest. For example, Argentina uses a nationwide set of general guidelines for addressing conflict of interest issues.¹⁷¹ A majority of the other state parties, however, have reported that they use some form of guidance, such as a code of conduct or integrity, specifically created for public employees and/or officials.¹⁷² Practical issues regarding the uneven and limited, agency-focused application of such codes,¹⁷³ however, have been identified.¹⁷⁴

Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions, at 38.

¹⁶⁹ See OECD, *Canada: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 33 (Mar. 25, 2004) [hereinafter *OECD Canada Report 2*].

¹⁷⁰ See OECD, *Italy: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 12 (Nov. 29, 2004) [hereinafter *OECD Italy Report 2*].

¹⁷¹ See OECD, *Argentina: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 12 (June 20, 2008) [hereinafter *OECD Argentina Report 2*].

¹⁷² See, e.g., OECD, *Belgium: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 43 (July 21, 2005); OECD, *Ireland: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 14, 45 (Mar. 14, 2007); OECD, *Luxembourg: Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Luxembourg*, at 57 (June 23, 2011) [hereinafter *OECD Luxembourg Report 3*]; OECD, *New Zealand: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 16 (Oct. 27, 2006) [hereinafter *OECD New Zealand Report 2*]; OECD, *Slovenia: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 12 (June 21, 2007) [hereinafter *OECD Slovenia Report 2*].

¹⁷³ See *OECD Slovenia Report 2*, *supra* note 172, at 12.

¹⁷⁴ See OECD, *Sweden: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 21 (Sept. 21, 2005) [hereinafter *OECD Sweden Report 2*].

3. Oversight Bodies

Contrary to the results of some other reporting systems, most of the OECD's state parties have reported that their conflict of interest oversight bodies were given specialized, rather than general, jurisdiction. One exception to this trend was Argentina, which described using a Comptroller General to handle issues of conflicts of interests, along with corruption in general.¹⁷⁵ Several other state parties reported that they had established oversight bodies for specific portfolios,¹⁷⁶ primarily those involving some form of quasi-corporate entity, rather than a traditional governmental entity.¹⁷⁷ Additionally, New Zealand reported using multiple oversight commissions to handle conflict of interest issues, rather than using a consolidated oversight body.¹⁷⁸

4. Disclosure and Reporting Requirements

To the extent that the OECD review process has examined and commented on the legal adequacy of member states' conflict of interest disclosure and/or reporting requirements, several state parties have been found to have passable disclosure and reporting regimes in place.¹⁷⁹ At least one state, however, was found to have implemented only a weak or limited regime.¹⁸⁰

5. Procurement

Conflict of interest and procurement issues are not widely discussed in the OECD review reporting system, but Canada has acknowledged in its reports that

¹⁷⁵ See *OECD Argentina Report 2*, *supra* note 171, at 12.

¹⁷⁶ See OECD, *Germany: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 22 (June 4, 2003) (relating to the Ministry of Defense); OECD, *Poland: Phase 2 Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 17 (Jan. 18, 2007) (relating to the Foreign Ministry).

¹⁷⁷ See *OECD Argentina Report 2*, *supra* note 171, at 12 (relating to extractive industries & defense/weapons); OECD, *Austria: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 14 (Feb. 16, 2006) (relating to the Austria Development Agency); OECD *Luxembourg Report 3*, *supra* note 172, at 53 (relating to the Lux-Development Agency); OECD, *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Sweden*, at 42–43 (June 15, 2012) (relating to the Swedish International Development Cooperation Agency).

¹⁷⁸ OECD *New Zealand Report 2*, *supra* note 172, at 10–11.

¹⁷⁹ See, e.g., *id.* at 25; OECD, *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in the United States*, at 20 (Oct. 15, 2010) [hereinafter *OECD United States Report 3*].

¹⁸⁰ See OECD, *Iceland: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 23, 32–33 [hereinafter *OECD Iceland Report 2*] (noting that the determination of limited effectiveness was made because the reporting regime did not extend to parliament and parliamentary officials).

it has dedicated conflict of interest provisions in its procurement procedures, particularly in the context of its foreign aid agency.¹⁸¹ Additionally, the OECD reports noted that, at the time of review, Mexico had no overall conflict of interest policies in place for procurement practices, although some individual agencies had started to implement their own policies.¹⁸²

6. Training in Conflict of Interest Issues

Several state parties reported that they have systems in place for training employees within specialized agencies to identify and address conflicts of interest¹⁸³ or that they have made publications discussing how to deal with conflicts of interest available in some capacity.¹⁸⁴ Additional OECD report information relating to training practices used by state parties was not as readily available as the comparable data obtained by means of other reporting mechanisms discussed in this article.

7. Conflicts of Interest in Auditing

The OECD has concentrated on potential conflict of interest issues in auditing procedures throughout the implementation of its reporting mechanism. Many state parties have established conflict of interest regimes that are specifically applicable to at least corporate auditors.¹⁸⁵ According to OECD review reports, however, many of these regimes have limited practical value, particularly because of loopholes that exist within the applicable laws and policies.¹⁸⁶ The French regime should be highlighted as a positive example in

¹⁸¹ See OECD *Canada Report 2*, *supra* note 169, at 36–37 (relating to the Canadian International Development Agency).

¹⁸² See OECD *Mexico Report 2*, *supra* note 167, at 32.

¹⁸³ See OECD, *Poland: Phase 2, Follow-Up Report on the Implementation of the Phase 2 Recommendations*, at 8–9 (relating to the Foreign Ministry); OECD, *Portugal: Phase 2, Follow-Up Report on the Implementation of the Phase 2 Recommendations of the Applications of the Convention and the 1997 Revised Recommendation on Combating Bribery of Foreign Public Officials in International Business Transactions*, at 4 (Oct. 6, 2009) (relating to the Foreign Ministry); OECD *Sweden Report 2*, *supra* note 174, at 25–26 (relating to the Foreign Ministry).

¹⁸⁴ See OECD, *Austria: Phase 2, Follow-up Report on the Implementation of the Phase 2 Recommendations*, at 7 (Mar. 20, 2008).

¹⁸⁵ See OECD, *Brazil: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 27 (Dec. 7, 2007); OECD, *Bulgaria: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 19 (June 6, 2003) [hereinafter *OECD Bulgaria Report 2*]; OECD, *France: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 18 (Jan. 22, 2004) [hereinafter *OECD France Report 2*]; OECD *United States Report 3*, *supra* note 179, at 18.

¹⁸⁶ See OECD *Argentina Report 2*, *supra* note 171, at 22; OECD *Bulgaria Report 2*, *supra* note 185, at 20 (challenging the effectiveness of these measures due to existing loopholes); OECD *Italy Report 2*, *supra* note 170, at 21 (challenging the effectiveness of these measures due to existing

that it specifically addresses the potential for collusion and conflicts of interest by auditors and officials as well as corporate actors.¹⁸⁷ Furthermore, the OECD review reports found that Hungary and Switzerland were in the process of establishing a conflicts of interest regime for auditors.¹⁸⁸

8. Societal Issues

As noted in the GRECO review reports discussed above, an issue that plagues the application and understanding of conflicts of interest is social acceptance of conflicts of interest both as having a negative impact and as being susceptible to legal control. Unfortunately, societies in some state parties view conflicts of interest as prevalent in society and, therefore, essentially impossible to eradicate at either the national or social level.¹⁸⁹ At least one state party, Iceland, reported that there was a direct societal tie between the necessity for some level of conflicts of interest and the well-functioning grey economy.¹⁹⁰

IV. ADB/OECD

A. ADB/OECD and Conflicts of Interests

The Asian Development Bank (“ADB”), which exists to provide financing to member Asian states that seek to engage in development-based projects, and the OECD have formed an alliance to combat corruption. This partnership is a novel method of combining resources to address the corruption-related needs and problems facing the ADB member states with the expertise of both entities with the ultimate goal of preventing corruption.¹⁹¹ Currently, there are 30 ADB/OECD member states from the Asia-Pacific region, representing all spectrums of developmental status and a variety of legal systems.¹⁹²

The ADB/OECD alliance was created in 2001 through the Anti-Corruption Action Plan for Asia and the Pacific (the “ADB/OECD Action Plan”), a

loopholes); OECD, *Phase 1 Report on Implementing the OECD Anti-Bribery Convention in the Russian Federation*, at 26 (Mar. 16, 2012).

¹⁸⁷ See OECD *France Report 2*, *supra* note 185, at 20.

¹⁸⁸ See OECD, *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Hungary*, at 28–29 (Mar. 16, 2012); OECD, *Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Switzerland*, at 29–30 (Dec. 16, 2011).

¹⁸⁹ See OECD, *Hungary: Phase 2, Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997 Recommendation on Combating Bribery in International Business Transactions*, at 12 (May 6, 2005); OECD *Slovenia Report 2*, *supra* note 172, at 7–8.

¹⁹⁰ See OECD *Iceland Report 2*, *supra* note 180, at 7.

¹⁹¹ See *ADB/OECD Anti-Corruption Initiative*, ASIAN DEV. BANK & ORG. FOR ECON. CO-OPERATION AND DEV.: ANTI-CORRUPTION INITIATIVE FOR ASIA AND THE PACIFIC, <http://www.oecd.org/site/adboecdanti-corruptioninitiative/> (last visited Mar. 15, 2013).

¹⁹² *Member countries and economies*, ADB/OECD, http://www.oecd.org/document/23/0,3746,en_34982156_35315367_35030743_1_1_1_1,00.html (last visited Mar. 15, 2013).

document that set out the foundational pillars of the alliance's efforts.¹⁹³ Conflicts of interest and related areas, such as the use of codes of conduct and transparency and accountability for public officers and employees, form the first pillar of the alliance.¹⁹⁴ Although the ADB/OECD Action Plan did not create a systematic policy review mechanism for member states to the same extent that the IACAC, GRECO, and the OECD did, the ADB/OECD Secretariat has overseen the review of state party policies on certain topics that relate to conflicts of interest.¹⁹⁵

B. *Evaluation Trends*

The primary review reports issued under the joint ADB/OECD structure focus on procurement and related topics.¹⁹⁶ Despite their narrow scope, however, the reports still provide some insight relating to conflicts of interest by shedding light on how many of the reviewed state parties address the high-risk relationship between procurement and conflicts of interest.

The majority of reporting state parties have a legal system that establishes a framework for the procurement process. While some state parties have highly detailed legal frameworks for procurement,¹⁹⁷ others have more limited frameworks that depend largely on a combination of other laws.¹⁹⁸ Still other

¹⁹³ See generally ADB/OECD, *Anti-Corruption Initiative for Asia-Pacific* (Nov. 30, 2001), available at http://www.oecd.org/site/adboecdanti-corruptioninitiative/meetings_andconferences/35021642.pdf.

¹⁹⁴ *Id.* at 3.

¹⁹⁵ See *id.* at 9–11.

¹⁹⁶ See *Thematic Review on Curbing Corruption in Public Procurement*, ADB/OECD, <http://www.oecd.org/site/adboecdanti-corruptioninitiative/policyanalysis/thematicreviewoncurbingcorruptioninpublicprocurement.htm> (last visited Mar. 15, 2013) (containing links to electronic versions of each country's report).

¹⁹⁷ See, e.g., ADB/OECD, *Anti-corruption Policies in Asia and the Pacific: Self-Assessment Report Australia*, at 10–11 (2005) [hereinafter *ADB/OECD Australia Report*]; ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Japan*, at 2 (2005) [hereinafter *ADB/OECD Japan Report*]; ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Kazakhstan*, at 2 (2005) [hereinafter *ADB/OECD Kazakhstan Report*]; ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Korea*, at 2–3 (2005) [hereinafter *ADB/OECD Korea Report*]; *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Kyrgyz Republic*, at 2–3 (2005) [hereinafter *ADB/OECD Kyrgyz Republic Report*].

¹⁹⁸ See, e.g., ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Bangladesh*, at 2 (2005); ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Cambodia*, at 2–3 (2005) [hereinafter *ADB/OECD Cambodia Report*]; ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report China*, at 2 (2005) [hereinafter *ADB/OECD China Report*]; ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Cook Islands*, at 2 (2005) [hereinafter *ADB/OECD Cook Islands Report*]; ADB/OECD, *Anti-corruption*

state parties have procurement frameworks which either do not apply to some quasi-state actors¹⁹⁹ or do not apply at the local level.²⁰⁰

Similarly, there is a lot of variation in state party propensity to either include or exclude²⁰¹ specific references to conflicts of interest in procurement laws and policies. Those states that do include references to conflicts of interest position such references in various locations throughout their legal frameworks. Some states place them directly within their legal and rule-based structures,²⁰² while others place them within the applicable general²⁰³ or procurement-specific codes of conduct.²⁰⁴ There is also a notable difference among states in terms of whether state actors are the sole actors who are eligible for punishment under the conflicts of interest laws²⁰⁵ and whether culpability for conflicts of interest extend to public and private actors.²⁰⁶ Training in dealing with procurement-

policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Fiji Islands, at 2 (2005) [hereinafter *ADB/OECD Fiji Report*].

¹⁹⁹ See ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Malaysia*, at 3 (2005) [hereinafter *ADB/OECD Malaysia Report*]; ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Palau*, at 3 (2005) [hereinafter *ADB/OECD Palau Report*].

²⁰⁰ See ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report India*, at 5 (2005) [hereinafter *ADB/OECD India Report*]; ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Pakistan*, at 2 (2005); ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Thailand*, at 2 (2005) [hereinafter *ADB/OECD Thailand Report*].

²⁰¹ See, e.g., ADB/OECD *Cambodia Report*, *supra* note 198, at 8; ADB/OECD *Fiji Report*, *supra* note 198, at 6; ADB/OECD *India Report*, *supra* note 200, at 8; ADB/OECD *Kazakhstan Report*, *supra* note 197, at 10; ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Vietnam*, at 9 (2005).

²⁰² See, e.g., ADB/OECD *Malaysia Report*, *supra* note 199, at 7; ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Mongolia*, at 7–8 (2005); ADB/OECD *Palau Report*, *supra* note 199, at 5; ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Philippines*, at 15 (2005); ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Samoa*, at 8 (2005).

²⁰³ See ADB/OECD *Japan Report*, *supra* note 197, at 7; ADB/OECD *Malaysia Report*, *supra* note 199, at 7; ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Nepal*, at 5 (2005).

²⁰⁴ See, e.g., ADB/OECD *Cook Islands Report*, *supra* note 198, at 6; ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Hong Kong*, at 5 (2005); ADB/OECD, *Anti-corruption policies in Asia and the Pacific: Thematic review on provisions and practices to curb corruption in public procurement: Self-assessment report Indonesia*, at 8 (2005); ADB/OECD *Korea Report*, *supra* note 197, at 7; ADB/OECD *Kyrgyz Republic Report*, *supra* note 197, at 9.

²⁰⁵ See generally ADB/OECD Reports, *supra* notes 197 and 198.

²⁰⁶ See ADB/OECD *Korea Report*, *supra* note 197, at 7–8; ADB/OECD *Thailand Report*, *supra* note 200, at 7.

related conflicts of interest is another area in which states reviewed differ in dedication and strength of legal and/or regulatory frameworks.²⁰⁷

V. FUTURE UNITED NATIONS AND EUROPEAN UNION EVALUATIVE MECHANISMS

A. *The UNCAC*

The UNCAC entered into force in 2005, but it did not immediately result in the creation of an evaluation mechanism for state party compliance with its terms.²⁰⁸ Under the UNCAC, state parties are to “adopt, maintain and strengthen” their governmental systems in order to “prevent conflicts of interest.”²⁰⁹ The EU further suggested that UNCAC state parties adopt codes of conduct and other measures for public officials in order to promote transparency and to address issues relating to conflicts of interest.²¹⁰ The UNCAC encourages state parties, in addition to public sector actors, to enact measures that control the potentially corrupt activities of the private sector, such as conflicts of interest, especially where there is an interaction between public and private sector actors.²¹¹

As stated above, although the UNCAC went into effect in 2005, the UNCAC Conference of the Parties did not create any form of review mechanism for UNCAC state parties until several years later.²¹² The initial goal of this evaluative mechanism was for state parties to first use self-assessments of UNCAC compliance,²¹³ followed by a more comprehensive assessment under the Mechanism for the Review of Implementation of the UNCAC (the “UNCAC Mechanism”).²¹⁴ The UNCAC Mechanism provides for a state party review process that assesses the efficacy of state party implementation of the UNCAC, while also providing suggestions and insights into potential improvements.²¹⁵ Technical assistance will also be offered to state parties for identified issues and weaknesses in UNCAC implementation.²¹⁶ The UNCAC Mechanism is presently in its early stages of implementation.²¹⁷

²⁰⁷ See ADB/OECD *Australia Report*, *supra* note 197, at 6-7, 23; ADB/OECD *Cambodia Report*, *supra* note 198, at 4; ADB/OECD *China Report*, *supra* note 198, at 9-10; ADB/OECD *Japan Report*, *supra* note 197, at 7.

²⁰⁸ U.N. Convention against Corruption, Oct. 31, 2003), 2349 U.N.T.S. 41, *available at* <http://www.unodc.org/unodc/en/treaties/CAC/> (last visited Mar. 15, 2013) (entered into force on December 14, 2005 per Article 68(1)).

²⁰⁹ *Id.* at art. 7.

²¹⁰ *Id.* at art. 8.

²¹¹ *Id.* at art. 12.

²¹² See Conference of the State Parties to the U.N Convention Against Corruption Res. 3/1, Mechanism for the Review of Implementation of the United Nations Convention against Corruption—Basic Documents, U.N. Doc. CAC/COSP/2009/15, at iii (Dec. 1, 2009).

²¹³ See *id.* at iv, ¶ 7.

²¹⁴ *Id.* at iv, ¶¶ 6-12.

²¹⁵ See *id.* at Annex I art. IV. A.

²¹⁶ *Id.* at iv, ¶ 10.

²¹⁷ See *id.* at iv, ¶ 14 (explaining that the Mechanism will not be implemented until 2013).

B. *European Union*

In 2011, the European Commission issued a decision establishing the EU Anti-corruption reporting mechanism for periodic assessment (the "Assessment").²¹⁸ Although GRECO already covers EU member states, it was deemed to be in the best interest of the EU as a whole to create an EU member-only system that provides for evaluations of the corruption practices of each member state and the EU as a whole.²¹⁹ Additionally, the EU has stated that the Assessment could be used to inform future EU policy developments in the field of corruption and associated areas.²²⁰ The Assessment will be published every two years starting in 2013.²²¹

VI. LESSONS FROM THE EVALUATIONS

The above review of the key issues identified in each set of conflicts of interest evaluations provides valuable insights into the common issues associated with conflicts of interest, as well as insights for the development of future review mechanisms. Such insights relating to conflict of interest laws, codes of conduct and/or ethics, disclosure and reporting requirements, oversight bodies, incompatibilities, post-governmental service conflicts or pantouflage, procurement and gifts, training and auditing, and local and municipal issues are discussed in this section.

A. *Conflicts of Interest Laws*

A majority of evaluated states evaluated had enacted at least some form of general legislation regarding conflicts of interest, and many of these states have enacted laws that are at least facially passable in terms of conflict of interest protections. Some states, however, still only have limited or weak conflict of interest laws at the national level, much less the local or municipal level. At the core of the issue, most evaluations have found that there is a split between states that have enacted passable conflict of interest definitions in their legal systems and those that have either limited or weak definitions that do not create robust enforcement mechanisms.

On a positive note, some states have also updated their criminal, administrative, and disciplinary laws to include conflict of interest prohibitions. Issues in implementing penalties, however, were also found. Balancing state interests with the application of conflict of interest laws and rules was an issue in some instances. All reporting systems noted that state parties needed to

²¹⁸ Commission Decision *EU Anti-Corruption Report*, *supra* note 95, at art. 1.

²¹⁹ *See generally id.* at pmb1.

²²⁰ *Id.* at pmb1., ¶ 11.

²²¹ *Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: Fighting Corruption in the EU*, at 4, 6 COM (2011) 203 final (June 6, 2011).

strengthen their conflict of interest laws; and, among these systems, there were consistently noted attempts by states to create stronger regimes.

From this information, it is apparent that evaluations involving conflicts of interest need to focus on ensuring that there are conflict of interest laws in each state party under evaluation and that such laws work their way into local legal regimes as well as national or federal legal regimes. These laws need to include robust definitions of the term “conflicts of interest.” Evaluations also need to examine the depth of conflict of interest laws’ application, especially in terms of providing for penalties, as well as effectively implementing them. Further, an evaluative system needs to be able to examine the strengths of existing conflict of interest laws beyond their facial adequacy and to provide guidance to states when they are attempting to strengthen their laws.

B. *Codes of Conduct/Ethics*

As the above sections have discussed,²²² there is a trend among all of the evaluative systems for states to address conflict of interest concerns in codes of conduct that are used at some level of government. Across the board, however, there was a difference in strength of the codes of conduct used and their applicability to either the entire governmental apparatus or to individual governmental agencies. In addition, regardless of whether they were definitionally strong or weak, there was a noticeable pattern of failure to properly implement and oversee such codes of conduct.

Where codes of conduct were used for specific governmental agencies and entities, uniformity of application has been an issue. Although, alternatively, the use of these specialized codes was found to be beneficial in that it allows for targeted measures to address agency-specific concerns. The evaluations, however, also observed states using a fragmented system of codes of conduct in order to shield certain problematic agencies from attention. Further, while guidelines for the implementation of codes of conduct were created by states throughout the evaluation systems, there were inconsistencies in their application and effectiveness.

From this information, it is apparent that the use of strong codes of conduct is important and that evaluative systems need to examine such codes carefully because the use of general governmental or agency specific codes of conduct can either be used effectively or used as a way to deflect the effectiveness of codes of conduct that address conflicts of interest. Additionally, the implementation of the terms of codes of conduct must be carefully scrutinized along with the overall strength of these terms.

C. *Disclosure and Reporting Requirements*

Throughout the evaluation mechanisms, there was a consistent pattern of state parties promulgating some form of disclosure or reporting requirements for

²²² See *supra* Parts II, III, IV, V, and VI.

conflicts of interest in the governmental setting. Again, there is a disjunction between states that have passable regimes and those that have limited or weak regimes. In general, all of the evaluative systems discussed the need for strengthening disclosure and reporting regimes.

The most detailed information about disclosure and reporting requirement compliance comes from MESICIC, which highlights issues such as the lack of transparency in reporting, the difficulties of societal acceptance of reporting requirements as necessary for good governance, the scope of the penalties available for violations of disclosure and reporting requirements, and the potential problems with targeting only certain areas of the government for disclosure and reporting requirements.

These comparisons and findings demonstrate that current and future evaluation mechanisms need to examine the terms and application of disclosure and reporting requirements to ensure that they are meaningfully crafted and implemented. Further, as the most detailed evaluation mechanism available at the moment, this article argues that the lessons from the MESICIC rounds regarding transparency, societal acceptance, penalties and limited disclosure should be taken into account when designing and implementing evaluation rounds.

D. *Oversight Bodies*

Most states discussed in the evaluations above had oversight bodies charged with monitoring the conduct of public employees and officers, including policing for conflicts of interest. The states split, however, in whether they used a government-wide oversight body, such as an ombudsman, or broke down oversight within individual governmental agencies or entities. Where internal oversight within governmental agency or entity was used, there tended to be issues with ensuring uniformity of oversight quality and protections. Some states with splintered oversight systems did report using an overall governmental coordinating body, but this was not the norm. Additionally, there was an uneven application of oversight over quasi-corporate entities in which the government held an interest.

In the future, evaluative mechanisms should examine the structure of the oversight body systems used within a state to determine the effectiveness of these structures on a case-by-case basis and to understand the scope of conflict of interest regulations within a particular state. Furthermore, as privatization becomes a pattern in many states, evaluative mechanisms need to examine the oversight used for monitoring quasi-corporations and during the privatization process in order to combat the potential for conflicts of interest in this sphere.

E. *Incompatibilities*

Both MESICIC and GRECO examined the use of incompatibility provisions within their member states to evaluate their existence and strength. Overall, most states in both systems did have some form of incompatibility

provisions, but some of the provisions were weak. Within these systems there were some instances of specialized incompatibility regulations, such as those specifically applicable to judicial offices, concurrent offices in general, public contracting, and political party activity.

Based on this information, it is apparent that evaluative mechanisms should examine the strength of incompatibility provisions as a whole, as well as the appropriateness of their use in certain instances.

F. *Post-Governmental Service Conflicts/Pantouflage*

As discussed in the sections above,²²³ both MESICIC and GRECO addressed pantouflage. In both mechanisms, a majority of state parties were found to have some form of pantouflage laws and/or restrictions, particularly in the realm of procurement activities. These laws ranged from passable to quite limited in existence and application, and most of the states at both ends of the spectrum received recommendations to strengthen their laws and/or restrictions.

Within the issue of pantouflage, there are two key areas of concern that must be mentioned. The first is the relationship between privatization and pantouflage, in which GRECO state parties, in particular, were found to lack significant controls. The second, which is a recurring theme in this article's analysis, is society's acceptance of pantouflage in general. In states where pantouflage is accepted as common, and perhaps even embraced as part of the traditional system, there has been limited success in trying to combat it.

In such states, where pantouflage is embraced as part of the local culture and as way of doing business, it is difficult to suggest an immediate way that future evaluative mechanisms can end this trend. Rather, this article submits that such a situation calls for long-term educational efforts by the particular evaluative entity. Where pantouflage does not enjoy such societal acceptance, future evaluative mechanisms should carefully examine state practice and regulation of pantouflage in the setting of privatization. Additionally, future evaluative mechanisms should examine the scope and application of pantouflage laws and regulations, as the issue itself can be insidious within a governmental or agency structure.

G. *Procurement and Gifts*

The issues of procurement and gift giving in the context of public actors is, by nature, heavily tied to conflicts of interest. A common trend between the findings of all of the evaluative mechanisms is that many of the states under their purview have largely limited or weak procurement laws that need to be strengthened. Furthermore, a focus on specialized agencies and quasi-corporate entities found that there was particularly uneven regulation of procurement in these areas.

²²³ See *supra* Parts II and III.

Given the high risk and gravity of conflicts of interest within the procurement process, future evaluative mechanisms must carefully examine and monitor the progress of procurement laws, rules and regulations. The evaluative mechanisms must also ensure that procurement laws and rules within specific agencies and quasi-corporate entities are functioning properly, as it is possible for government-wide policies regarding procurement to miss nuances that occur in particular agency or quasi-corporate settings.

H. *Training and Auditing*

Robust conflict of interest systems need training mechanisms in place in order to ensure that the systems work properly. With this assertion as a backdrop, the evaluative mechanisms have demonstrated that, while many states do have some form of training mechanism in place, most of the programs need to be strengthened, particularly to include educational components.

Additionally, auditing—both public auditing and transparent auditing for private entities that work with public agencies—has been identified as a critical area for the detection and prevention of conflicts of interest. Among the evaluation mechanisms, the OECD, in particular, has noted that there are often loopholes in auditing systems which need to be fixed in order for the laws to be meaningful.

In the future, evaluative mechanisms should ensure that they examine the types of conflicts of interest and anti-corruption training available to both governmental employees and the general public, as well as the effectiveness of such training programs. Furthermore, future evaluative mechanisms should ensure that they carefully scrutinize the auditing processes used.

I. *Local and Municipal Issues*

A final point to consider is the role of conflict of interest laws at the local and state levels. Conflicts of interest do not stop at the highest level of government. Rather, they permeate all levels of government. As the evaluative mechanisms discussed above have shown, there is a significant problem with the implementation of conflict of interest regulations and related regimes at the local level of government across a variety of states, levels of development, and governmental systems.

In the future, evaluative mechanisms should ensure that they carefully scrutinize the implementation of conflict of interest measures at the local level within each evaluated state, especially federal/provincial states such as Argentina, Brazil, and the United States.

CONCLUSION

Conflicts of interest are inherent to corruption. Without a conflict between the interests of the actor and his constituency, there would be few instances of corrupt behavior. As such, it is imperative that domestic, regional and

international regimes that aim to combat corruption by using mechanisms to evaluate the overall effectiveness of state party anti-corruption laws include effective and in-depth evaluations of the conflict of interest aspects of such laws, rules, and regulations in their reports.

This article has examined the key issues raised by and the lessons learned as a result of the evaluative mechanisms used under the IACAC, GRECO, OECD and ADB/OECD regimes. From these lessons, this article reviewed common trends in conflict of interest laws, rules, regulations and practices among these regimes and formulated recommendations as to how future evaluative mechanisms—such as those contemplated by the UNCAC and the EU—should conduct their evaluations.

The goal of this article has been to provide a comprehensive understanding of how conflicts of interest are handled, or not handled, under domestic, regional and international anti-corruption regimes. This understanding can, in turn, be used to inform the future of the evaluative mechanisms already in use and those evaluative mechanisms which will soon be put in place.

COMPULSORY LICENSING IN THE EUROPEAN UNION

Jarrod Tudor

INTRODUCTION

Professor Guy Tritton has commented that lawyers around the globe are rarely familiar with the national and international rules on compulsory licensing.¹ A compulsory license is a remedy issued by a court that allows a non-intellectual property right holder to have access to the protected technology despite the wishes of the intellectual property right holder not to allow access to the technology.² The compulsory license remedy is often issued to avoid and prevent monopolistic abuses.³ In a more radical sense, a compulsory license could be defined when a court denies an intellectual property holder injunctive relief against an infringer.⁴

The law regarding compulsory licensing in the European Union is no less challenging since it is a mix of both the national law of the twenty-seven Member-States and the European Union government sitting in Brussels.⁵ To the relief of the world's lawyers, the European Union and its Member-States are very transparent countries; so for those entities desiring entry into the European Union's common market, learning the law on compulsory licensing can be accomplished with adequate study.⁶

Articles 2 and 3 of the Treaty on the Functioning of the European Union (the "Treaty") makes European Union law applicable to the entire territory

¹ GUY TRITTON ET AL., *INTELLECTUAL PROPERTY IN EUROPE* 998 (3d ed. 2008).

² Susan Vastano Vaughan, Comment, *Compulsory Licensing of Pharmaceuticals Under TRIPS: What Standard of Compensation?*, 25 HASTINGS INT'L & COMP. L. REV. 87, 96–97 (2001).

³ Atif I. Azher, *Antitrust Regulators and the Biopharmaceutical Industry: Compulsory Licensing Schemes Ignoring Gene Therapy Patients' Needs*, 25 U. PA. J. INT'L ECON. L. 383, 384 (2004).

⁴ Andrew C. Mace, Note, *TRIPS, eBay, and Denials of Injunctive Relief: Is Article 31 Compliance Everything?*, 10 COLUM. SCI. & TECH. L. REV. 232, 245 (2009).

⁵ See, e.g., CHRISTOPHER WADLOW, *ENFORCEMENT OF INTELLECTUAL PROPERTY IN EUROPEAN AND INTERNATIONAL LAW: THE NEW PRIVATE INTERNATIONAL LAW OF INTELLECTUAL PROPERTY IN THE UNITED KINGDOM AND THE EUROPEAN COMMUNITY* 257 (1998) (stating that an action for infringement of a European Community patent will tend to involve the law of the nation where the court hears the action, the law of the nations where the patent was infringed, as well as Community law).

⁶ See Christopher J. Meyers, *European Union Competition Law and Intellectual Property Licensing: Trans-Atlantic Convergence and Compulsory Licensing*, in 11TH ANNUAL INSTITUTE ON INTELLECTUAL PROPERTY LAW, 135, 149–150 (Practising Law Institute 2005) (showing that the European Commission has issued the Technology Transfer Block Exemption Regulation and Notice — Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements, creating a "two-part structure" of Community IP law).

comprised by the European Union Member-States where the Treaty confers power on the European Union.⁷ Compulsory licensing is comprised of both national and international law in that Member-States define intellectual property protections within their respective borders while the European Union regulates competition among the territories of the Member-States.⁸ Specifically, Articles 34, 36, 101, and 102 of the Treaty dictate the scope and limitations of compulsory licensing in regard to both rights and remedies.⁹ Regulations passed by the European Council apply to the Member-States do not provide Member-States with the discretion to implement them.¹⁰ Directives, on the other hand, are a source of federal law that is applicable to Member-States, but provide Member-States with some flexibility in regard to implementation to achieve a particular goal of the larger European Union.¹¹ Any practitioner of this area of law, however, should recognize another harmonizing force in that all European Union Member-States are parties to the Paris Convention, the Berne Convention, and the World Trade Organization (“WTO”).¹²

Despite the several sources of European Union law, the balance between the responsibilities found in the above sources of international law and nationally-driven intellectual property rights is struck primarily by the European Commission (“EC”) and the European Court of Justice (“ECJ”).¹³ More narrowly, the balance found between these sources of law has come from the jurisprudence of the ECJ and the EC on the subject of copyright.¹⁴ Furthermore, one of the most important beliefs found in this jurisprudence is that the harmonization of the law through the Treaty’s Articles will maximize the

⁷ Consolidated Version of the Treaty on the Functioning of the European Union arts. 2, 3, 2010 O.J. (C 83) 50 [hereinafter TFEU].

⁸ Rita Coco, *Antitrust Liability for Refusal to License Intellectual Property: A Comparative Analysis and the International Setting*, 12 MARQ. INTEL. PROP. L. REV. 1, 7 (2008).

⁹ See generally discussion *infra* Part I.

¹⁰ See BELLAMY & CHILD, EUROPEAN COMMUNITY LAW OF COMPETITION 15, 26 (Peter Roth QC & Vivien Rose eds. 2008) (stating that the function of the Council of the European Communities is to regulate economic policies among Member-States, and that it promulgated regulations and directives offered by the Commission, and also that the Council has used its authority under Article 83 to create five different regulations). The most important of which is Regulation 17 adopted in 1962. *Id.* at 33 (showing that Regulation 17 governed procedures when dealing with the Commission, instructed aggrieved parties on how to make complaints, and detailed the Commission’s powers of enforcement).

¹¹ TFEU art. 86(3); see also BELLAMY & CHILD, *supra* note 10, at 1047 (explaining that the Commission uses directives to enforce Article 81(6) of the Treaty).

¹² See Meyers, *supra* note 6, at 143–44.

¹³ See *Court of Justice*, EUR. UNION, http://europa.eu/about-eu/institutions-bodies/court-justice/index_en.htm (last visited Mar. 6, 2013) (“The Court of Justice interprets EU law to make sure it is applied in the same way in all EU countries. It also settles legal disputes between EU governments and EU institutions”); see *European Commission*, EUR. UNION, http://europa.eu/about-eu/institutions-bodies/european-commission/index_en.htm (last visited Mar. 6, 2013) (the EC enforces EU law through letters to infringing parties, assessment of penalties, and by referring matters to the ECJ).

¹⁴ See TREVOR COOK, EU INTELLECTUAL PROPERTY LAW 52 (2010).

benefits of the common market.¹⁵ Despite the well-known advantages of complete harmonization, it should be remembered that all Member-States pursue national policies over and above the goals of harmonization, undistorted competition, and the free movement of goods. These competing policies can often get in the way of harmonization.¹⁶

Competition law in the European Union is, by its nature, designed to ensure that both firms and Member-States are able to operate in a liberal economy without distorting or restricting competition that would inhibit the operations of a free market.¹⁷ Recently, across the globe, there has been a growing trend toward limiting intellectual property rights in order to promote public interests.¹⁸ One scholar has taken notice of the clash between, on the one hand, free movement of goods and open competition and, on the other hand, intellectual property rights.¹⁹ Professor Tritton has argued that much of this evolving conflict stems from the fact that the free movement of goods and competition law are relatively new in comparison to centuries-old intellectual property law.²⁰ Further compounding the conflict in the European Union, the federal laws established by the Treaty Articles mentioned above also have two different sets of goals including the free movement of goods and the protection of intellectual property rights.²¹ Indeed, the free movement of intellectually protected goods is different than that of free competition.²² Professor Ghidini has offered a more harmonious metaphor, whereby competition law acts as a “thermostat,” and when intellectual property rights become too “hot,” or entrenched, then competition law is used by the ECJ and the EC to douse those rights to promote the public interest.²³

For entities and practitioners that operate between the European Union and

¹⁵ See, e.g., LAURENT GARZANITI, TELECOMMUNICATIONS, BROADCASTING AND THE INTERNET: EU COMPETITION AND REGULATION 13 (Laurent Garzaniti & Matthew O'Regan eds. 3d ed. 2010) (stating that effective application of the EC Treaty's competition rules is crucial to liberalizing the European telecommunications market).

¹⁶ See ALISON JONES & BRENDA SUFRIN, EC COMPETITION LAW: TEXT, CASES AND MATERIALS 38 (2d ed. 2004) (citing a Commission report on competition policy noting that more intense competition with other EU firms brings pressure upon Member-States to shore up their firms against outside influence, such as by granting them State aid and thus distorting competition further).

¹⁷ See *id.* at 1.

¹⁸ See Frank Fine, *European Community Compulsory Licensing Policy: Heresy Versus Common Sense*, 24 NW. J. INT'L L. & BUS. 619, 619 (2004).

¹⁹ Meyers, *supra* note 6, at 141.

²⁰ TRITTON ET AL., *supra* note 1, at 999.

²¹ See, JONES & SUFRIN, *supra* note 16, at 693 (stating that there is little in the Treaty concerning intellectual property, and therefore Community law recognizes the existence of Member-States' ownership of rights pursuant to national law).

²² See CHRISTOPHER STOTHERS, PARALLEL TRADE IN EUROPE: INTELLECTUAL PROPERTY, COMPETITION AND REGULATORY LAW 189 (2007) (raising the problem of the existence of an “anti-competitive restriction even where there is no exhaustion of rights.”).

²³ GUSTAVO GHIDINI, INTELLECTUAL PROPERTY AND COMPETITION LAW: THE INNOVATION NEXUS 7 (2006).

the United States, matters can become even more complex, especially in regard to competition law and its relation to intellectual property law. Virtually all countries in the world provide some level of exclusive intellectual property rights.²⁴ There is significant contention, however, that there is a growing divide between the United States and the European Union on how to handle competition matters (*i.e.*, “antitrust” in the United States).²⁵ In regard to this division, the United States is more likely to defend intellectual property rights than the European Union which is more likely to protect competition interests.²⁶ For example, the European Union is more likely to consider the interests of potential licensors (*e.g.*, intellectual property holders) and licensees in contrast to United States courts.²⁷ In addition, the showing of a dominant position – the equivalent to the concept of market power in the United States – has a lower threshold in Europe than in the United States.²⁸ Thus, it is easier to show a competition rules/antitrust violation in Europe. Therefore, the European Union is more likely to grant a compulsory license than United States courts. Since 1988, this trend in the European Union has become more significant.²⁹

Much of the separation between the law in the United States and the laws in the European Union can be characterized as cultural. Historically, in Europe, intellectual property rights have been viewed with suspicion and have been associated with creating barriers to entry and price increases.³⁰ In contrast, the United States has little sympathy for compulsory licensing, thanks in part to significant lobbying efforts by large firms, especially in the biotech and pharmaceutical industry.³¹ There is also evidence that United States firms are cognizant of the above mentioned trend to weaken intellectual property rights and are willing to compromise on their own and license their intellectual

²⁴ DAVID T. KEELING, *INTELLECTUAL PROPERTY RIGHTS IN EU LAW VOLUME 1: FREE MOVEMENT AND COMPETITION LAW 2* (2004).

²⁵ Melanie J. Reichenberger, Note, *The Role of Compulsory Licensing in Unilateral Refusals to Deal: Have the United States and European Approaches Grown Further Apart After IMS?*, 31 J. CORP. L. 549, 550 (2006).

²⁶ Fine, *supra* note 18, at 620.

²⁷ STEVEN D. ANDERMAN, *EC COMPETITION LAW AND INTELLECTUAL PROPERTY RIGHTS* 32–33 (1998) (contrasting the United States system, which focuses solely on the economic benefit and risk effects of licensing agreements, with the broader approach in EC competition law).

²⁸ VALENTINE KORAH, *INTELLECTUAL PROPERTY RIGHTS AND THE EC COMPETITION RULES* 133 (2006).

²⁹ Fine, *supra* note 18, at 620–21 (stating that beginning with the *Magill* decision in 1988, and continuing to the present, the European Union continues to expand the use of compulsory licensing).

³⁰ Coco, *supra* note 8, at 10.

³¹ See Donna M. Gitter, *International Conflicts Over Patenting Human DNA Sequences in the United States and the European Union: An Argument for Compulsory Licensing and a Fair-Use Exception*, 76 N.Y.U. L. REV. 1623, 1681, 1681 n.379 (2001); Lissett Ferreira, Note, *Access to Affordable HIV/AIDS Drugs: The Human Rights Obligations of Multinational Pharmaceutical Corporations*, 71 FORDHAM L. REV. 1133, 1157 (2002) (discussing how through the United States government, the American pharmaceutical lobby has fought African efforts to make HIV/AIDS drugs affordable by compulsory licensing).

property rights.³² Professor Gitter has recommended that the United States follow the more favorable attitude toward compulsory licensing found in the European Union as a means to stimulate innovation, research, and development.³³ Moreover, Professor Reichenberger has argued that the European Union approach to competition law is preferable to the U.S. approach to competition/antitrust matters in that a compulsory license allows for the more powerful firm to stay intact whereas the United States approach requires, if the transgressions are egregious, the powerful firm be dissolved.³⁴ Reichenberger's position would allow for a larger firm to maintain intact, provides efficiencies of scale, and pass those efficiencies onto the public even in the form of a compulsory license to competitors.³⁵

One of the most significant attempts at harmonization has come from efforts by the World Intellectual Property Organization ("WIPO") which currently boasts 185 member-states around the globe including all twenty-seven Member-States of the European Union.³⁶ WIPO has attempted to create a global patent system, which would have to address compulsory licensing.³⁷ However, despite Europe's greater support for compulsory licensing, the European Union has recently backed away from international agreements that would tie its Member-States to global compulsory licensing conditions.³⁸ Although the European Union was a willing participant in the negotiations leading to the Agreement on Trade Related Aspects of Intellectual Property Rights ("TRIPS Agreement"), an agreement designed to foster protection and recognition of intellectual property rights among its members, the European Union has not provided consent to compulsory licensing technology to assist in international environmental affairs.³⁹ Indeed, the TRIPS Agreement allows for countries to

³² *Id.* at 1679–80.

³³ *See id.* at 1691.

³⁴ Reichenberger, *supra* note 25, 563–64 (concluding that though compulsory licensing is a last resort, it is preferable to the dismantling of a large firm).

³⁵ *Id.* at 564–65.

³⁶ *Member States*, WORLD INTELLECTUAL PROP. ORG., <http://www.wipo.int/members/en/> (last visited Mar. 6, 2013).

³⁷ Susan K. Sell, *The Quest for Global Governance in Intellectual Property and Public Health: Structural, Discursive, and Institutional Dimensions*, 77 TEMP. L. REV. 363, 385–86 (2004). "[M]any suspect that the momentum behind the renewed effort is animated by a quest to increase property rights protection . . . [t]he current deliberations pose a danger to developing countries." *Id.* at 386 (alterations added). The renewed (since 2001) WIPO effort stalled in 2006 when a coalition of developing countries proposed that the system should include provisions on "anti-competitive practices, [and] safeguarding of public interest flexibility." *Draft Substantive Patent Law Treaty*, WORLD INTELLECTUAL PROP. ORG., <http://www.wipo.int/patent-law/en/harmonization.htm> (last visited Mar. 23, 2013) (alteration added).

³⁸ *See* Matthew Rimmer, *A Proposal for a Clean Technology Directive: European Patent Law and Climate Change*, 3 RENEWABLE ENERGY L. & POL'Y REV. 195, 198 (2011) (stating that the European Union was hostile to measures including compulsory licensing in a February 10, 2010 annex on enhanced action on technology development, and that there was no mention of intellectual property in the Cancun Agreements of 2010).

³⁹ *Id.* at 198; Agreement on Trade-Related Aspects of Intellectual Property Rights, Including

mandate compulsory licenses when there has been a good faith attempt to secure a license or in times of emergency such as a health-related epidemic.⁴⁰

Resistance to global compulsory licensing schemes shown by the European Union, its Member-States, and the United States is not shared globally. African and Asian countries have a different philosophy of compulsory licensing in that the governments are more likely to issue a compulsory licenses to patented medications to stave off critical illnesses.⁴¹ One of the dominant beliefs across the globe, and what furthers the movement toward a reduction of intellectual property rights in favor of the public interest, is a belief that all people should have access to scarce resources, including medicine.⁴² To some governments, there is a moral and ethical responsibility to require compulsory licenses for pharmaceutical firms to operate in the respective country.⁴³ At least one commentator has characterized this reality as an “emotional battleground” and that in the face of such poor public relations, the mere threat of a compulsory license issued by a government has forced pharmaceutical firms to negotiate a license on at least slightly more favorable terms than a compulsory license.⁴⁴

The Doha Round of WTO negotiations, which continues today, is the successor to the Uruguay Round of negotiations and has attempted to further integrate the WTO member-states.⁴⁵ The Doha Round was left to address unresolved issues from the Uruguay Round, some of which involve intellectual property rights including compulsory licensing.⁴⁶ The WTO Doha Declaration on the TRIPS Agreement did maintain a provision for compulsory licensing in line with the existing TRIPS Agreement.⁴⁷ The Doha Declaration loosened the

Trade in Counterfeit Goods, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 320 (1999), 1869 U.N.T.S. 299 [hereinafter TRIPS Agreement].

⁴⁰ TRIPS Agreement, *supra* note 39, at 313–14.

⁴¹ Fine, *supra* note 18, at 619 (illustrating an instance where African and Asian countries were able to obtain compulsory licenses to get critical medicine to help combat AIDS epidemics through the Doha round of WTO talks in 2001).

⁴² See Ferreira, *supra* note 31, at 1158–59; Michael A. Santoro, *Human Rights and Human Needs: Diverse Moral Principles Justifying Third World Access to Affordable HIV/AIDS Drugs*, 31 N.C. J. INT'L L. & COM. REG. 923, 939–42 (2006).

⁴³ *Id.* at 930 (citing the Doha Declaration as a victory for developing countries).

⁴⁴ Alexandra G. Watson, *International Intellectual Property Rights: Do TRIPS' Flexibilities Permit Sufficient Access to Affordable HIV/AIDS Medicines in Developing Countries?*, 32 B.C. INT'L & COMP. L. REV. 143, 150 (2009).

⁴⁵ Robert Howse, *Multilateralism and Diversity: Rethinking the Structure of WTO Agreements*, 103 AM. SOC'Y INT'L L. PROC. 427, 427 (2009).

⁴⁶ See *id.*; Brent Savoie, Note, *Thailand's Test: Compulsory Licensing in an Era of Epidemiological Transition*, 48 VA. J. INT'L L. 211, 213–14 (2007) (stating that the WTO Ministerial Conference tried to clarify the extent of the compulsory license provisions from the Doha Declaration on the TRIPS Agreement and Public Health).

⁴⁷ World Trade Organization, *Ministerial Declaration on the Trips Agreement and Public Health*, WT/MIN(01)/DEC/2, 41 I.L.M. 755, 755 (2002).

TRIPS limitation ability of countries to issue compulsory licenses to domestic firms to allow them to manufacture and export patented medicines to countries that would otherwise qualify to issue a compulsory license.⁴⁸ Pursuant to the Doha Declaration, it is up to the World Health Organization to determine whether a country has the domestic capacity to develop a protected good.⁴⁹

The Doha Round of negotiations has stalled,⁵⁰ and many developed countries, including the United States, still fear that compulsory licensing will be abused by developing countries.⁵¹ Many of the world's large pharmaceutical firms also fear abuse of compulsory licensing practices if the Doha Declaration were implemented, especially if the royalty rates are low and firms with compulsory licenses are able to produce at low expense and then export.⁵² There is some evidence that this concern is overstated. Many Asian and African nations have successfully granted compulsory licenses for antiretroviral drugs for domestic consumption with virtually no threat that any excess supply is being created or exported.⁵³ Regardless, the world's largest pharmaceutical firms are challenging domestic compulsory licensing laws that make it easier for governments to grant, and competing drug producers to produce, needed pharmaceuticals.⁵⁴

I. SUBSTANTIVE PROVISIONS OF THE TREATY

Article 34 of the Treaty prohibits Member-States from enacting laws or enforcing judgments that serve as a quantitative restriction on imports.⁵⁵ Article 34 and its close cousin that addresses exports, Article 29, are the chief

⁴⁸ *Id.*

⁴⁹ Ellen 't Hoen, *TRIPS, Pharmaceutical Patents, and Access to Essential Medicines: A long Way From Seattle to Doha*, 3 CHL J. INT'L L. 27, 35–36 (2002).

⁵⁰ Jeffrey T. Lewis, *WTO Candidate Says Stalled Talks Put Group at Risk*, THE WALL STREET JOURNAL (Feb. 20, 2013, 3:44 PM), <http://online.wsj.com/article/SB10001424127887324503204578316424118557546.html>.

⁵¹ See Ian F. Ferguson, CONG. RESEARCH SERV., RL 33750, THE WTO, INTELLECTUAL PROPERTY RIGHTS, AND THE ACCESS TO MEDICINES CONTROVERSY 1 (2006) (stating that developed countries view the TRIPS agreement as a safeguard).

⁵² *A Big Worry for Big Pharma*, HINDUSTAN TIMES, Mar. 13, 2012, <http://www.hindustantimes.com/editorial-views-on/Edits/A-big-worry-for-big-pharma/Article1-824967.aspx>.

⁵³ Lisa Forman, *Trade Rules, Intellectual Property, and the Right to Health*, 21 ETHICS & INT'L AFF. 337, 341 (2007).

⁵⁴ *E.g.*, Bryan C. Mercurio, *TRIPS, Patents, and Access to Life-Saving Drugs in the Developing World*, 8 MARQ. INTELL. PROP. L. REV. 211, 223–24 (2004) (discussing challenges by firms to South African compulsory licensing law).

⁵⁵ Article 34 of the Treaty states: "Quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between the Member States." TFEU art. 34. Article 35 of the Treaty is also a provision designed to promote the free movement of goods. Article 35 states: "Quantitative restrictions on exports, and all measures having equivalent effect, shall be prohibited between Member States." TFEU art. 35.

mechanisms to block attempts by Member-States to engage in protectionism. Article 36 of the Treaty allows for exceptions to Articles 34 and 29 whereby Member-States can write laws that may limit imports and exports on several grounds, including public morality, public security, protection of life and animals, protection of national artifacts, and/or the protection of industrial and commercial property.⁵⁶ However, such exceptions cannot be instituted by a Member-State in a way that is arbitrary or as a disguised restriction on imports or exports.⁵⁷

Articles 101 and 102 focus on competition matters. Article 101 of the Treaty prohibits agreements between commercial entities that interfere with the operation of a common market allowing for the free flow of goods, services, capital, and labor.⁵⁸ Specifically, Article 101 focuses on the agreements

⁵⁶ Article 36 of the Treaty states:

The provisions of Articles 34 and 35 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.

TFEU art. 36.

⁵⁷ *Id.*

⁵⁸ Article 101 of the Treaty on European Union states:

1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction, or distortion of competition within the internal market, and in particular those which:

- (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
- (b) limit or control production, markets, technical development, or investment;
- (c) share markets or sources of supply;
- (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to the Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings,
- any decision or category of decisions by associations of undertakings,
- any concerted practice or category of concerted practices,

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair

between private parties and not governments.⁵⁹ However, Member-State governments are not permitted to enforce such agreements.⁶⁰ Article 102 prohibits successful market participants who enjoy a dominant position from abusing that dominant position either directly or indirectly.⁶¹ Article 102 prohibits Member-States from allowing the abuse of a dominant position to continue, as well.⁶²

Although outside the scope of this work, but perhaps helpful to the practitioner, all European Union Member-States are party to the World Trade Organization's TRIPS Agreement.⁶³ Article 21 of the TRIPS Agreement does not allow for the compulsory licensing of trademarks but Article 31 allows for the compulsory licensing of patents.⁶⁴ However, it is questionable as to whether Article 13 allows for the compulsory licensing of copyrighted works.⁶⁵

II. THE COMPULSORY LICENSE REMEDY

Advocate General Jacobs of the ECJ stated that a compulsory license can be granted when "in terms of competition policy only in cases in which the

share of the resulting benefit, and which does not:

- (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
- (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Id. at art. 101.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ Article 102 of the Treaty on European Union states:

Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States.

Such abuse may, in particular, consist in:

- (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- (b) limiting production, markets or technical development to the prejudice of consumers;
- (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Id. at art. 102.

⁶² TFEU art. 102.

⁶³ TRITTON ET AL., *supra* note 1, at 54–55.

⁶⁴ TRIPS Agreement, *supra* note 39, at arts. 21, 31.

⁶⁵ *See id.* at art. 13.

dominant undertaking has a genuine stranglehold on the related market.”⁶⁶ The European Union and its Western commercial partners, including the United States and Canada, have the ability to issue compulsory licenses requiring the holders of intellectual property rights to license their rights to competitors in cases where the right holder possesses a dominant position in the market place.⁶⁷ However, there are some stark differences among the three governmental bodies as to how remedies are provided. In Canada and the United States, severe criminal and civil penalties can be used to punish those who engage in the abuse of a dominant position, yet a compulsory licensing remedy is rarely ordered.⁶⁸ In contrast, the European Union, as compared to the United States and Canada, more frequently and more generously requires a compulsory license.⁶⁹ This separation of philosophy seems to be marked by the desire to punish in the United States and Canada versus the desire for uniform regulation and access to scarce resources in the European Union.⁷⁰

A compulsory license is generally ordered by the executive or judicial branch of a government as a remedy when intellectual property law itself does not afford a remedy.⁷¹ A compulsory license is created when the governmental mandate requires an owner of intellectual property to provide at least one other firm or a government with a right to import, reproduce, and/or sell the intellectual property.⁷² In addition to a compulsory license, the EC, the executive body of the European Union and the governmental body likely to mandate a compulsory license in the European system, can issue an injunction against the non-competitive and abusive behavior of an intellectual property owner and/or can assess financial penalties.⁷³

A couple of challenges face the EC when it imposes a compulsory license. First, the EC must dictate the life of the compulsory license.⁷⁴ This is becoming more challenging due to the fact that technology is rapidly changing and the technology subject to the compulsory license can be replaced quickly.⁷⁵ A second challenge is to set the correct level of royalty payment. According to Tritton, the dominant theory supporting a royalty levied in a compulsory license

⁶⁶ Case C-7/97, Opinion of Advocate General Jacobs, *Oscar Bronner GmbH&Co. KG v. Mediaprint Zeitungs- und Zeitschriftenverlag GmbH&Co. KG*, [1998] E.C.R. I-7813, ¶ 65.

⁶⁷ Brian A. Facey & Dany H. Assaf, *Monopolization and Abuse of Dominance in Canada, the United States, and the European Union: A Survey*, 70 ANTITRUST L.J. 513, 556 (2002).

⁶⁸ *Id.* at 569–72, 574.

⁶⁹ *See id.* at 579 (stating that European Union laws “provide greater powers to force compulsory licensing.”).

⁷⁰ *Id.* (arguing that the European Union favors more of a regulatory approach in its competition regime).

⁷¹ TRITTON ET AL., *supra* note 1, at 1000; Vaughan, *supra* note 2, at 96–97.

⁷² Vaughan, *supra* note 2, at 96–97.

⁷³ Council Directive 2004/48, of the European Parliament and of the Council of 29 April 2004 on the Enforcement of Intellectual Property Rights art. 9, 2004 O.J. (L 157) 1, 70 (EC).

⁷⁴ Fine, *supra* note 18, at 629.

⁷⁵ *Id.*

includes a measure of the intellectual property right holder's costs plus a reasonable return.⁷⁶ Therefore, given the EC's power under Articles 101 and 102, the EC can deal a three-part blow to a property right holder: the compulsory license itself, the duration of the license, and the royalty supporting the license. The ECJ, however, does have the ability to alter and/or nullify an EC decision to mandate a compulsory license,⁷⁷ as it did in *NDC Health Corp. v. IMS Health Inc.*⁷⁸

A common argument made by those that oppose compulsory licensing is that such a threat dilutes the power of intellectual property.⁷⁹ Professor Fine has argued that what dilutes intellectual property rights is not the possibility of compulsory licensing, but the frequency by which the EC and the ECJ mandate a compulsory license.⁸⁰ At least one commentator noted that an increase in the number of compulsory licenses can so dilute intellectual property rights that firms will withdraw their efforts to become innovative, harming the public interest.⁸¹ Fine has further suggested that it would be best for the legislatures to create a compulsory licensing scheme providing notice to innovators ahead of time instead of allowing the EC and the ECJ to determine the merit of a compulsory license on a case-by-case basis.⁸² In contrast, Keeling has stated that a compulsory license can be a gain to an intellectual property right owner in that if a compulsory license is ordered, that order is a source of protection against a competitor claiming that the owner's rights have been exhausted since the use of the intellectual property is not voluntary.⁸³

III. COMPULSORY LICENSING, AND ARTICLES 34 AND 35 OF THE TREATY

The purpose of this work is to provide the reader with a working knowledge of the compulsory licensing issues that commonly arise in the European Union. The scope of this work is limited to the more noteworthy cases in European Union jurisprudence that best reflect the issues most frequently encountered by parties either seeking to gain, or seeking to prevent, a compulsory license.

⁷⁶ TRITTON ET AL., *supra* note 1, at 1082–83. Tritton discusses the criticisms of the cost plus reasonable return approach and the alternate approach of considering what rate would have been set in negotiation between a willing licensor and licensee. *Id.* at 1082–86.

⁷⁷ *Id.* at 1110.

⁷⁸ Case C-481/01, [2002] E.C.R. I-3407, ¶ 1, I-3436, ¶ 92.

⁷⁹ Fine, *supra* note 18, at 622.

⁸⁰ *Id.*

⁸¹ E.g., Katarzyna A. Czapracka, *Where Antitrust Ends and IP Begins – on the Roots of the Transatlantic Clashes*, 9 YALE J.L. & TECH. 44, 47–48, 72–77 (2007).

⁸² See Fine, *supra* note 18, at 645–46 (noting that the current regime creates uncertainty because the essential facilities doctrine is still in the process of being defined by the EC and ECJ).

⁸³ KEELING, *supra* note 24, at 87.

A. *Case Law on Articles 34⁸⁴ and 36⁸⁵*

The facts of *Pharmon BV v. Hoechst AG* serve as a good beginning to the exploration of compulsory licensing within the European common market.⁸⁶ In *Pharmon BV*, the Hoechst firm held a process patent in Germany, the United Kingdom, and the Netherlands for the manufacture of the pharmaceutical frusemide.⁸⁷ Pursuant to British law which allowed for compulsory licenses for patents in the foodstuffs, medicines, and surgical instruments sectors, DDSA Ltd. secured a non-exclusive, non-assignable, compulsory license granted by the British government to manufacture the product in the United Kingdom.⁸⁸ Despite the British government's stipulation on the compulsory license that the products could not be exported, DDSA Ltd. imported the frusemide medicine into the Netherlands.⁸⁹ Pharmon was a Dutch firm that purchased large quantities of frusemide to be sold in the Netherlands and petitioned the Dutch courts to find that Article 34 would be violated by the enforcement of the export ban associated with the compulsory license granted by the United Kingdom.⁹⁰

Pharmon BV's chief argument was that Article 34 must allow the holder of a compulsory license to produce patented goods in one Member-State and export them to another Member-State when the patent holder has parallel patent rights in both Member-States so long as the patent holder receives reasonable compensation.⁹¹ In contrast, Hoechst, the owner of the patent rights to frusemide, contended that Article 34 is not violated if a patent owner chooses to exercise its rights under domestic Member-State law and prohibit the parallel

⁸⁴ Article 34 of the TFEU was formerly Article 28 under the Treaty Establishing the European Community ("TEC") before the Treaty of Lisbon changed the name of the TEC Treaty to the TFEU, and also changed the article numbers. Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Communities art. 5, Dec. 13, 2007, 2007 O.J. (C 306) 1 [hereinafter Treaty of Lisbon]; Consolidated Version of the Treaty Establishing the European Community art. 28, 2002 O.J. (C 325) 33 [hereinafter TEC Treaty]. Article 28 of the TEC was Article 30 under the Treaty Establishing the European Economic Community ("EEC") before the the Treaty of Maastricht changed the EEC to the TEC and the Treaty of Amsterdam changed the article numbers. Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts art. 12, Oct. 2, 1997, 1997 O.J. (C 340) 1 [hereinafter Treaty of Amsterdam]; Treaty on European Union art. G, Feb. 7, 1992, 1992 O.J. (C 191) 1 [hereinafter Treaty of Maastricht]; Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11, 26 [hereinafter EEC Treaty].

⁸⁵ TFEU Article 36 was formerly TEC Article 30 under the TEC before the Treaty of Lisbon. Treaty of Lisbon art. 5; TEC Treaty art. 30. Article 30 of the TEC was Article 36 under the EEC before the Treaty of Maastricht changed the EEC to the TEC and the Treaty of Amsterdam changed the article numbers. Treaty of Amsterdam art. 12; Treaty of Maastricht art. G; EEC Treaty art. 36.

⁸⁶ See generally Case 19/84, [1985] E.C.R. 2281.

⁸⁷ *Id.* at 2293, ¶ 3.

⁸⁸ *Id.* at 2293, ¶¶ 4–7.

⁸⁹ *Id.* at 2293, ¶¶ 7–8.

⁹⁰ *Id.* at 2293–95, ¶¶ 8, 10–12, 14.

⁹¹ *Id.* at 2295–96, ¶¶ 15–16.

import of its patent-protected pharmaceutical.⁹²

The ECJ made two indirect statements about the nature of compulsory licenses and the jurisprudence behind Article 34.⁹³ First, the ECJ noted that there is a significant difference between a compulsory license and a traditional license in that compulsory licenses do not allow for “real negotiations” between the licensor and the licensee, and the objective of a compulsory license is designed to meet the special needs of an individual Member-State.⁹⁴ Second, the ECJ noted that the Court itself had consistently held that Articles 34 and 36 “preclude the application of national provisions [that allow a patent owner] to prevent the importation and marketing of a product which has been lawfully marketed in another Member State by the patent [owner] himself, with his consent, or by a person legally or economically dependent on him.”⁹⁵

However, the Court found that the fact that the license is compulsory makes a difference in the application of Articles 34 and 36.⁹⁶ According to the Court, Article 34 would bar a patent holder from prohibiting its protected goods made in one Member-State and exported to another Member-State if the license held by the exporter-manufacturer were a traditional license since the patent holder could then partition markets and restrict trade between the Member-States.⁹⁷ In the case of a compulsory license, the patent holder is not voluntarily placing the patented good into the market of a particular Member-State and thus the patent holder should have the ability to assert rights under the law of the compulsory license-granting Member-State to block the exportation of its goods to another Member-State even if the patent holder has parallel rights in the latter Member-State under Articles 34 and 36.⁹⁸

Perhaps the most complicated case involving compulsory licensing in European Union jurisprudence, yet also the most revealing of its jurisprudence on the subject matter, is *Allen & Hanburys Ltd v. Generics (UK) Ltd.*⁹⁹ Here, the ECJ, while addressing four questions referred by the British House of Lords, provided several statements serving as guidelines for the difficult nature of patents that provide for licenses of right.¹⁰⁰

Allen & Hanburys Ltd., a pharmaceutical firm, held a patent on the pharmaceutical Salbutamol that was qualified as a patent allowing for licenses of right.¹⁰¹ Pursuant to the British Patents Act of 1977, if a patent is qualified as providing for licenses of right, the British government can grant a compulsory

⁹² *Pharmon BV*, [1985] E.C.R. at 2296, ¶ 17.

⁹³ *See id.* at 2296–97, ¶¶ 18–19, 22.

⁹⁴ *Id.* at 2296, ¶¶ 18–19.

⁹⁵ *Id.* at 2297, ¶ 22 (alterations added).

⁹⁶ *See generally Pharmon BV*, [1985] E.C.R. 2281.

⁹⁷ *Id.* at 2297–98, ¶¶ 23–24.

⁹⁸ *Id.* at 2298–99, ¶¶ 26–27.

⁹⁹ *See generally Case 434/85*, [1988] E.C.R. 1245.

¹⁰⁰ *See generally id.*

¹⁰¹ *Id.* at 1269, ¶¶ 2–3.

license to a license applicant if negotiations between a patent holder and the license applicant fail to produce a license.¹⁰² The British law also allowed the government to put forth stipulations on the compulsory license, which could include a prohibition on the product being imported into the United Kingdom, which was in contrast to Generics' plan to import the patent-protected drug from Italy.¹⁰³ The ECJ held that such a stipulation on a government-granted compulsory license violates Article 34's prohibitions on quantitative restrictions in that the stipulation provided for differential treatment of goods based on their location of manufacture.¹⁰⁴ Likewise, the ECJ stated that Article 36 does not allow for a Member-State's national court to issue an injunction against importation based on the Article's protection of industrial and commercial property clause.¹⁰⁵ According to the ECJ, only in circumstances whereby national law does not discriminate based on whether the intellectual property-protected goods are imported or manufactured domestically can a Member-State invoke the industrial and commercial property clause.¹⁰⁶

The ECJ has on several occasions reminded the reader of its jurisprudence that patent law in the European Union has not been harmonized and thus that patent rights are granted individually by each Member-State.¹⁰⁷ However, one of the questions posed to the ECJ by the House of Lords was whether Articles 34 and 36 should be applied differently if, such as in this case regarding pharmaceuticals, the goods are not patentable in the Member-State in which they are produced.¹⁰⁸ The ECJ stated that the Articles should not be applied differently based on the patent law of the exporting and importing Member-States despite the fact manufacturers in Member-States that do not grant such patent protection need not bear the costs of research and development.¹⁰⁹

Similar to the outcome in *Allen & Hanburys Ltd.*, the ECJ held in *Generics (UK) Ltd. v. Smith Kline*¹¹⁰ that Articles 34 and 36 bar the governments of

¹⁰² *Id.* at 1270, ¶ 4(1).

¹⁰³ *Id.* at 1269–70, ¶¶ 2, 4(1).

¹⁰⁴ *Id.* at 1276, ¶ 27.

¹⁰⁵ *Allen & Hanburys Ltd.*, [1988] E.C.R. at 1272–75, ¶¶ 9–23.

¹⁰⁶ *See id.* at 1272–73, ¶¶ 9, 14, 1275, ¶¶ 22–23 (holding that import restrictions justified under the industrial and commercial property clause cannot discriminate arbitrarily, that the injunction was arbitrarily discriminated, and finally that Articles 34 and 36 prohibit injunctions against importers where no injunction would be available against a domestic manufacturer). The ECJ held the same rationale for restrictions based on consumer protection and fair trading concerns. *Id.* at 1278, ¶ 36.

¹⁰⁷ *See, e.g., id.* at 1269, ¶¶ 1–3; Case 235/89, *Comm'n v. Italian Republic*, [1992] E.C.R. I-823–24, ¶¶ 12–13. This lack of harmonization is likely to persist since the ECJ recently found the European Union's proposal to create a "European and Community Patents Court" incompatible with European Union law. Opinion 1/09, 2011 O.J. (C 211) 2–3. The ECJ's ruling also stops efforts to create a single European patent to replace the domestic patent law across Europe. *Single European Patent Court is 'Incompatible' with Law*, BIOWORLD INT'L, Aug. 25, 2010, <http://www.bioworld.com/content/single-european-patent-court-incompatible-law-0>.

¹⁰⁸ Case 434/85, *Allen & Hanburys, Ltd.*, [1988] E.C.R. 1276, ¶ 28.

¹⁰⁹ *Id.* at 1276–77, ¶¶ 30–32.

¹¹⁰ Case C-191/90, [1992] E.C.R. I-5335.

Member-States from limiting the grant of compulsory licenses to patented products that come from non-European Union countries when the owner of those same patented goods manufactures the goods within the European Union.¹¹¹ The patent held by Smith Kline on the drug Cimetidine was subject to British law requiring the British government to grant licenses to applicants who wished to develop and/or import the drug if the applicant and the patent holder could not agree on their own to a licensing agreement.¹¹² Smith Kline and Generics were unable to reach their own agreement, but when the British government established a compulsory licensing agreement between the two parties, the government included a ban on the importation of Cimetidine from non-Member-States, as well as from Portugal and Spain, despite the fact that the drug was partially manufactured in Ireland and finished in the United Kingdom.¹¹³

In consistent fashion, the ECJ found that the British government's compulsory license was discriminatory because it encouraged patent owners to manufacture their protected products within the home Member-State and such a dynamic hinders trade within the European Union in violation of Article 34.¹¹⁴ The ECJ did state that Member-States can prohibit imports from non-Member-States when exercising compulsory licensing legislation, but they cannot do so in a way that is discriminatory *and* affects trade between Member-States.¹¹⁵

Likewise, the ECJ stated that Article 36 only allows for exceptions when the rights of patent holders of industrial and commercial property are facing a threat specific to the subject matter of the patent, and here, no such threat existed and the British government was only favoring domestic production.¹¹⁶ The ECJ again cited the threat to the economy and consumers if Member-States were able to unilaterally condition their compulsory licensing schemes.¹¹⁷

In *Commission v. Italian Republic*,¹¹⁸ the ECJ flatly stated that Member-States cannot treat patent right holders who produce goods outside Italy differently from domestic patent right holders who produce patented products domestically in regard to compulsory licensing.¹¹⁹ Here, Italian law provided for the award of a non-exclusive compulsory license to any applicant when the foreign patent right holder did not either "exploit" (*i.e.*, use, sell or market the good) the patent in Italy or did not "exploit" the patent in a way that was

¹¹¹ *Id.* at I-5376, ¶ 28.

¹¹² *Id.* at I-5369–70, ¶¶ 2–4.

¹¹³ *Id.* at I-5370–71, ¶ 8. It should be noted that although Spain and Portugal had joined the European Union, they were treated as non-Member States for the purposes of importation by the accession agreements specific to those countries. *Id.*

¹¹⁴ *Id.* at I-5374, ¶ 20.

¹¹⁵ *Id.* at I-5374, ¶¶ 17–18.

¹¹⁶ *Smith Kline*, [1992] E.C.R. at I-5375, ¶¶ 21–24.

¹¹⁷ *Id.* at I-5376, ¶ 27.

¹¹⁸ Case C-235/89, [1992] E.C.R. I-777.

¹¹⁹ *See id.* at I-822, ¶ 8, I-827, ¶ 29.

seriously disproportionate to the country's needs.¹²⁰ Specifically, Italian law provided that any manufacture of a product associated with a patent was not alone considered "exploitation" which in turn allowed the Italian government to provide compulsory licenses to any product that was manufactured outside Italy.¹²¹

The Italian government argued that its decree was justified on several grounds. Firstly, and most importantly, the Italian government argued that the decree was supported by Articles 34 and 36.¹²² More specifically, the exceptions allowed for public policy and the protection of industrial and commercial property.¹²³ The Italian government also argued that the law could be justified under Article 345,¹²⁴ which prohibits the Treaty's ability to interfere with a Member-State's ability to regulate property ownership.¹²⁵

The ECJ agreed with the EC's assertion that the Italian law was an illegal quantitative restriction under Article 34 and stated that the patent right holder should be able to decide in what country within the European Union to exploit the technology and how to exploit the technology, either by directly manufacturing the product or by granting a license.¹²⁶ If the Italian law were to stand, however, then the patent right holder would have a significant incentive to produce the product in Italy to avoid a punitive compulsory license that doubtfully could match the market rate for a traditional license.¹²⁷ The ECJ clearly believed that the Italian government's mission was to move production of patented goods to Italy and stated that such a law specifically frustrates the purpose of the common market.¹²⁸ The ECJ also stated that it was not important to the outcome as to how many times the Italian government invoked its power to order a compulsory license.¹²⁹

¹²⁰ *Id.* at I-820–21, ¶¶ 3–4.

¹²¹ *Id.* at I-820, ¶ 3, I-822, ¶ 8.

¹²² *Id.* at I-823, ¶ 11.

¹²³ *See id.* at I-824, ¶ 14.

¹²⁴ EEC Treaty art. 222 (as in effect 1958) (now TFEU Article 345).

¹²⁵ *Italian Republic*, [1992] E.C.R. at I-823–24, ¶¶ 11, 14. The Italian government also argued that its decree did not limit imports and that the European Commission's argument that the Italian decree was a quantitative restriction on imports would make the Community Patent Convention violate the Treaty. *Id.* at I-823, ¶ 11. As well, the Italian government argued that its law was justified under the Paris Convention. *Id.* The ECJ disagreed with these arguments. *Id.* at I-823, ¶ 12 (noting that neither the first or second version of the Community Patent Convention were in force), I-825, ¶ 23 (holding that the decree had "an effect equivalent to quantitative restrictions on imports"), I-826, ¶ 27 (stating that the Paris Convention cannot override Treaty violations). Article 345 of the Treaty states: "The Treaties shall in no way prejudice the rules in Member States governing the system to property ownership." TFEU art. 345.

¹²⁶ *Italian Republic*, [1992] E.C.R. at I-824–25, ¶¶ 17, 23.

¹²⁷ *Id.* at I-825, ¶ 20.

¹²⁸ *Id.* at I-826, ¶¶ 25–26.

¹²⁹ *Id.* at I-825, ¶ 21.

B. *Analysis of Articles 34 and 36 and the ECJ's Jurisprudence*

After reviewing the case law from the ECJ on compulsory licensing and Articles 34 and 36, one can see the competition between a Member-State's desire to use intellectual property law to develop its economy, and the mission of the Treaty to prevent restraints on trade between Member-States. In the above four cases, each Member-State was attempting to develop its economy by either keeping production and manufacture of the protected goods within its boundaries and/or attempting to control the prices of those goods.¹³⁰ For example, if the British government had not been successful in preventing the export of frusemide into the Netherlands, the government would have lost the ability to control the supply of the product and, in turn, lost the ability to control the price of frusemide.¹³¹ In contrast, if the good were able to be exported, the price of the good may have fluctuated based on the amount produced in the United Kingdom and how much of the product would be marketed in the United Kingdom and how much would have been exported.¹³² If one of the goals of the European Union is to make markets more efficient, then the *Pharmon BV* case represents a blow to the ability of the markets to set prices for goods by dictating the amount produced, held for domestic sale, and exported into another Member-State.¹³³

The verdict in *Allen & Hanburys Ltd.* worked against the British government's ability to regulate the location of manufacture of the protected product by way of a compulsory license.¹³⁴ Thus, the ECJ placed a significant limitation on the ability of a Member-State to use intellectual property law to stimulate the domestic manufacture of a particular product to provide jobs for the local economy as many countries instinctively wish to do. The same is true, but to a lesser extent, in *Smith Kline*.¹³⁵ The ECJ effectively placed a limit on the ability of Member-States to use intellectual property laws to keep production of a protected product within the European Union.¹³⁶ The outcome in *Italian Republic* has the same effect.¹³⁷ The Italian government's approach, when comparing the facts of all four cases in this section, was the most aggressive as it tried to provide a compulsory license to Italian firms when an Italian right

¹³⁰ See generally *Pharmon BV v. Hoechst AG*, [1985] E.C.R. 2281; Case 434/85, *Allen & Hanburys Ltd v. Generics (UK) Ltd.*, [1988] E.C.R. 1245; Case C-191/90, *Generics (UK) Ltd. v. Smith Kline*, [1992] E.C.R. I-5335; Case C-235/89, *Comm'n v. Italian Republic*, [1992] E.C.R. I-777.

¹³¹ See generally Case 19/84, *Pharmon BV v. Hoescht AG*, [1985] E.C.R. 2281.

¹³² See *id.*

¹³³ See *id.*

¹³⁴ Case 434/85, [1988] E.C.R. 1278-79.

¹³⁵ Compare *id.*, with *Smith Kline*, [1992] E.C.R. at I-5381.

¹³⁶ *Smith Kline*, [1992] E.C.R. at I-5381.

¹³⁷ See generally Case C-235/89, *Comm'n v. Italian Republic*, [1992] E.C.R. I-824-25, ¶¶ 17, 23, I-827, ¶ 29.

holder would not manufacture or sell the product in Italy.¹³⁸ The ECJ's decision, however, effectively gives control to the patent right holder to decide where to manufacture the protected good. In theory, the patent right holder could choose any European Union Member-State in which to make the product.

IV. COMPULSORY LICENSING AND ARTICLES 101 AND 102 OF THE TREATY

A. *Case Law on Articles 101 and 102*

The case law covering compulsory licensing, and Articles 101 and 102 can be placed into three issue-based subcategories including the (1) failing to supply and denying of access to commercial channels, (2) broadcasting, and (3) price setting.

1. Failing to supply and denying of access

When one firm decides to no longer supply a client with a particular product after years of doing so, the EC and the ECJ may find that the firm has abused of a dominant position, and may levy both a compulsory license and fines upon the firm.¹³⁹ In *Istituto Chemioterapico Italiano S.p.A. and Commercial Solvents Corporation v. Commission*, a complaint was filed by Zoja, a customer of Commercial Solvents, after being told it would no longer distribute aminobutanol, a raw material used to make ethambutol, an anti-tuberculosis drug, to Zoja.¹⁴⁰ At the time, only Commercial Solvents, the parent firm of Istituto which served as the European-based distributor, could supply adequate amounts of aminobutanol on the world market.¹⁴¹ The ECJ found that Commercial Solvents held a dominant position despite the fact that there were other methods available to make aminobutanol.¹⁴² The EC, as well as the ECJ, rejected Commercial Solvents' defense to the accusation of holding a dominant position since the alternative processes identified by Commercial Solvents were in their experimental stages.¹⁴³ The ECJ further found that Commercial Solvents had abused its dominant position through documentary evidence that made it clear the firm desired to increase its own supply of raw materials to get into the ethambutol market on its own instead of supplying raw materials to Zoja.¹⁴⁴ Interestingly, the ECJ stated that the finding of abuse was not negated

¹³⁸ See *id.* at I-824, ¶¶ 14–15.

¹³⁹ Joined Cases 6 & 7/73, *Istituto Chemioterapico Italiano S.p.A., Commercial Solvents Corp. v. Comm'n*, [1974] E.C.R. 256, ¶ 49.

¹⁴⁰ *Id.* at 226, 235, 245.

¹⁴¹ *Id.* at 250–51, ¶ 25.

¹⁴² *Id.* at 247, ¶ 9.

¹⁴³ *Id.* at 247–48, ¶ 13.

¹⁴⁴ *Commercial Solvents Corp.*, [1974] E.C.R. at 250, ¶ 24.

by the fact that Zoja had at one time cancelled a purchase of aminobutanol.¹⁴⁵ According to the ECJ, when Zoja once again approached Commercial Solvents for another order of the raw material, Commercial Solvents was required to reply to Zoja.¹⁴⁶ Commercial Solvents could not rely on a change in its commercial policy as an escape from the abuse accusation since the change in commercial policy and practice was designed to remove Zoja as a competitor in the market for ethambutol.¹⁴⁷

Three additional illustrative points on the subject of compulsory licensing can be deducted from *Commercial Solvents Corp.* First, the ECJ found that there was no escape from the finding of abuse of a dominant position due to the fact that the Italian-based supplier, Istituo, was merely a subsidiary of Commercial Solvents since their action was considered by the ECJ to be “united.”¹⁴⁸ Second, the ECJ did not find fault with the EC’s decision to order both a compulsory license for Commercial Solvents to supply Zoja with aminobutol and fines against Commercial Solvents for the act of infringing Article 102.¹⁴⁹ Third, and related to the point prior, the ECJ upheld the time period and quantity terms of the compulsory license set by the EC.¹⁵⁰

One of the most important doctrines in ECJ jurisprudence on the subject of abuse of a dominant position and its link to compulsory licensing is the essential facilities doctrine, which was essentially birthed in the EC decision of *Sea Containers v. Stena Sealink*.¹⁵¹ *Sea Containers* was initiated in 1992, when Sea Containers filed a complaint with the EC after it was denied access to a port in the United Kingdom controlled wholly by Stena Sealink, arguing that the latter’s control over the port and refusal to grant the former access to develop a new, faster ferry service constituted an abuse of a dominant position under Article 102.¹⁵² To further support its argument that the defendant had engaged in abuse, Sea Containers showed that it had offered Stena Sealink with specifics about times and passenger volumes to accommodate Stena Sealink’s shipping schedule, but was effectively denied access to Stena Sealink’s port.¹⁵³

The EC found that Stena Sealink maintained a dominant position and, in effectively denying access to Sea Containers, engaged in abuse of that dominant position.¹⁵⁴ According to the EC, the dominant position was established based on the fact that the “relevant market” for ferry passenger service was specific to

¹⁴⁵ *Id.* at 250, ¶ 23.

¹⁴⁶ *Id.* at 250–51, ¶¶ 23, 25.

¹⁴⁷ *Id.*

¹⁴⁸ *Id.* at 245, ¶ 1, 254–55, ¶ 41.

¹⁴⁹ *Id.* at 256, ¶ 46.

¹⁵⁰ *Commercial Solvents Corp.*, [1974] E.C.R. at 255–56, ¶¶ 42, 45–46.

¹⁵¹ *See* Commission Decision 94/19, of 21 December 1993, 1994 O.J. (L 15) 8, 15–19 (EC) [hereinafter *Sea Containers*].

¹⁵² *Id.* at 9.

¹⁵³ *Id.* at 10–11.

¹⁵⁴ *Id.* at 16, 18.

location and that alternative ports were geographically too far.¹⁵⁵ In regard to abuse, the Commission found evidence supporting Sea Containers' argument in that Stena Sealink had established the same fast, ferry service that Sea Containers had offered and was ready to provide two years earlier.¹⁵⁶

Most likely due to the complaint filed by Sea Containers, the parties agreed by 1994 to what the EC believed to be adequate access for the plaintiff, and thus a remedial measure issued by the EC was not necessary.¹⁵⁷ It is clear from the EC's opinion, however, that without the agreement, it would have granted the compulsory license to give the plaintiff access since Article 102 was infringed and Stena Sealink's actions negatively affected trade between the Member-States of the United Kingdom and Ireland, and since the location of the port was an essential facility.¹⁵⁸

The EC's decision in *Decca Navigator System* is illustrative of European Union law on the issues of a dominant position, the abuse thereof, and the evidence used to show both.¹⁵⁹ Racial Decca was the owner of the Decca Navigation System ("DNS") which was used world-wide, principally for sea navigation, and was at the time of the Commission's decision, one of only eleven sea navigation systems in existence and the only system used in the United Kingdom and Denmark.¹⁶⁰ At one time, Racial Decca had patents on the DNS which it used to prohibit use of the DNS without a license.¹⁶¹ The firm refused to sell the DNS receivers; it only leased them.¹⁶² Equally important was that the EC found that Racial Decca had a monopolistic position on sea navigation systems in the Northern European waters even after the firm's patents expired and that the firm continued to engage in behavior that would maintain and extend its dominant position.¹⁶³

Racial Decca first attempted to claim copyright protection on the details of the transmissions provided by the DNS, including mast positions, frequencies, and speeds so that competing receivers could not be imported into European Union Member-States.¹⁶⁴ Second, Racial Decca attempted to vary its signals so that competing receivers could not use them.¹⁶⁵ Third, the transmission signals were changed without notice to the consumer public which, according to the EC,

¹⁵⁵ *Id.* at 16–18.

¹⁵⁶ *See id.* at 17.

¹⁵⁷ *Sea Containers*, *supra* note 151, at 18.

¹⁵⁸ *Id.*

¹⁵⁹ *See generally* Commission Decision 89/113, of 21 December 1988, 1989 O.J. (L 43) 27 (EC) [hereinafter *Decca Navigator System*].

¹⁶⁰ *Id.* at 28.

¹⁶¹ *Id.* at 29–30.

¹⁶² *See id.* at 30.

¹⁶³ *Id.* at 41.

¹⁶⁴ *Id.* at 31–32.

¹⁶⁵ *Decca Navigator System*, *supra* note 159, at 32.

created great disturbances in the Northern European shipping area.¹⁶⁶ Fourth, the EC found that the few agreements that Racal Decca was able to reach with competing firms were coercive in nature.¹⁶⁷

According to the EC, the actions of Racal Decca were “beyond normal competitive behaviour.”¹⁶⁸ The EC found that the firm performed legally abusive maneuvers to limit technological and economic progress, and to alter the patterns of competition within the European Union in regard to investment, production capacity, and the number of competitors.¹⁶⁹ Not only did the EC find that Racal Decca’s internal actions abused a dominant position under Article 102 (*ex 86*), but also that the agreements that Racal Decca established with its competitors violated Article 101 (*ex 85*).¹⁷⁰ Although the EC was not asked to provide a compulsory license, the decision in the case at bar is a playbook for parties who desire to create a case for the need of a compulsory license.

Not all intellectual property falls neatly into the confines of patent, trademark, or copyright and indeed can include a method of doing business, including a distribution network, that is not subject to national industrial property protection. In *Oscar Bronner GmbH&Co. KG v. Mediaprint Zeitungs- und Zeitschriftenverlag GmbH&Co. KG*, the ECJ found that it is not an abuse of a dominant position under Article 102 (*ex 86*) for the owner of a large newspaper distribution chain to refuse to allow a smaller newspaper publisher to have access to that distribution chain.¹⁷¹

In the case at bar, Oscar Bronner filed suit in the Austrian courts alleging that Mediaprint’s large distribution network, along with its forty-six percent market share of home delivery newspaper subscribers in Austria, constituted a dominant position and that an abuse had occurred when Oscar Bronner asked for, and was denied, the ability to have its newspapers delivered alongside Mediaprint’s newspapers for a fee.¹⁷² In further support of its argument, Oscar Bronner alleged that the fact that Mediaprint allowed another newspaper to be distributed alongside its own newspaper, along with other services provided, such as printing, was proof of discrimination and abuse of a dominant position.¹⁷³ In contrast, Mediaprint contended that it did not hold a dominant position because there are other ways to deliver newspapers instead of home delivery, such as kiosk placement, and that it did not intend to eliminate

¹⁶⁶ *Id.*

¹⁶⁷ *Id.* at 42.

¹⁶⁸ *Id.*

¹⁶⁹ *Id.* at 44.

¹⁷⁰ *Id.* at 46.

¹⁷¹ See generally Case C-7/97, [1998] E.C.R. I-7791.

¹⁷² Case C-7/97, Opinion of Advocate General Jacobs, *Oscar Bronner GmbH&Co. KG v. Mediaprint Zeitungs- und Zeitschriftenverlag GmbH&Co. KG*, [1998] E.C.R. I-7794, ¶¶ 1–2.

¹⁷³ *Id.* at I-7794–95, ¶¶ 1, 2, 4.

competition.¹⁷⁴ Mediaprint also argued that its distribution network was at a capacity and could not tolerate the additional news delivery, and that it spent handsomely to develop the network it maintained.¹⁷⁵

The ECJ stated that only in exceptional circumstances can a government body compel a party holding a dominant position to contract with another party if the dominant position is merely dominant and not abused.¹⁷⁶ The ECJ also agreed with the EC's view that it is up to a national court to define the market for a particular good and/or service.¹⁷⁷ However, the Court also stated that any analysis of a dominant position must consider the interchangeability of goods and services, and any analysis of abuse should include a determination of whether the actions taken have hampered competition within the European Union.¹⁷⁸ Additionally, the ECJ, by equating the case at bar to a traditional intellectual property case, stated that a mere refusal to grant access or a license to a competitor is not alone abuse of a market place position even if the position is a dominant one.¹⁷⁹

Holding that Mediaprint did not breach Article 102 (*ex* 86), the ECJ stated, in contrast to Oscar Bronner's argument, that it did not seem impossible or unreasonably difficult to establish a home delivery distribution network for newspapers either alone or in conjunction with other newspaper firms.¹⁸⁰

The 2004 *Microsoft Corp. v. Commission* case is perhaps the most famous of compulsory licensing case in the European Union largely because the litigation covered the span of a decade.¹⁸¹ It is also noteworthy because it addressed all forms of intellectual property, including patent, copyright, trademark, and trade secrets.¹⁸² In *Microsoft Corp.*, Sun Microsystems, also an United States firm, filed a complaint with the EC alleging a violation of Article 102 due to the fact that Microsoft would not release its technology to Sun so that the latter firm could make its work group server compatible with Microsoft's Windows system.¹⁸³ The EC upheld Sun's complaint by establishing that Microsoft had abused a dominant position in two of three markets identified.¹⁸⁴ The ECJ required Microsoft to provide the technology necessary to other

¹⁷⁴ *Id.* at I-7795, ¶ 5, I-7801, ¶ 30.

¹⁷⁵ *Id.* I-7821, ¶ 9 (citing to the judgment of the ECJ).

¹⁷⁶ *Id.* at I-7827, ¶ 26.

¹⁷⁷ *Id.* at I-7828, ¶ 29, I-7830, ¶ 34.

¹⁷⁸ *Mediaprint*, [1998] E.C.R. at I-7828–29, ¶¶ 32, 34.

¹⁷⁹ *Id.* at I-7830, ¶ 39.

¹⁸⁰ *Id.* at I-7831–32, ¶¶ 44, 47.

¹⁸¹ *See generally* Case T-201/04, [2004] E.C.R. II-4463.

¹⁸² *See id.* at II-4499 (considering the risk of harm to the Microsoft and Windows trademarks that Microsoft argued could result from an application of Article 6(a) of the Decision), II-4506–08 (showing the court's analysis of the relevant copyright, patent and trade secrets issues).

¹⁸³ *Id.* at II-4473, ¶ 2.

¹⁸⁴ *Id.* at II-4475, ¶ 7.

software firms to ensure interoperability and imposed a significant fine.¹⁸⁵

On appeal, Microsoft stated that the EC's decision would force it to reveal intellectual property, regarding both copyright and patent rights, which would harm it irreparably.¹⁸⁶ Microsoft further argued that it would not, within the EC's set 120-day time limit for compliance, be able to file for patent rights to protect its patentable technology.¹⁸⁷ Microsoft additionally argued that a compulsory license was not needed since its competitors need only decompile its Windows system to get the interoperability technology needed.¹⁸⁸ Lastly, Microsoft contended that a compulsory license would prevent the firm from being able to decide for itself how to develop its products since the firm could only improve its products based on the limitations of other firms' products.¹⁸⁹

Despite the wealth of arguments put forth by the large, American-based firm, the ECJ found no evidence that the compulsory license requiring copyrighted, patent-protected, and patent-eligible data to be turned over to competitors would cause irreparable harm.¹⁹⁰ Interestingly, part of the ECJ's analysis focused on the fact that no party had intervened on Microsoft's behalf.¹⁹¹ In more concrete fashion, the ECJ did not find that Microsoft could show that the revelation of its intellectual property would reduce the appeal of its products.¹⁹² The ECJ also stated that it would be quite difficult to show irreparable harm without showing a diminished sense of quality under the Microsoft name which the firm, according to the ECJ, could not do.¹⁹³ Furthermore, and perhaps more importantly to the ECJ, Microsoft could not prove that the competing firms could replicate its technology.¹⁹⁴ Lastly, the ECJ was not convinced that any damage would be brought to bear on Microsoft's trademark as a source of "the basic concept" behind personal computing.¹⁹⁵

2. Broadcasting

Articles 101 (*ex* 85) and 102 (*ex* 86) constitute the European Union's antitrust law equivalent to that of the United States.¹⁹⁶ The case of *Tiercé Ladbroke SA v. Commission* is Europe's most descriptive discussion of the

¹⁸⁵ *Id.* at II-4482, ¶¶ 26, 27.

¹⁸⁶ *Id.* at II-4504, ¶ 113.

¹⁸⁷ *Microsoft Corp.*, [2004] E.C.R. at II-4507, ¶ 122.

¹⁸⁸ *Id.* at II-4509, ¶ 127.

¹⁸⁹ *Id.* at II-4514, ¶ 143.

¹⁹⁰ *Id.* at II-4598, ¶ 417.

¹⁹¹ *Id.* at II-4598, ¶ 418.

¹⁹² *Id.* at II-4598, ¶¶ 417–19.

¹⁹³ *See Microsoft Corp.*, [2004] E.C.R. at II-4604, ¶ 442 (noting that Microsoft argued that a compulsory license would damage its reputation as "a developer of quality software products").

¹⁹⁴ *Id.* at II-4605, ¶ 448.

¹⁹⁵ *Id.* at II-4611–12, ¶ 469.

¹⁹⁶ *See* TFEU arts. 101, 102.

scope of the market place in regard to agreements that inhibit commerce and the abuse of a dominant position.¹⁹⁷ In *Tiercé Ladbroke SA*, the ECJ was faced with an appeal of an EC decision finding that Articles 101 and 102 were not infringed by an agreement between a licensor and a licensee of copyrighted television broadcasts of horse races in French language whereby the agreement prohibited the licensee from sub-licensing the broadcasts to a third party (Ladbroke), and the licensor owner of the broadcasts would also not provide the third party with a license.¹⁹⁸ PMI was an owner of the copyrighted works which under French law allowed PMI to be the exclusive operator of off-track betting in France.¹⁹⁹ This designation allowed the firm to exclusively take bets for races from outside of France on French races as well as refuse to allow Ladbroke, a book-maker in Belgium, to broadcast the French-language races in Belgium.²⁰⁰ Additionally, although PMI had reached a licensing agreement with another firm, DSV, to rebroadcast the French races in Germany, the agreement between PMI and DSV prohibited sub-licensing, and when Ladbroke approached DSV seeking a license, DSV refused based on the PMI-DSV agreement.²⁰¹ Ladbroke filed a complaint with the EC seeking interim measures, including a compulsory license, which the EC denied.²⁰²

The ECJ upheld the EC's definition of the market place which was designated as the entire market for broadcasts for sound and pictures, and not just French language broadcasts for sound and pictures.²⁰³ The EC's belief that the market place for analysis of Articles 101 and 102 included the technical feasibility of broadcasting and other factors, including gambling habits, the types of bets wagered, and the countries in which the races were organized, was also upheld by the ECJ.²⁰⁴ Partial to the ECJ's support for the EC's findings was the ECJ's belief that its own jurisprudence supported the notion that the market place for Article 102 (*ex 86*) analysis is quite broad, and includes products and services which are both substitutable and sufficiently interchangeable in a way that meets the demands of consumers.²⁰⁵

The ECJ, however, went further in its analysis finding no infringement of Article 102. First, the ECJ stated that the fact that PMI refused to issue a license to Ladbroke despite the fact that PMI had offered licenses to other Belgian firms did not constitute a violation of either Article especially since PMI itself was not active in Belgium nor was PMI ever successful in reaching a licensing deal with

¹⁹⁷ See generally Case T-504/93, [1997] E.C.R. II-923.

¹⁹⁸ *Id.* at II-931-33, ¶¶ 5, 11.

¹⁹⁹ *Id.* at II-930-33, ¶¶ 1, 5, 11.

²⁰⁰ *Id.* at II-931-33, ¶¶ 5, 11.

²⁰¹ *Id.* at II-931, ¶ 5.

²⁰² *Id.* at II-939, ¶ 34.

²⁰³ *Tiercé Ladbroke SA*, [1997] E.C.R. at II-936, ¶ 27, II-956, ¶ 88.

²⁰⁴ *Id.* at II-937, ¶ 28, II-961, ¶ 108.

²⁰⁵ *Id.* at II-959, ¶ 101.

a Belgian firm.²⁰⁶ Second, the ECJ held that the mere fact that PMI had agreed to license firms in other European Union countries was not a form of discrimination or an abuse of a dominant position under Article 102.²⁰⁷

The ECJ also agreed with the EC that Article 101 (*ex* 85) was not infringed merely because the agreement between PMI and DSV did not allow for sub-licensing and that PMI did not grant Ladbroke a license directly.²⁰⁸ According to the ECJ, the EC's analysis was correct that the agreement was a rational means for a copyright holder to maintain the value of its asset and that a mere direct or indirect refusal is not indicative of an attempt to prevent, restrict, or distort competition.²⁰⁹ The ECJ, however, did stress that any such agreement, including exclusive licenses, that had the intent to have these effects on competition would violate Article 101.²¹⁰

The EC, in addition to domestic Member-State courts, has the ability to grant a compulsory license.²¹¹ In *Radio Telefis Eireann (RTE) v. Commission*, the ECJ upheld the ability of the EC to require a compulsory license when Article 102 (*ex* 86) is violated so long as the EC adequately states the reasons for requiring the compulsory license.²¹² Pursuant to Article 253 (*ex* 190) of the Treaty, any act by the EC must state the reasons for the act as well as refer to any opinions or proposals that the EC used when acting.²¹³ According to the ECJ, its own case law states that Article 190 requires that the EC put forth enough information about its decision to require a compulsory license so that the ECJ itself can exercise judicial review, and also that interested parties and Member-State governments will understand how the EC has applied the Treaty.²¹⁴ The ECJ, however, also stated that this is a maximum standard and that the EC need not "discuss all the matters of fact and law which may have been dealt with" to arrive at the decision.²¹⁵

Perhaps the most interesting part of the *Radio Telefis Eireann RTE* case is that there were two licenses involved. The first came from broadcasters, such as RTE, that would publish and then release their television listings to newspapers upon request with a license under which the licensees, although not obligated to

²⁰⁶ *Id.* at II-966, ¶ 121. Ladbroke had argued that the mere offer of a license in Belgium was an exhaustion of PMI's copyright on the broadcasts. *See id.* at II-966-67, ¶¶ 121-22.

²⁰⁷ *Id.* at II-970, ¶¶ 133-34.

²⁰⁸ *Tiercé Ladbroke SA*, [1997] E.C.R. at II-975, ¶¶ 151-52.

²⁰⁹ *Id.* at II-973, ¶ 147.

²¹⁰ *Id.* at II-973, ¶ 146.

²¹¹ *See, e.g.*, Case C-241/91, *Radio Telefis Eireann (RTE) v. Comm'n*, [1995] E.C.R. I-743.

²¹² *Id.* at I-812-13, ¶ 12, I-835-36, ¶ 98.

²¹³ EEC Treaty art. 190 (as in effect 1958) (now TFEU art. 253) states: "Regulations, directives and decisions of the Council and of the Commission shall state the reasons on which they are based and shall refer to any proposals or opinions which were required to be obtained pursuant to this Treaty." TFEU art. 253.

²¹⁴ *Radio Telefis Eireann (RTE)*, [1995] E.C.R. at I-835-36, ¶ 98.

²¹⁵ *Id.* at I-836, ¶ 99.

compensate the broadcasters, were held to strict requirements as to what they could do with the listings.²¹⁶ Magill TV attempted to take the listings published by the broadcasters' licensees and compile a composite set of listings for consumers.²¹⁷ Several broadcasters sought an injunction against Magill TV's actions.²¹⁸ Magill TV then filed a complaint with the EC.²¹⁹ The EC promptly required that the broadcasters provide a license to all publishers, but also stated that the broadcasters can expect a reasonable royalty.²²⁰

While concluding that the EC's decision was robust enough to meet the requirements of Article 253, the ECJ also agreed with the EC's decision that the broadcasters held and abused a dominant position within the scope of Article 102 by restricting the publication of their copyrighted listings to only the licensees, despite the argument by the broadcasters that the copyright would be lost since the real essence of the right is the right to prohibit unauthorized reproduction.²²¹ The broadcasters believed that the EC's decision was erroneous since it rested on the idea that a copyright is more so a right to attribution than a right to compensation for reproduction.²²²

3. Price Setting

Sales data held by a pharmaceutical company can be the source of a dominant position in the pharmaceutical sales industry and is also subject to copyright protection. In *NDC Health Corp. v. IMS Health Inc.*, however, the ECJ held that the EC cannot require the holder and seller of such sales data that has become the industry standard to provide a license to competitors to use this information.²²³

The *NDC Health Corp.* case possesses an unusual litigation history.²²⁴ IMS had created a data file on the pharmaceutical market in Germany that became the *de facto* industry standard, and IMS was able to sell this data to customers at a premium price.²²⁵ NDS Health Corp. had petitioned, and received from the EC, an order for IMS to grant NDS Health Corp. a compulsory license as a remedy for IMS's abuse of its dominant position.²²⁶ IMS Inc., however, successfully challenged the EC's decision at the ECJ's Court

²¹⁶ *Id.* at I-812, ¶ 9.

²¹⁷ *Id.* at I-812, ¶ 10.

²¹⁸ *Id.*

²¹⁹ *Id.* at I-812, ¶ 11.

²²⁰ *Radio Telefís Eireann (RTE)*, [1995] E.C.R. at I-812-13, ¶ 12.

²²¹ *Id.* at I-816, ¶ 25, I-819, ¶ 34.

²²² *Id.* at I-820, ¶ 41.

²²³ Case C-481/01, [2002] E.C.R. I-3416, ¶ 20, I-3436, ¶ 92.

²²⁴ *Id.* at I-3407-08, ¶¶ 3-4, I-3419, ¶ 21.

²²⁵ *Id.* at I-3407-08, ¶ 3.

²²⁶ *Id.* at I-3408, ¶ 4.

of First Instance, and NDS Health Corp. then appealed the reversal.²²⁷

The ECJ's analysis focused on a "balance of interests" between IMS Inc.'s ability to maintain complete control over its copyrighted material and the public interest, the latter of which was, specifically, making sure that IMS Inc. was forced to face competition.²²⁸ The ECJ, while upholding the decision of the Court of First Instance, stated that the mere fact that competing pharmaceutical companies were unhappy with paying a high price for the data and services provided by a copyright holder does not constitute an abuse of a dominant position.²²⁹

In *AB Volvo v. Erik Veng (UK) Ltd*, the ECJ was referred three questions by the British High Court that attempted to find a balance between intellectual property rights owned and the benefits of trade for consumers of automobiles.²³⁰ In this case, AB Volvo, a manufacturer of automobiles and the owner of a design patent for the "front wings" of its cars, refused to license an after-market supplier that repaired Volvo models still in circulation.²³¹ The first question posed by the British court was whether the refusal to grant a license for its design to manufacture the front wings, which was necessary for after-market business owners to repair the patent right owner's cars, was a dominant position under Article 102 (*ex* 86) of the Treaty even if the potential licensee was offering a reasonable royalty.²³² The High Court's second question was whether, if the first question were to be answered affirmatively, the patent holder's refusal to license was a *prima facie* case of an abuse of a dominant position under Article 102.²³³ The third question, also related and in sequence, was whether the patent holder's refusal to license would negatively affect trade since the potential licensee could not import the protected goods from another Member-State.²³⁴

Interestingly, the ECJ solely answered the second question and, by doing so, believed that it was not necessary to answer the first and third questions.²³⁵ The Court noted in a strong manner that intellectual property rights are designed in part to prevent unlicensed third parties from manufacturing, selling, and importing goods protected by the patent holder's rights even when a prospective

²²⁷ *Id.* at I-3408, ¶¶ 5, 6.

²²⁸ *Id.* at I-3416, ¶ 20.

²²⁹ [2002] E.C.R. I-3416, ¶ 20 (citing Case 158/86, Warner Bros. Inc. v. Erik Viuff Christiansen, [1988] E.C.R. 2629, ¶ 13; Joined Cases C-92/92 & C-326/92, Phil Collins and Others, [1993] E.C.R. I-5179, ¶ 20; Case C-200/96, Metronome Musik GmbH v. Music Point Hokamp GmbH, [1998] E.C.R. I-1953, I-1977, ¶ 15, I-1980, ¶ 24; Case C-61/97, Foreningen af Danske Videogramdistributører v. Laserdisken, [1998] E.C.R. I-5194-96, ¶¶ 13-18).

²³⁰ Case 238/87, [1988] E.C.R. 6233, ¶ 1.

²³¹ *Id.* at 6233, ¶ 3, 6235, ¶ 9.

²³² *Id.* at 6234, ¶ 4(1).

²³³ *Id.* at 6234, ¶ 4(2).

²³⁴ *Id.* at 6234, ¶ 4(3).

²³⁵ *Id.* at 6236, ¶ 10.

licensee offers a reasonable royalty.²³⁶ The ECJ in turn stated that to hold otherwise would deprive a right holder of its exclusive right and thus any refusal to grant a license cannot be an abuse of a dominant position under Article 102.²³⁷

Despite the strong language above, the ECJ did state that Article 102 can be violated by the holder of a design patent if it holds a dominant position and engages in abusive conduct such as, in this particular industry, refusing to supply spare parts on an arbitrary basis, fixing the price of spare parts at an unfair level, and/or refusing to make spare parts while the manufacturer's cars are still in circulation, assuming the conduct will affect trade between Member-States.²³⁸

In a case similar to *AB Volvo*, the ECJ entertained a two-pronged argument by a secondary car parts manufacturer that the exercise of an ornamental design intellectual property right to prevent the manufacture of and importation of the secondary parts was a violation of Articles 34 (*ex* 36) and 36 (*ex* 36) as well as a violation of Article 102 (*ex* 86) of the Treaty.²³⁹ In *Consorzio Italiano della Componentistica di Ricambio per Autoveicoli* (“CICRA”) v. *Régie Nationale des Usines Renault*, an organization of secondary car parts manufacturers, CICRA, filed an order in Italy arguing that, under Article 34, the holder of an industrial property right under domestic law cannot use the right to block creation of or importation of protected property that does not have any “intrinsic aesthetic value.”²⁴⁰ CICRA also contended that the monopoly and exclusive control over those property rights which constitute the car parts violates Article 102 since there is no competition for those car parts.²⁴¹ Interestingly, the Italian court recognized the industrial property rights associated with the car parts, but also found that the exercise of exclusive rights associated with the car parts was a violation of Article 102, thus opening the door for the Italian government to order a compulsory license.²⁴²

The ECJ began its analysis with recognition that many non-industrial property holding manufacturers often invoke Articles 34 and 36 as a source of protection against a national court applying domestic intellectual property rights if an argument can be made that the application will interfere with intra-Community trade.²⁴³ Despite the recognition, the ECJ found that the exercise of such rights, be it to prevent the manufacture, export, or import of goods, is not a

²³⁶ *AB Volvo*, [1988] E.C.R. at 6235, ¶ 8.

²³⁷ *Id.*

²³⁸ *Id.* at 6235, ¶ 9.

²³⁹ Case 53/87, *Consorzio Italiano della Componentistica di Ricambio per Autoveicoli v. Régie Nationale des Usines Renault*, [1988] E.C.R. 6069, ¶ 1, 6070, ¶ 7.

²⁴⁰ *Id.* at 6069–70, ¶¶ 3, 5, 7.

²⁴¹ *Id.* at 6070, ¶ 5.

²⁴² *Id.* at 6069, ¶ 4.

²⁴³ *Id.* at 6071, ¶ 9.

violation of Articles 34 or 36.²⁴⁴ The ECJ was clear that, unless there is evidence of arbitrary discrimination by the Member-State government, the government can, under Article 36, impose legislation that protects industrial or commercial property.²⁴⁵

In regard to Article 102, the ECJ stated that exercising a set of exclusive rights over intellectual property is not an infringement of the Treaty unless it amounts to the abuse of a dominant position evidenced by actions such as refusing to deliver spare parts, setting the prices of those parts at an unfair level, and/or deciding not to produce spare parts for cars that are currently still in circulation.²⁴⁶ Additionally, the Court mentioned that the very fact that independent car parts producers were granted a license, abuse of a dominant position is not present if the industrial property right holder decides to set its prices higher than the independent producers as the right holder may lawfully attempt to recoup its research and development costs.²⁴⁷

B. *Analysis of Articles 101 and 102 and the ECJ's Jurisprudence*

The risk that a holder of intellectual property rights faces in regard to compulsory licensing is that the holder of such rights is not in complete control of its property. The case law surveyed above reveals that in cases whereby there is very little in the way of alternatives for a competitor or consumers, the ECJ will uphold a compulsory license forcing a property holder, intellectual or otherwise (as in the *Mediaprint* case), to provide competitors and consumers access to the property, be it access to a protected good such as in the *Commercial Solvents*, access to data such as in *Decca Navigation System*, or access to a port as in *Sea Containers*. *Microsoft Corp.* was perhaps an even better example as the ECJ could not find a true alternative to Microsoft's system for European consumers. However, if a clear alternative exists for the competitor and/or customer, such as an alternative method to sell newspapers found in *Mediaprint*, the ECJ will likely not force the dominant party to share its property with the competitor.

Another lesson from this line of cases, if *Tiercé Ladbroke SA* were added to the mix, is that the mere fact that a right holder selectively offers access to property to one competitor does not make the ownership of that property an abuse of a dominant position if the holder does not offer access to other parties. A question left unanswered here is whether a right holder can offer access to its property to just one competitor and escape the wrath of Articles 101 and 102.

The ability to set prices, however, seems to be handled differently by the ECJ. The ECJ does not seem to find abuse of a dominant position when the holder of intellectual property rights commands a hefty price for access to its

²⁴⁴ *Id.* at 6072, ¶ 13.

²⁴⁵ *CICRA*, [1988] E.C.R. at 6072, ¶ 12.

²⁴⁶ *Id.* at 6073, ¶ 16.

²⁴⁷ *Id.* at 6060, ¶ 17.

protected goods, so long as the holder allows access to the property. In the *AB Volvo*, *NDC Health Corp.*, and *CICRA* cases, complaints were filed against property holders with the common argument that a high price was an abuse of a dominant position and the equivalent of a refusal to supply. However, the ECJ uniformly allowed the property owners to set high prices as long as the prices were not exorbitant and the property owners allowed access to their property. The question left unanswered is at what point a price demanded by a property owner becomes too high and thus an abuse of a dominant position. In other words, there is no guideline set for intellectual property owners so that they can maximize their profits from investing in intellectual property and avoid running afoul of Articles 101 or 102. However, at least one commentator has suggested that any price divergence found within the European Union could provide grounds for the EC or the ECJ to find a violation of Article 101.²⁴⁸

V. REMAINING ISSUES IN REGARD TO COMPULSORY LICENSING IN THE EUROPEAN UNION

Articles 34, 36, 101, and 102 serve as the true parameters for compulsory licensing in the European Union. Together, these Articles define the scope of compulsory licenses in regard to the free movement of goods and the abuse of a dominant position. However, akin to comments made by Fine above, the European Council has issued directives that comment on the power of Member-States to provide compulsory licenses in some narrow areas of law. The Biotechnological Patent Directive allows Member-States to issue non-exclusive compulsory licenses for the technology covered by the Directive but only if the petitioning party has made a good faith effort to secure a license from the property right holder on reasonable terms.²⁴⁹ Likewise, the Rental Rights Directive allows Member-States to impose compulsory licenses for intellectual property that is subject to a rental agreement.²⁵⁰ The Community Plant Variety Right Directive also allows for Member-States to grant compulsory licenses.²⁵¹

The Database Directive, however, does not allow for compulsory licensing by Member-States and thus only the EC may order such a remedy.²⁵² Likewise, the Satellite Broadcasting Directive does not create a right to a compulsory license nor can Member-States provide a compulsory license, and thus the only avenue for a compulsory license is through a petition to the EC with hopes that the it will find that the intellectual property holder has abused a dominant

²⁴⁸ Sandra Marco Colino, *On the Road to Perdition? The Future of the European Car Industry and Its Implications for EC Competition Policy*, 28 NW. J. INT'L L. & BUS. 35, 42–43 (2008).

²⁴⁹ TRITTON ET AL., *supra* note 1, at 197, 203.

²⁵⁰ *Id.* at 501, 503.

²⁵¹ *Id.* at 624.

²⁵² COOK, *supra* note 14, at 145–46. It should be noted that there was a proposal to include a compulsory licensing provision in the Database Directive but it was dropped. *Id.*

position.²⁵³

VI. UNITED STATES BY COMPARISON

Given the robust amount of trade between the United States and European Union, those practicing law or engaged in international business in the United States and Europe should have a working knowledge of the differences between the two legal regimes on the point of compulsory licensing. One general guideline to help the practitioner operating within both legal regimes is that the tension between the assertion of intellectual property rights and the prevention of the abuse of those rights is more noteworthy in Europe than in the United States.²⁵⁴ One comment states that the *Microsoft Corp.* decision itself is a terrific example of the schism between legal approaches found in the European Union and the United States.²⁵⁵ The European Union has tilted the balance toward a more short-term consumer benefit and a lesser level of intellectual property right protection whereas the United States takes a much stronger intellectual property protection approach that sacrifices some short-term consumer welfare.²⁵⁶ This is despite the fact that the qualifications for gaining intellectual property rights are similar across the United States and the Member-States of the European Union.²⁵⁷ However, there is commentary that this divergence in jurisprudence between the United States and Europe is recent.²⁵⁸ This divergence has also recently separated the United States from Canada, its leading trading partner, as Canada has taken an approach to compulsory licensing as a remedy more akin to that of the European Union.²⁵⁹

Indeed, the compulsory licensing experience has been drastically different in the United States. General compulsory licensing laws have never gained a firm footing in the United States.²⁶⁰ The prevailing fear that compulsory licenses will dull the drive for innovation is stronger in the United States than in Europe.²⁶¹ However, there is comment that the EC has realized that a constant

²⁵³ COOK, *supra* note 14, at 84, 125.

²⁵⁴ Donna M. Gitter, *The Conflict in the European Community Between Competition Law and Intellectual Property Rights: A Call for Legislative Clarification of the Essential Facilities Doctrine*, 40 AM. BUS. L.J. 217, 218–19 (2003).

²⁵⁵ Alan Devlin, Michael Jacobs & Bruno Peixoto, *Success, Dominance, and Interoperability*, 84 IND. L.J. 1157, 1160 (2009).

²⁵⁶ *Id.* at 1164–66, 1169.

²⁵⁷ Sandra Schmieder, *Scope of Biotechnology Inventions in the United States and in Europe – Compulsory Licensing, Experimental Use and Arbitration: A Study of Patentability of DNA-Related Inventions with Special Emphasis on the Establishment of an Arbitration Based Compulsory Licensing System*, 21 SANTA CLARA COMPUTER & HIGH TECH. L.J. 163, 169 (2004).

²⁵⁸ Devlin, Jacobs & Peixoto, *supra* note 255, at 1166–67.

²⁵⁹ Facey & Assaf, *supra* note 67, at 579.

²⁶⁰ Cole M. Fauver, Comment, *Compulsory Patent Licensing in the United States: An Idea Whose Time Has Come*, 8 NW. J. INT'L L. & BUS. 666, 674 (1988).

²⁶¹ Colleen Chien, *Cheap Drugs at What Price to Innovation: Does the Compulsory Licensing*

barrage of compulsory licensing grants could have the effect of limiting the incentives for investment and innovation thus mirroring some of the concerns associated with jurisprudence in the United States.²⁶² Regardless, enforcement of limitations on the exercise of intellectual property rights in the name of consumer welfare continues to be much greater in the European Union than in the United States.²⁶³

In the United States, there is some argument that a general compulsory licensing law would be an unconstitutional infringement on Congress' ability to grant exclusive rights and/or an unconstitutional taking.²⁶⁴ In cases where United States courts believe that an intellectual property right holder is abusing such rights, the more common remedy is a denial of an injunction requested by the right holder against the use by the accused infringer.²⁶⁵ Although compulsory licensing is a remedy under United States patent law, United States courts have aggressively avoided using it.²⁶⁶ In cases where the abuse of intellectual property rights might endanger public health if a particularly vulnerable group does not have access to a helpful technology, the more likely outcome of a United States court case for the intellectual property rights holder is to get denied an injunction against a competitor manufacturer.²⁶⁷ A court allows a competitor to serve the vulnerable group without the court needing to formally issue a compulsory license when the court denies an injunction to stop the competitor from manufacturing the protected technology.²⁶⁸

United States companies also seem to be part of an anti-compulsory licensing culture. When sovereign governments have attempted to utilize their compulsory licensing authority under international law, United States firms have withdrawn applications seeking patent rights in those countries for fear that compulsory licensing will be abused.²⁶⁹ Additionally, the United States government has placed such countries on a "watch list" which serves as a bulletin for United States firms seeking intellectual property protection.²⁷⁰

In *Borden v. F T C*, the Federal Trade Commission ("FTC") heard a complaint brought by a regionally-based, reconstituted lemon juice distributor,

of *Pharmaceuticals Hurt Innovation?*, 18 BERKELEY TECH. L.J. 853, 872 (2003).

²⁶² Gitter, *supra* note 254, at 277–78.

²⁶³ Spencer Weber Waller, *Antitrust and Social Networking*, 90 N.C. L. REV. 1771, 1796 (2012).

²⁶⁴ Fauver, *supra* note 260, at 677–78.

²⁶⁵ See, e.g., Michael C. Brandt, Comment, *Compulsory Licenses in the Aftermath of eBay Inc. v. MercExchange, L.L.C.: The Courts' Authority to Impose Prospective Compensatory Relief for Patent Infringement*, 17 FED. CIR. B.J. 699, 701 (2008).

²⁶⁶ *Id.* at 700.

²⁶⁷ *Id.* at 701.

²⁶⁸ *Id.*

²⁶⁹ Robert C. Bird, *Developing Nations and the Compulsory License: Maximizing Access to Essential Medicines While Minimizing Investment Side Effects*, 37 J.L. MED. & ETHICS 209, 211 (2009).

²⁷⁰ *Id.*

Golden Crown, against the Borden Corporation, a nationally-based reconstituted lemon juice producer and distributor, concerning the latter's "ReaLemon" trademark.²⁷¹ As Golden Crown attempted to move from a regional distribution and sales network to a national distribution and sales network, Borden significantly dropped its prices to a level the Administrative Law Judge ("ALJ") called "unreasonably low" and "predatory pricing," and the FTC found to be an abuse of monopoly power.²⁷² One of the many penalties levied by the ALJ against Borden was the grant of a compulsory license to Golden Crown for 10 years for use of the ReaLemon trademark.²⁷³ The FTC upheld the all of the ALJ's recommended penalties against Borden with the exception of the compulsory license.²⁷⁴ The FTC believed that the remedy prohibiting Borden from engaging in predatory pricing was sufficient.²⁷⁵

The FTC is more likely to order, and the United States courts are more likely to uphold, a compulsory license in a patent case.²⁷⁶ In such cases, compulsory licenses are almost always tied to a reasonable royalty requirement unless the conduct by the right holder is abusive.²⁷⁷ United States law also supports compulsory licensing as a remedy in antitrust cases much akin to the European Union's use of Article 102.²⁷⁸

The United States Copyright Act does allow for compulsory licensing in the area of sound recordings.²⁷⁹ In fact, the United States government has sanctioned a collective organization called "SoundExchange," created by the Recording Industry Association of America, to distribute the royalties from compulsory licenses granted to public performances of digital audio recordings.²⁸⁰

The United States and European philosophies did reach some unification in the proposed Doha Declaration in an attempt to limit the scope of possibilities

²⁷¹ 674 F.2d 498, 503 (6th Cir. 1982), *cert. granted, judgment vacated sub nom.* Borden, Inc. v. FTC, 461 U.S. 940 (1983).

²⁷² *Id.* at 503–04.

²⁷³ *Id.* at 503.

²⁷⁴ *Id.*

²⁷⁵ *Id.*

²⁷⁶ See *Foster v. Am. Mach. & Foundry Co.*, 492 F.2d 1317, 1319 (2d Cir. 1974); *Baxter Int'l Inc.*, 123 F.T.C. 904, 910–11 (1997); *Eli Lilly & Co.*, 95 F.T.C. 538, 546 (1980).

²⁷⁷ *American Intellectual Property Law Association (AIPLA)*, FED. TRADE COMM'N, <http://www.ftc.gov/opp/global/aipla.shtm> (last updated June 25, 2007), *quoted in* Jon Matthews, *Renewing Healthy Competition: Compulsory Licenses and Why Abuses of the TRIPS Article 31 Standards are Most Damaging to the United States Healthcare Industry*, 4 J. BUS. ENTREPRENEURSHIP & L. 119, 132 (2010).

²⁷⁸ *Hartford-Empire Co. v. United States*, 323 U.S. 386, 419 (1945); *Am. Cyanamid v. FTC*, 363 F.2d 757, 771–72 (6th Cir. 1966).

²⁷⁹ Neil Conley, *The Future of Licensing Music Online: The Role of Collective Rights Organizations and the Effect of Territoriality*, 25 J. MARSHALL J. COMPUTER & INFO. L. 409, 424 (2008).

²⁸⁰ *Id.*

for compulsory licenses during the initial negotiations.²⁸¹ Both parties successfully negotiated with and convinced several developed countries not to issue compulsory licenses in any circumstances.²⁸² The United States and the European Union also successfully negotiated agreements with several developing countries that only allow them to grant compulsory licenses when a national health emergency exists.²⁸³

VII. OVERALL ANALYSIS OF COMPULSORY LICENSING LAW IN THE EUROPEAN UNION

If one were to keep a scorecard of sorts, it is clear after a review of the above case law²⁸⁴ that the ECJ has preference for a reduction of intellectual property rights in the face of restrictions that interfere with the free movement of goods across Member-State borders and when a consumer may suffer due to a right holder's dominant position. The preference for free movement and limitations of dominant positions, however, are not without exceptions. An analysis of the cases presented above expose several themes that can be used by the practitioner in the area of compulsory licensing in the European Union.

First, the ECJ will not allow Member-States to write compulsory licensing laws, nor mandate compulsory licenses, in a way that interferes with the free movement of goods across Member-State lines unless the intellectual property right holder has not voluntarily acquiesced to the compulsory license.²⁸⁵ When the voluntary placement has occurred, the rights of the intellectual property owner are exhausted in a way that does not allow the right holder or the Member-State to block reentry of the protected goods into said Member-State. However, if the compulsory license is not voluntary, or if the compulsory license is discriminatory in that it pushes intellectual property owners to produce their goods within the Member-State granting the intellectual property rights, the right holder can claim that the placement of the goods was not voluntary in that Member-State and thus their rights are not exhausted, and a parallel import from a competitor can be blocked.

Second, and related to the first dominant theme, is that the jurisprudence of the ECJ has pushed compulsory licensing laws crafted by Member-States toward harmonization. As stated above, intellectual property rights are granted individually by the twenty-seven Member-States. Although they are free to

²⁸¹ Brook K. Baker, *Arthritic Flexibilities for Accessing Medicines: Analysis of WTO Action Regarding Paragraph 6 of the DOHA Declaration on the TRIPS Agreement and Public Health*, 14 *IND. INT'L & COMP. L. REV.* 613, 636 (2004).

²⁸² *Id.*

²⁸³ *Id.*

²⁸⁴ See *supra* Parts III.A & IV.A for a discussion of these cases.

²⁸⁵ Case C-235/89, *Comm'n v. Italian Republic*, [1992] E.C.R. I-828; Case C-191/90, *Generics (UK) Ltd v. Smith Kline*, [1992] E.C.R. I-5374, I-5381; Case 434/85, *Allen & Hanburys Ltd v. Generics (UK) Ltd*, [1988] E.C.R. I-1272; Case 19/84, *Pharmon BV v. Hoescht AG*, [1985] E.C.R. I-2294-95.

draft compulsory licensing laws, they cannot violate Articles 34 and 36 of the Treaty. With the ECJ playing the role of final arbiter of the Treaty Articles, with each passing decision on compulsory licensing in the face of Articles 34 and 36, the law across the European Union becomes more harmonized, thus creating a need for Member-States to redraft their domestic laws. It may be that such harmonization will push the Member-States toward a federal compulsory licensing regulation or directive. Indeed, it may be more beneficial, in an effort to save time and litigation costs, to allow the legislative and executive arms of the European Union to create federal rules instead of continuing the piece-meal approach through case law.

The third dominant theme concerns the compulsory license remedy. The ECJ has made it clear that a dominant position alone does not make for abuse either in regard to agreements between right holders and licensees, or when licensees are refused licenses. The party seeking a license must prove that the dominant position has been abused. Therefore, intellectual property right holders need not fear that their success in the market place will immediately lead to the grant of a compulsory license. In addition, intellectual property right holders need not fear that their actions infringe Article 101 if the agreements with licensees prohibit the latter from engaging in sub-licensing or provide for a higher than ordinary royalty.

The fourth dominant theme is related to the third. Although a dominant position does not in itself constitute abuse, there are some responsibilities associated with having that dominant position. As several of the above cases point out, the intellectual property right holder that maintains a dominant position must be able to serve the entire market place. For example, the dominant position holder must be able to provide spare parts at reasonable prices to all that need them. Otherwise, a competitor is likely to be able to file a successful complaint with the European Commission and have a compulsory license imposed because the public interest is not being met and competition is being distorted. The complaining competitor, however, has the duty to show that the market place is not being served adequately.

Lastly, it is clear that there is an incentive for parties to negotiate licenses without government involvement, be it a Member-State, the EC, or the ECJ. Although virtually all of the above cases show an incentive, when operating in the European Union, to agree to a license and avoid costly and time-consuming litigation, the *Microsoft Corp.* decision should push parties toward voluntary licensure. Intellectual property holders should see that, since the EC is likely to grant a compulsory license when the conditions are right and set the duration and the royalty of the license, they should be able to successfully negotiate to a royalty perhaps less than what the right holder believes the market will bear, but above the level to be ordered by the EC, plus litigation costs. In other words, the intellectual property right holder operating within the European Union should take advantage of its knowledge of the case law and of the costs to be assumed by the party attempting to convince the EC or a Member-State government that a compulsory license is the appropriate remedy. In the great majority of situations, compulsory licenses are only granted when the parties

cannot agree upon a licensing scheme through their own negotiations.

The *Microsoft Corp.* decision, in conjunction with the other salient cases touching on compulsory licensing and the knowledge of European culture toward intellectual property, could move innovators to plan for compulsory licenses. Since the ECJ was not swayed by Microsoft's constant drumbeat argument that it would be irreparably harmed if forced to provide the technology to competitors, practitioners should advise their innovator-clients to have contingency plans for compulsory licensing and/or plans for voluntary licensing. What is likely not a successful strategy is to plan not to license at all if the innovator will be the leader in an industry but cannot service the entire market.

Additionally, the intellectual property right holder should also recognize that a compulsory license is not a complete loss. Indeed, any compulsory license awarded to a competing firm by the EC provides for a royalty payment, even if that royalty may not be to the level preferred by the right holder.

CONCLUSION

One commentator has gone as far as calling a compulsory license, given the fact that it serves as an exception to intellectual property rights, a "controversial legal instrument."²⁸⁶ The purpose of this work was not to illustrate a comparison between the European Union and the United States, but to allow the reader to take this work and explore comparisons with the case law of the United States. What is clear from an examination of the text above is that the law on compulsory licensing will continue to evolve, probably not without controversy. This evolution is most likely due to the fact that the notion of intellectual property rights is ancient in contrast to rules that prohibit protectionism and fair competition. In addition, this evolution may serve as a model for other legal societies that are commercially advanced, such as the United States. Indeed, the evolution, in conjunction with a global movement toward lessening the strength of intellectual property rights in the face of the public interest, could become the global norm with the advancement of the World Trade Organization and the hypothetical Free Trade Area of the Americas. The challenge will also continue for regulatory authorities in the European Union. Just recently, despite the lessons learned from the Microsoft litigation saga, the Google Corporation settled with the European Union government over allegations of abuse of a dominant position.²⁸⁷

The evolution in Europe, however, should not be thought to be complete. The evolution toward lesser intellectual property protection to advance fair competition and the free movement of goods has not been uniform, as European Union law does place some limits on the functions of fair competition and free

²⁸⁶ Matthews, *supra* note 277, at 120.

²⁸⁷ Alex Barker, *Google Agrees Outline Deal with EU to Avoid Long Antitrust Battle*, FIN. TIMES (July 25, 2012, 5:42 PM), <http://www.ft.com/cms/s/0/3ec475c6-d599-11e1-b306-00144feabdc0.html#axzz2LDfCcJ98>.

movement of goods. Furthermore, a short examination of the Biotechnological Patent, Rental Rights, Community Plant Variety Right, Database, and Satellite Broadcasting Directives show that the European Union has not adopted a uniform approach, or philosophical belief, in the concept of compulsory licensing.²⁸⁸

²⁸⁸ See generally Directive 98/44, of the European Parliament and of the Council of 6 July 1998 on the Legal Protection of Biotechnological Inventions, 1998 O.J. (L 213) 13 (EC); Directive 96/9, of the European Parliament and of the Council of 11 March 1996 on the Legal Protection of Databases, 1996 O.J. (L 77) 20 (EC); Council Regulation 2100/94, of 27 July 1994 on Community Plant Variety Rights, 1994 O.J. (L 227) 1 (EC); Council Directive 93/83, of 27 September 1993 on the Coordination of Certain Rules Concerning Copyright and Rights Related to Copyright Applicable to Satellite Broadcasting and Cable Retransmission, 1993 O.J. (L 248) 15 (EC); Directive 92/100, of 19 November 1992 on Rental Right and Lending Right and on Certain Rights Related to Copyright in the Field of Intellectual Property, 1992 O.J. (L 346) 61 (EC).

CREDIT RATING AGENCIES AND MUNICIPAL BONDS:
HOW A MISUNDERSTOOD INDUSTRY HAS COST TAXPAYERS

*Jason Saylor**

INTRODUCTION

In 2008, the global financial crisis opened the eyes of many investors to the fact that Credit Rating Agencies (“CRAs”) do not always give accurate, reliable ratings to investments.¹ During the debt-ceiling debacle of 2011, it became apparent that CRAs also have significant influence over the global economy. The mere threat of a rating downgrade for United States Treasury Bonds shocked financial markets. When Standard & Poor’s (“S&P”) eventually downgraded the rating, stocks plummeted for several days, even though the United States has never defaulted on its debt obligations.² S&P’s representatives indicated that they might cut the rating again if the country did not arrange to reduce its deficit.³

A downgrade in debt rating for the United States or any other bond issuer means the cost of the debt increases, or even worse, creditors refuse to lend. This phenomenon is a result of the value investors place on these ratings as indicators of a borrower’s ability to pay. CRAs also have great influence over state and local governments. In order to finance civic projects, states, cities, towns, and other municipal entities issue bonds.⁴ Many investors feel that municipal bonds are an extremely safe investment, second only to United States

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¹ See, e.g., John Patrick Hunt, *Credit Rating Agencies and the “Worldwide Credit Crisis”*: *The Limits of Reputation, the Insufficiency of Reform, and a Proposal for Improvement*, 2009 COLUM. BUS. L. REV. 109, 121-22 (2009) (the common criticism of credit rating agencies with respect to the financial crisis “is that the rating agencies did a poor job of assessing the default risk of . . . instruments based on subprime [mortgage backed securities] . . . and that when a large number of borrowers started to default on subprime mortgages in 2007, the low quality of the ratings was revealed and systemic consequences ensued.”) (internal citations omitted).

² See Craig McCann, Sherry Liu, Geng Deng, and Joseph Pendergast, *Leveraged Municipal Bond Arbitrage: What Went Wrong?*, 1755 PLI/Corp 205, 207 (2009) (“Treasury securities are free of default risk . . .”); but see, Gold Clause Cases (Norman v. Baltimore & Ohio R.R. Co., 294 U.S. 240 (1935), United States v. Bankers Trust Co., 294 U.S. 317 (1935), Perry v. United States, 294 U.S. 330 (1935)) (indicating that the United States was in a state of technical default).

³ Walid Petiri, *After the Downgrade...Patience & Pragmatism is a Must*, Examiner (Aug. 23, 2011), <http://www.examiner.com/finance-in-baltimore/after-the-downgrade-patience-pragmatism-is-a-must#ixzz1VtyASICg>.

⁴ Education, *Two Types of Bonds: General Obligation vs. Revenue Bonds*, MunicipalBonds.com, <http://www.municipalbonds.com/education/read/60/two-types-of-bonds-general-obligation-vs-revenue-bonds> (last visited Sept. 21, 2011) (“There are over 80,000 issuers of municipal bonds in the United States. With so many different types of issuers ranging from states to cities, transportation systems, school districts, hospitals, and housing projects . . .”).

Treasury bonds. A default on a General Obligation Municipal bond (“GO bond”) is an extremely rare occurrence because municipalities can repay them with almost any source of income, including the tax base.⁵ Even with a rate of default near zero, municipal bonds generally receive ratings lower than their corporate counterparts, leading some states to cry foul.⁶

CRA are such an integral part of our financial system that they seem to have near regulatory authority.⁷ Though CRAs perform an essential function in our financial system, they are independent, for-profit companies, whose incentives may occasionally be misaligned. Historically, there has been little accountability for any misrepresentations in their ratings. However, the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) tried to alleviate some of these problems.⁸ In addition to creating greater transparency, Dodd-Frank potentially opens the door to liability in instances when CRAs have traditionally enjoyed protection. This paper will discuss in further detail how misaligned incentives have led CRAs to diminish ratings of municipal bonds, how CRAs have forced municipalities to purchase their services, how courts and regulators have missed opportunities to hold CRAs accountable, and how new laws may offer relief.

Section I of this paper will discuss the background of CRAs, including their history, current status, potential conflicts of interest. It will also discuss the basics of municipal bonds and the criteria the major CRAs use to evaluate the risk associated with municipal bonds. Section II will analyze the First Amendment issues, argue that those issues have inappropriately shielded CRAs from liability, and explore potential antitrust theories that could hold CRAs accountable. Finally, Section III will discuss Dodd-Frank may reduce the First Amendment defense and open the door for antitrust liability.

⁵ Moody’s Investors Serv., THE U.S. MUNICIPAL BOND RATING SCALE: MAPPING TO THE GLOBAL RATING SCALE AND ASSIGNING GLOBAL SCALE RATINGS TO MUNICIPAL OBLIGATION, 3 (Mar. 2007) available at http://www.moody.com/sites/products/DefaultResearch/102249_RM_.pdf [hereinafter GLOBAL RATING SCALE].

⁶ See Press Release, Connecticut Attorney General, Attorney General Sues Credit Rating Agencies For Illegally Giving Municipalities Lower Ratings, Costing Taxpayers Millions (July 30, 2008), available at <http://www.ct.gov/ag/cwp/view.asp?Q=420390&A=2795>.

⁷ See, e.g., Frank Partnoy, *The Siskel and Ebert of Financial Markets?: Two Thumbs Down for the Credit Rating Agencies*, 77 WASH. U. L.Q. 619, 682 (1999) (explaining the regulatory function of ratings agencies: “[i]f the applicable regulation imposes costs, and a favorable rating eliminates or reduces those costs, then rating agencies will sell regulatory licenses to enable issuers and investors to reduce their costs.”).

⁸ The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 931, 124 Stat. 1376, 1872 (2010).

I. BACKGROUND

A. *Credit Rating Agencies*

1. History

Understanding the power and influence of CRAs is difficult without first looking at the background of the agencies. CRAs provide an essential service to our financial system by providing an ostensibly objective analysis of the likelihood that a corporation, government, or municipality will be able to repay its debts.⁹ In doing so they facilitate transactions and create market efficiencies that could not otherwise exist.¹⁰ They are “central to capital formation, investor confidence, and the efficient performance of the United States economy.”¹¹

CRAs began in the early 1900s when John Moody applied a simple rating methodology to bonds.¹² He wanted to synthesize the complex data found in financial reports into a single rating symbol to sell the information to the public.¹³ These ratings became very popular because they increased market efficiencies by allowing investors to compare a variety of securities at a glance instead of analyzing each investment with the limited and often unreliable public information.¹⁴ Seeing the popularity of Moody’s ratings publications, Poor’s Publishing, Standard Statistics,¹⁵ and Fitch Publishing soon began publishing their own ratings on a scale similar to Moody’s.¹⁶ In the early years, CRAs utilized a subscription-based model by selling ratings information directly to the

⁹ See Hunt, *supra* note 1, at 114-15 (“Credit rating agencies provide evaluations of the likelihood that obligations will be repaid. The agencies issue ratings on . . . corporate, government, and municipal bonds.”).

¹⁰ See Jeffrey Manns, *Rating Risk After the Subprime Mortgage Crisis: A User Fee Approach for Rating Agency Accountability*, 87 N.C. L. REV. 1011, 1035 (2009) (“Ratings agencies serve to bridge an information gap between issuers and existing and prospective creditors. Sifting through the myriad of financial and nonfinancial disclosures of issuers may simply be economically infeasible for most creditors . . .”).

¹¹ The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 931, 124 Stat. 1376, 1872 (2010).

¹² Partnoy, *supra* note 7, at 637-38.

¹³ *Id.*

¹⁴ See *id.* at 636 (“[I]t was difficult for sellers to gather credible information about the reputation of buyers: letters of reference were faked or forged, detailed financial data were not available, and the process was tediously slow. As Markets and trade evolved during the nineteenth century, it became clear that there were economies of scale associated with gathering and disseminating credit information in a systematic, organized way.”).

¹⁵ Poor’s Publishing and Standard Statistics eventually merged to become Standard and Poor’s (S&P).

¹⁶ Partnoy, *supra* note 7, at 642.

investors, which resulted in low barriers to entry in the credit rating market.¹⁷ If the ratings agencies did not produce high quality and accurate ratings, customers would purchase ratings from another company.¹⁸ As a result, their revenues came largely from their reputation for accurate ratings.

2. Current State

The subscription-based business model used in the early years may have kept CRAs incentives properly aligned, but as is the trouble with any publication, CRAs could not keep their subscribers from sharing the valuable information with non-subscribers. The CRAs ended the subscription-based model in the 1970s to eliminate the free rider problem.¹⁹ Under the current business model, the bond issuers pay CRAs to rate their bonds instead of potential investors or subscribers. CRAs, therefore, derive a substantial portion of their revenue from bond issuers.²⁰ This business model creates a significant conflict of interest by encouraging CRAs to give a higher than warranted rating to paying customers.²¹ The problem worsens when the financial instruments are complex and it is harder to question the rating provided.²²

What enables these agencies to continue this business model is that the largest three ratings agencies – Moody's, Standard and Poor's, and Fitch, (the "Big Three") – enjoy an oligopoly by regulation, and they no longer rely on their reputations for new business. The federal government "[issued] numerous regulations that require[] issuers to secure ratings concerning their creditworthiness in order to participate in financial markets."²³ In an effort to ensure the legitimacy of CRAs, the Securities and Exchange Commission ("SEC") designated that they meet certain requirements.²⁴ The CRAs who met the requirements were designated Nationally Recognized Statistical Ratings

¹⁷ See *id.* at 639 (stating that there was evidence that in the early years there were low barriers to entry and "the cost of accumulating the relevant statistics and data to generate a rating were not prohibitively high."); see also Deryn Darcy, *Credit Rating Agencies and the Credit Crisis: How the "Issuer Pays" Conflict Contributed and What Regulators Might Do About It*, 2009 COLUM. BUS. L. REV. 605, 623 (2009) ("While these CRAs originally charged subscription fees, they switched to the issuer pays model in the mid-1970s.").

¹⁸ See Partnoy, *supra* note 7, at 639 ("[A]n agency that did not generate accurate and credible ratings probably would not have expected to survive long."); see also Hunt, *supra* note 1, at 114-15 ("[t]he value of a rating agency's business derives from the agency's reputation for issuing high-quality ratings.").

¹⁹ Darcy, *supra* note 17, at 623.

²⁰ See Partnoy, *supra* note 7, at 639 (stating that ninety-five percent of CRAs revenue comes from user fees); Darcy, *supra* note 17, at 622 ("CRAs receive approximately 90 to 95% of their annual revenues from issuer fees.").

²¹ See Darcy, *supra* note 17, at 622-45 (providing a complete analysis of the conflicts of interest created by the issuer pays model).

²² See, *id.*, at 623.

²³ Manns, *supra* note 10, at 1035.

²⁴ Parisa Haghshenas, *Obstacles to Credit Rating Agencies' First Amendment Defense in Light of Abu Dhabi*, 8 FIRST AMEND. L. REV. 452, 463-64 (2010).

Organizations ("NRSROs").²⁵ Since the 1970s, the SEC has utilized NRSROs and their ratings in many of its regulations.²⁶ The problem is that very few companies could meet the SEC's stringent requirements, and the Big Three quickly absorbed the smaller firms that could do so.²⁷ Since 2006, the SEC has tried to make it easier for other agencies to become NRSROs, but the damage to competition is still evident.²⁸ The Big Three still control around 95% of the market.²⁹ Unlike competitive markets, a tradition of obtaining two ratings for a bond issue has all but eliminated competition between the Big Three CRAs.³⁰

The regulatory requirements and the increased complexity of financial instruments have increased investor reliance on CRAs and their ratings. "Ratings agencies serve to bridge an information gap between debt issuers and . . . creditors."³¹ This information gap has expanded in recent decades as new types investments with growing complexity have entered the market making it more difficult for investors to analyze risk on their own.³² The resulting increase in reliance on ratings has sometimes been to the detriment of investors, as we saw with the collapse of the mortgage backed securities market in 2008.³³

²⁵ See *id.* (stating that the SEC developed the designation of NRSRO in order to ensure the credibility of ratings).

²⁶ See, e.g., Darcy, *supra* note 17, at 623 ("According to the SEC, at least forty-four of its rules and forms incorporate references to credit ratings.") (citing Christopher Cox, Chairman, SEC, Statement on Proposal to Increase Investor Protection by Reducing Reliance on Credit Ratings (June 25, 2008), available at http://www.sec.gov/news/speech/2008/spch062508cc_credit.htm).

²⁷ Haghshenas, *supra* note 24, at 463-65.

²⁸ Manns, *supra* note 10, at 1051-52.

²⁹ See SEC, 2011 SUMMARY REPORT OF COMMISSION STAFF'S EXAMINATION OF EACH NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (September 2011) (hereinafter "SEC EXAMINATION OF NRSROs") available at http://www.sec.gov/news/studies/2011/2011_nrsro_section15e_examinations_summary_report.pdf [hereinafter SEC Examination of NRSROs] (indicating that the Big Three have issued 97% of the outstanding ratings); see also Claire A. Hill, *Regulating the Rating Agencies*, 82 WASH. U. L.Q. 43, 59 (2004) (noting that Moody's and Standard and Poor's have over 80% of the market and Fitch approximately 14%).

³⁰ See Claire A. Hill, *Regulating the Rating Agencies*, 82 WASH. U. L.Q. 43, 59-60 (2004) ("Issuers typically attempt to obtain both Moody's and Standard & Poor's ratings, and very occasionally use Fitch as a third rating."); see also Darcy, *supra* note 17, at 629 (noting that the two-rating norm allows Moody's and S&P to dominate the market); Manns, *supra* note 10, at 1035 (indicating that the two-rating norm has given Moody's and S&P a near duopoly in the ratings market).

³¹ Manns, *supra* note 10, at 1035.

³² See Hunt, *supra* note 1, at 118-19 (indicating that structured finance products have become more popular in the past 25 years and that they have also become more complicated than ever before and that investors prefer complex products carry ratings).

³³ See Manns, *supra* note 10, at 1044 ("Rating agencies employed methodologies that failed to reflect the risks of subprime mortgage debt instruments . . ."). See also The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 931, 124 Stat. 1376, 1872 (2010) ("In the recent financial crisis, the ratings on structured financial products have proven to be inaccurate . . . [which] contributed significantly to the mismanagement of risk by financial institutions and investors . . .").

B. *Municipal bonds*

1. Overview

Generally, municipal bonds are the method by which state and local government raise capital for civic projects. There are two basic types of municipal bonds: GO bonds and Revenue bonds. The issuer guarantees to repay GO bonds by any means possible, including new taxes.³⁴ Some states even prioritize the repayment of municipal bonds in their constitutions.³⁵ On the other hand, public service providers such as hospitals, sewer systems, water authorities, and transit authorities issue revenues bonds, and the only guarantee of repayment is the revenue raised by the project.³⁶ For example, if a bond is issued to finance a road, the toll proceeds are then used to pay the bond.

Rates of default for municipal bonds are very low.³⁷ GO bonds in particular are extremely safe since their repayment sources are so flexible.³⁸ Similarly, certain revenue bonds, such as water and sewer utility bonds, have the ability to raise prices on an inelastic product, which decreases the risk of default.³⁹ Even with thousands of bond issuers in various state and local governments, GO, water and sewer bonds have experienced only one default since 1970.⁴⁰ During this same period, there were only 41 total defaults of all municipal bonds, with the bulk of those coming from the healthcare or housing sectors.⁴¹ The default rate for investment grade municipal bonds between 1970 and 2007 is 0.1%, compared to 2.1% for investment grade corporate bonds over that same period.⁴²

³⁴ Education, *What are municipal bonds?*, MunicipalBonds.com, <http://www.municipal-bonds.com/education/read/47/what-are-municipal-bonds> (last visited Sept. 21, 2011).

³⁵ See, e.g., Cal. Const. art. XIII B, § 7. (“Nothing in this Article shall be construed to impair the ability of the state or of any local government to meet its obligations with respect to existing or future bonded indebtedness.”).

³⁶ Education, *What are municipal bonds?*, MunicipalBonds.com, <http://www.municipal-bonds.com/education/read/47/what-are-municipal-bonds> (last visited Sept. 21, 2011).

³⁷ See *contra* Jason Appleton, Eric Parsons, and Andrew Haughwout, *The Untold Story of Municipal Bond Defaults*, FEDERAL RESERVE BANK OF NEW YORK (Aug. 15, 2012) (arguing that municipal bonds have a much higher rate of default than most investors realize) available at <http://libertystreeteconomics.newyorkfed.org/2012/08/the-untold-story-of-municipal-bond-defaults.html>; but see, Mary Walsh, *Muni Bonds Not as Safe as Thought*, THE NEW YORK TIMES (Aug. 15, 2012) (noting that “[t]he lion’s share of the defaults occur in the unrated market, and they have for many years.”) (quoting Steve Murphy, Managing Director, Standard & Poors) available at <http://www.nytimes.com/2012/08/16/business/municipal-bonds-default-more-than-advertised.html>.

³⁸ See GLOBAL RATING SCALE, *supra* note 5, at 3 (“Since 1970, defaults of Moody’s-rated general obligation (GO) and water and/or sewer (water/sewer) revenue municipal bonds have been extremely rare.”).

³⁹ *Id.*

⁴⁰ *Id.* at 5, Figure 2.

⁴¹ *Id.*

⁴² *Id.* at 6, Figure 3.

Even though municipal bonds are generally thought to be extremely safe investments, they do not always receive the highest ratings.⁴³ Since ratings are supposed to be a measure of risk associated with a particular investment, investors will shy away from an investment whose rate of return does not sufficiently compensate for this perceived risk. Municipal bond issuers must, therefore, offer investors higher interest rates in order to compensate for a lower rating.⁴⁴ The only viable alternative to paying higher interest rates is purchasing bond insurance to raise the rating and thereby lower the perceived risk.⁴⁵ Either alternative creates additional cost for the bond issuer when financing civic projects. This additional cost is passed on to the citizens of the municipality in the form of higher taxes or fewer funds available for civic projects.

2. Municipal Ratings

When municipalities issue bonds, the CRAs rate them using the same symbols as corporate bonds but different criteria. For example, Moody's rates bonds by giving them one of the following classifications: Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C, with Aaa being the highest and C being the lowest.⁴⁶ The other two large CRAs, S&P and Fitch, use very similar scales with only minor variations.⁴⁷ There are also other increments to provide finer gradation, including symbols such as + or - and the numbers 1-3.⁴⁸ These same letter symbols are used to rate many types of investments, including corporate bonds, structured financial instruments, and insurance products.⁴⁹ As Moody's acknowledges, "municipal credit opinions are unique in that they are expressed through Moody's municipal bond rating scale, which while sharing the familiar symbology is nevertheless conceptually distinct from Moody's global rating scale that is used for debt issued by corporations, non-US governmental issuers and structured finance securities."⁵⁰

These similar ratings symbols lead to comparisons between municipal and corporate bonds. They also give a misleadingly low indication of the credit worthiness of municipalities because the ratings are established using different

⁴³ See, e.g., GLOBAL RATING SCALE, *supra* note 5, at 3 (discussing the low default rate of municipal bonds and the criteria for their ratings).

⁴⁴ See, e.g., John Yinger, *Municipal Bond Ratings and Citizens' Rights*, 12 AM. L. & ECON. REV. 1, 8-10 (Spring, 2010) (indicating a link between municipal bond ratings and borrowing costs).

⁴⁵ See, e.g., *id.*

⁴⁶ *Id.*

⁴⁷ See Hunt, *supra* note 1, at 115-16 (listing the ratings for all three ratings agencies).

⁴⁸ See *id.* at 116 n.10 ("Standard & Poor's uses the "+" and "-" notation; Moody's uses a three-level numerical code within each rating grade, i.e., B1, B2, B3.").

⁴⁹ RATING SYMBOLS, *supra* note 46, at 9, 14.

⁵⁰ Moody's Investors Serv., U.S. MUNICIPAL BOND DEFAULTS AND RECOVERIES, 1970-2009, 2 (2010) available at http://v2.moody.com/cust/content/Content.ashx?source=StaticContent/Free%20Pages/Regulatory%20Affairs/Documents/us_municipal_bond_defaults_and_recoveries_02_10.pdf.

methodologies. There are two major factors determining the rating of a corporate bond: the probability of default and the expected loss in the event of a default.⁵¹ On the other hand, municipal bond ratings measure the issuer's ability to pay its debt, looking only at the likelihood that the issuer will reach a state of financial distress.⁵² Essentially, the analysis for municipal bond ratings ignores the "expected loss" factor. Brokers, fund managers, or other buyers then rely on these ratings when they buy or sell municipal bonds.⁵³

The disparity in the equations is easy to see. Not only is "financial distress" not the equivalent of "default," but also the expected loss in the event of default is not factored in to municipal bond ratings at all. In addition, CRAs do not fully factor "extraordinary support," which is often available for municipalities, into the rating, and it is a major factor in determining the real risk of a municipal bond investment.⁵⁴ Even when municipalities default, they generally pay creditors in full due to extraordinary support from higher levels of government or tax increases.⁵⁵ For example, when Orange County, California defaulted on its obligations in 1994, creditors were still paid one hundred cents on the dollar.⁵⁶ Moody's claims to factor in extraordinary support,⁵⁷ but it acknowledges that "the form and timing of extraordinary support that will be provided . . . is usually not known until the municipality is under significant enough strain that there is considerable concern that a payment default on the debt may occur."⁵⁸ The fact that the extraordinary support cannot fully be factored in contributes to lower ratings for municipal bonds than the actual risk warrants.

⁵¹ Moody's Investors Serv., REQUEST FOR COMMENT: MAPPING OF MOODY'S U.S. MUNICIPAL BOND RATING SCALE TO MOODY'S CORPORATE RATINGS SCALE AND ASSIGNMENT OF CORPORATE EQUIVALENT RATINGS TO MUNICIPAL OBLIGATIONS, 1 (2006), available at http://www.moody.com/sites/products/DefaultResearch/102249_RM.pdf [hereinafter CORPORATE EQUIVALENT].

⁵² GLOBAL RATING SCALE, *supra* note 5, at 3.

⁵³ CFR § 240.15c2-12(b)(1) ("Prior to the time the Participating Underwriter bids for, purchases, offers, or sells municipal securities in an Offering, the Participating Underwriter shall obtain and review . . . [t]he offering price(s), interest rate(s), selling compensation, aggregate principal amount, principal amount per maturity, delivery dates, any other terms or provisions required by an issuer of such securities to be specified in a competitive bid, *ratings*, other terms of the securities depending on such matters, and the identity of the underwriter(s).") (emphasis added).

⁵⁴ See, e.g., GLOBAL RATING SCALE, *supra* note 5, at 3 ("The Gulf Coast communities most severely affected by Hurricane Katrina provide a recent illustration of the occurrence of extraordinary support. Most of these municipalities are likely to avoid default because they have received, or will receive, extraordinary assistance from federal and state levels of government.")

⁵⁵ Education, *What are municipal bonds?*, MunicipalBonds.com, <http://www.municipalbonds.com/education/read/47/what-are-municipal-bonds> (last visited Sept. 21, 2011).

⁵⁶ *Id.*

⁵⁷ CORPORATE EQUIVALENT, *supra* note 51, at 2 ("Moody's considers extraordinary support to include any form of financial, legal or regulatory relief – *beyond routine or regular forms of ongoing support* – that is provided by an external entity or by the voters to assist a distressed municipal obligor in meeting its financial obligations.") (emphasis in original).

⁵⁸ *Id.* at 3.

According to Moody's, municipal bonds receiving a rating of investment grade (Aaa to Baa)⁵⁹ have fewer instances of default than even the highest rated corporate bonds.⁶⁰ Despite this fact, only 15% of state-issued GO bonds and 3% of local GO bonds received Moody's top rating.⁶¹ Acknowledging this discrepancy, Moody's created a conversion to their "Global Rating Scale," which rates municipal bonds on a scale equivalent to that of corporate bonds.⁶² While the Global Rating Scale factors in both the probability of default,⁶³ the "core U.S. municipal ratings" continues to be on the traditional municipal ratings scale.⁶⁴ The effects of this Global Rating Scale have yet to be borne out. This new scale may ultimately compound the problem as CRAs are now affirmatively representing, as opposed to tacitly allowing the belief, that the municipal scale is equivalent to the corporate scale. Moreover, there is still little accountability for the ultimate rating and nothing to prevent the undervaluation of municipal bonds.⁶⁵ In other words, by using this global scale, CRAs fail to acknowledge that they are comparing apples and oranges and continue to encourage the comparison.

One of the major costs of the municipal bond rating scale can be seen when bond insurers are brought into the equation. Bond insurers pay the debtors in the event the bond issuer defaults on its obligation.⁶⁶ The purpose of bond insurance is to lower a bond's perceived risk and raise its rating, thereby lowering the interest rate that the issuer must pay. Bond insurance companies, which are also rated entities, essentially pass on their strong rating to the investment they are insuring.⁶⁷ Bond insurance is very popular.⁶⁸ Since the cost of bond insurance is less than the cost of raising the interest rate of the bond, municipal issuers can save money by purchasing bond insurance.⁶⁹ The fact that CRAs rate municipal bonds and the bond insurance companies on different ratings scales is

⁵⁹ *Id.*

⁶⁰ See GLOBAL RATING SCALE, *supra* note 5, at 6 ("In fact, the 10-year cumulative default rate for all investment grade Moody's-rated municipal bond issuers, excluding GO and water/sewer revenue bonds, stands at 0.2883%, which is lower than the 0.5208% [sic] rate for Aaa-rated corporate bonds.").

⁶¹ *Id.* at 4.

⁶² *Id.* at 1.

⁶³ *Id.* at 12.

⁶⁴ *Id.* at 2.

⁶⁵ See *infra* notes 175-178 and accompanying text (discussing the difficulties with enforcing transparency).

⁶⁶ Angela Gore, Kevin Sachs & Charles Trzcinka, *Financial Disclosure and Bond Insurance*, 47 J.L. & ECON. 275, 276 (2004).

⁶⁷ *Id.* at 279 ("Bond Insurance substitutes the default risk of the insurance company for the default risk of the issuer.").

⁶⁸ *Id.* at 276 (indicating that as of 2004 over half of new debt issues in the municipal sector were insured).

⁶⁹ See, e.g., John Yinger, *Municipal Bond Ratings and Citizens' Rights*, 12 AM. L. & ECON. REV. 1, 8-10 (Spring, 2010) (indicating a link between municipal bond ratings and borrowing costs).

problematic.⁷⁰ Municipal bond issuers, rated by tougher criteria, may actually have a lower risk of default than the company insuring them against default may.⁷¹ Insurers of municipal bonds benefit from the ratings discrepancy in two ways. First, they are highly rated because they insure extremely safe municipal bonds. Second, they receive business because the bonds issuers want to save money.

Municipal bond ratings may be deceptive on two fronts. First, CRAs knowingly use the same letter gradation to represent conclusions about diverse types of investments even though the formulation of the rating and the risks may be different. The CRAs are also aware that their ratings are used to compare these different types of investments against each other and encourage such comparison. Though technically distinct, the ratings criteria are reduced to identical nomenclature, which facilitates an easy comparison. These technically true statements have the potential to create widespread deception that is “designed to mislead others into inferring false beliefs”⁷² Second, by not accounting for the loss given default, or the historically low incidence of default for municipal bonds, the ratings are not accurately calculating the true risk of these investments. In failing to fully measure the true risk of municipal bonds, CRAs are deceiving investors by using “careless falsehoods or half-truths that have the effect of misleading the intended audience, even if they are not designed to deceive”⁷³

These lower ratings are costly to municipalities. For example, in a suit filed by the Connecticut State Attorney General, the complaint noted of several GO municipal bonds:

Moody's gave each of New Haven's bonds an "A3" credit rating and each of East Hartford's bonds an "A1" credit rating. As a result of Moody's deliberate underrating of public bonds, New Haven taxpayers paid a total of \$2.2 million in unnecessary bond insurance premiums to receive a higher "Aaa" rating from Moody's. East Hartford taxpayers paid over \$150,000 for their "Aaa" bond insurer credit rating.⁷⁴

According to Moody's own charting, if these bonds were rated on the global scale they each would have received a much higher "Aa1" rating.⁷⁵

⁷⁰ See, e.g., GLOBAL RATING SCALE, *supra* note 5 (explaining the differences between the two scales).

⁷¹ *Id.* at 2 (“Moody’s will use [global scale] metrics in . . . analyzing the municipal exposures of financial guarantors.”).

⁷² Jonathan Varat, *Deception and the First Amendment: A Central, Complex, and Somewhat Curious Relationship*, 53 UCLA L. REV. 1107, 1109 n.3 (2006) (citing George Steiner, *After Babel* 214 (1975)).

⁷³ *Id.*

⁷⁴ *Connecticut v. Moody's Corp.*, Compl. at para. 8, No. 08-4038928-S (Conn. Super. Ct. July 30, 2008) available at <http://www.ct.gov/ag/lib/ag/antitrust/moodycomplaint73008.pdf>.

⁷⁵ GLOBAL RATING SCALE, *supra* note 5, at 13, Figure 14.

II. ANALYSIS

CRAs enjoy a unique and somewhat ambiguous position in our economy. Despite the difficulties CRAs impose on municipalities, they face very little accountability in court.⁷⁶ They have successfully defended “Underwriter” liability and “Control Persons” claims brought under the Securities Act of 1933, among other securities law claims.⁷⁷ Often, securities laws are very specific to certain actors, and CRAs’ ambiguous position allows them to avoid scrutiny.⁷⁸ If properly applied, traditional legal principals may help solve some of these issues.

A. *First Amendment*

Bonds issuers and purchasers suing CRAs often claim negligent misrepresentation or defamation.⁷⁹ In the past, they have been able to avoid liability by claiming that the ratings are only “opinion” and are therefore protected by the First Amendment. CRAs receive additional First Amendment protection by asserting they play a role similar to that of journalists.⁸⁰ Defamation cases require a plaintiff to show “that the statement in question was false and that the defendant had the requisite state of mind.”⁸¹ Under this rule, the first issue to address is if credit ratings are a matter of truth or if they are purely opinion.

⁷⁶ See, e.g., Christopher Schmitt, *Holding the Enablers Responsible: Applying Sec Rule 10b-5 Liability to the Credit Rating Institutions*, 13 U. PA. J. BUS. L. 1035 (2011) (arguing for 10b-5 liability for CRAs as a way to fill the legal and regulatory gap that the CRAs have fallen into).

⁷⁷ See, e.g., In re Lehman Brothers Mortgage-Backed Securities Litigation, 650 F.3d 167, 176-182, (holding that despite their role in structuring the investments CRAs did not qualify as “Underwriters” under § 11 of the 33 Act or as “Control Persons” under § 15).

⁷⁸ See e.g., *id.* (despite their large role CRAs did not fit under any of the statutory definitions for liability).

⁷⁹ Haghshenas, *supra* note 24, at 469 (“In lawsuits against rating agencies, plaintiffs have alleged defamation, negligent misrepresentation and libel.”).

⁸⁰ See, e.g., Gregory Husisian, *What Standard of Care Should Govern the World’s Shortest Editorials?: An Analysis of Bond Rating Agency Liability?*, 75 CORNELL L. REV. 411, 413-14, 414 n.16 (1990) (“bond rating agencies receive full first amendment protection as a member of the media . . .”) (citing *First Equity Corp. of Fla. v. Standard & Poor’s Corp.*, 869 F.2d 175 (2d Cir. 1989); *First Equity Corp. of Fla. v. Standard & Poor’s Corp.*, 690 F. Supp. 256 (S.D.N.Y. 1988), *aff’d*, 869 F.2d 175 (2d Cir. 1989); *First Equity Corp. of Fla. v. Standard & Poor’s Corp.*, 670 F.Supp. 115 (S.D.N.Y. 1987), *aff’d*, 869 F.2d 175 (2d Cir. 1989); *Pittman v. Dow Jones & Co.*, 662 F. Supp. 921 (E.D. La. 1987), *aff’d*, 834 F.2d 1171 (5th Cir. 1987); *Gale v. Value Line, Inc.*, 640 F. Supp. 967 (D.R.I. 1986); *Milberg v. Western Pac. R.R.*, 51 F.R.D. 280 (S.D.N.Y. 1970), appeal dismissed sub nom. *Korn v. Franchard Corp.*, 443 F.2d 1301 (1971); *Jaillet v. Cashman*, 115 Misc. 383, 189 N.Y.S. 743 (Sup. Ct. 1921), *aff’d mem.* 202 A.D. 805, 194 N.Y.S. 947 (App. Div. 1922), *aff’d mem.*, 235 N.Y. 511, 139 N.E. 714 (1923); *Daniel v. Dow Jones & Co.*, 520 N.Y.S.2d 334 (N.Y. City Civ. Ct. 1987); *Gutter v. Dow Jones, Inc.*, 22 Ohio St. 3d 286, 490 N.E.2d 898 (1986)).

⁸¹ *Jefferson County School Dist. v. Moody’s Inv. Svc., Inc.* 175 F.3d 848, 852 (10th Cir. 1999).

1. Credit Ratings as Opinion

The traditional view is that ratings are predictions about default risk, making them opinions because future events cannot be true or false.⁸² In *Milkovich v. Lorain Journal*,⁸³ the Supreme Court, in discussing the First Amendment protections for opinions, points out that there is not a “wholesale defamation exemption for anything that might be labeled ‘opinion.’”⁸⁴ Courts have recently begun to recognize that CRAs should not always receive full First Amendment protection.

One of the distinctions between CRAs and typical journalists is that the bond issuers pay the CRA for issuing its rating. In *In re Fitch, Inc.*,⁸⁵ the Second Circuit rejected granting Fitch protection under New York’s Shield Law as a professional journalist.⁸⁶ The court considered it relevant that Fitch only rates bond issuers that pay for a rating, something that cannot be said of Moody’s or S&P.⁸⁷ The court also found it relevant that Fitch played a role in structuring the transaction to achieve a desired rating.⁸⁸ In *Commercial Financial Services, Inc. v. Standard & Poor’s*,⁸⁹ the court found it significant that the CRA and the issuer had a paid relationship, unlike a journalist reporting on a topic.⁹⁰ In *Abu Dhabi Commercial Bank v. Morgan Stanley*,⁹¹ the Southern District of New York rejected granting a First Amendment immunity to a CRA because their “compensation was contingent upon the receipt of desired ratings...and only [happened] in the event that the transaction closed with those ratings.”⁹² These cases indicate that courts are beginning to recognize CRAs as different from typical journalists.

Another difficulty with the presumption that ratings are opinions is that they are not merely future predictions. In *Compuware Corp. v. Moody’s Investor Services*,⁹³ the Sixth Circuit found that a “rating is a predictive opinion of a company’s future creditworthiness”⁹⁴ Since ratings are based largely upon

⁸² See Haghshenas, *supra* note 24, at 472-73 (“Although the test for defamation requires that the statements be proven false, this test is misplaced in the rating agencies context because the ratings assigned are predictions about future issuances, and intuitively one cannot prove in the present that a prediction of future events is false.”).

⁸³ 497 U.S. 1 (1990).

⁸⁴ *Id.* at 18.

⁸⁵ 330 F.3d 104 (2nd Cir. 2003).

⁸⁶ *Id.* at 109.

⁸⁷ *Id.*

⁸⁸ *Id.* at 110-11.

⁸⁹ 94 P.3d 106 (Okla. 2004).

⁹⁰ *Id.* at 111.

⁹¹ 651 F. Supp. 2d 155 (S.D.N.Y. 2009).

⁹² *Id.* at 167.

⁹³ 499 F.3d 520 (6th Cir. 2007).

⁹⁴ *Id.* at 522.

the issuer's current financial situation, they could also be viewed as an evaluation of a company's current state. This feature means that ratings are less like pure opinion than they are deductions, or conclusions based on facts.⁹⁵ Viewed as deductions, ratings are "assertion[s] of fact inasmuch as [they are] a claim of the past, present, or future existence or attribute of some event, person, place, or thing."⁹⁶ Although some debate remains,⁹⁷ courts continue to use a totality the circumstances test to make the determination.⁹⁸ Under this analysis, ratings are less likely to be opinion because CRAs purportedly use facts in making their ratings.

When establishing a rating, a CRA "considers several objective factors, but [the rating] is ultimately derived from the subjective weighing of those factors."⁹⁹ Conflicts of interest are inherent in the rating process, increasing the subjectivity of the process. Thus, ratings may be skewed when CRAs potentially benefit.¹⁰⁰ CRAs claim to disclose the methodology for how they arrive at a particular rating. This methodological transparency should help determine whether ratings are verifiable as true or false and ensure that they are objectively created.

In *Milkovich v. Lorain Journal*, the Supreme Court ruled that "[e]ven if the speaker states the facts upon which he bases his opinion, if those facts are either incorrect or incomplete, or if his assessment of them is erroneous, the statement may still imply a false assertion of fact."¹⁰¹ Similarly, in *Jefferson County School Dist. v. Moody's Investment Services, Inc.*,¹⁰² the Tenth Circuit found that if ratings "were shown to have materially false components, the issuer should not be shielded from liability by raising the word 'opinion' as a shibboleth."¹⁰³ Under this reasoning, if part of the rating criteria is "materially false" or if the ratings assessment is erroneous, then the rating itself may be a false statement. With increased methodological transparency, the ratings objective criteria gain weight and, if the objective data does not support the final rating, any subjective criteria that enter the equation should receive greater scrutiny.

⁹⁵ Robert Sack, *Protection of Opinion Under the First Amendment: Reflections on Alfred Hill*, "DEFAMATION AND PRIVACY UNDER THE FIRST AMENDMENT", 100 Colum. L. Rev. 294, 299 (2000).

⁹⁶ *Id.*

⁹⁷ Restatement (Second) of Torts §566 (1977) ("The simple expression of opinion, or the pure type, occurs when the maker of the comment states the facts on which he bases his opinion of the plaintiff and then expresses a comment as to the plaintiff's conduct, qualifications or character.").

⁹⁸ *Id.* (citing *Capan v. Daugherty*, 402 N.W.2d 561, 563 (Minn. Ct. App. 1987)).

⁹⁹ 499 F.3d at 522.

¹⁰⁰ See Haghshenas, *supra* note 24, at 494 (indicating that conflicts of interest cloud the subjectivity of ratings).

¹⁰¹ 497 U.S. at 18-19.

¹⁰² 175 F.3d 848 (10th Cir. 1999) (hereinafter *Jefferson County*).

¹⁰³ *Id.* at 856.

2. Required State of Mind

The Supreme Court has held that public figures must prove “actual malice” in order to recover for a defamatory falsehood relating to matters of public concern.¹⁰⁴ In *County of Orange v. McGraw-Hill*,¹⁰⁵ after the county defaulted on its debt obligations, it sued S&P for the rating it gave its bond issue.¹⁰⁶ The district court held the plaintiff must meet the actual malice standard to prove that S&P did not issue a rating in a competent manner.¹⁰⁷ The *McGraw* case shows that municipalities, often considered matters of public concern, require plaintiffs to show “actual malice” to prevail.¹⁰⁸

To prove “actual malice” the plaintiff must show that the CRA acted “with knowledge that the statement was false or with reckless disregard for whether or not it was true.”¹⁰⁹ While no case has shown actual malice on the part of CRAs, courts have found them to be liable under certain circumstances. In *Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc.*,¹¹⁰ the Supreme Court found that a company’s credit report was not a matter of public concern because it remained confidential, and therefore, the plaintiff did not have to show actual malice.¹¹¹ In *In re National Century* and in *Abu Dhabi Commercial Bank*, the respective courts relied on *Dun & Bradstreet* in finding that the defendant CRAs did not qualify for full First Amendment protection because the ratings were only disseminated to a limited number of people.¹¹² While these decisions will allow for a lesser mental state in private placements,¹¹³ they will likely not have an effect on municipal bonds. Municipal bonds are available to the public at large, and it would be difficult to claim that a municipal bond rating is not a matter of public concern.

As with the fact/opinion determination, CRAs and ratings do not fit well into the actual malice evaluation. As previously discussed, CRAs are often incentivized to increase or decrease a particular rating because the issuer pays for the service. Perhaps these misaligned incentives are enough to show actual

¹⁰⁴ See *New York Times Co. v. Sullivan* 376 U.S. 254, 279-80 (1964) (holding that public officials must show actual malice for defamatory falsehoods relating to official conduct); *Curtis Pub. Co. v. Butts*, 388 U.S. 130, 164-65 (1967) (Warren, C.J., concurring) (applying the public official standard to public figures if the matter is a public concern).

¹⁰⁵ 245 B.R. 151 (C.D. Cal. 1999).

¹⁰⁶ *Id.* at 153-54.

¹⁰⁷ *Id.* at 157.

¹⁰⁸ *Id.* at 160-61 (holding that credit ratings were statements of opinion and that “actual malice” must be shown in order to overcome First Amendment protection.).

¹⁰⁹ *Id.* at 155 (quoting *Hustler Magazine v. Falwell*, 485 U.S. 46, 56 (1988)).

¹¹⁰ 472 U.S. 749 (1985).

¹¹¹ *Id.* at 761-63.

¹¹² *In re Nat'l Century Fin. Enters., Inc.*, 580 F. Supp. 2d 630, 640 (S.D. Ohio 2008); *Abu Dhabi Comm. Bank v. Morgan Stanley & Co., Inc.*, 651 F. Supp. 2d 155 (S.D.N.Y. 2009).

¹¹³ See John Crawford, *Hitting the Sweet Spot by Accident: How Recent Lower Court Cases Help Realign Incentives In the Credit Rating Industry*, 42 CONNTEMPORATIONS 13, 23 (2009).

malice when a court finds that the objective criteria do not match the final rating, resulting in a financial benefit to the CRA.

B. *Antitrust Liability*

1. Monopolization

Municipalities have also charged CRAs with violations of the Sherman Antitrust Act with historically little success. The case of *Jefferson County* provides an illustration.¹¹⁴ Despite previously working with Moody's, the School District chose two other CRAs for this particular bond issue.¹¹⁵ When the bonds were brought to the market, they initially sold well based on favorable ratings by the two other agencies. Soon after the sales period began, Moody's published an unsolicited opinion, giving the School District a negative outlook.¹¹⁶ This unsolicited article created a chilling effect on the sales of the School District's bond issue, resulting in an increased interest rate.¹¹⁷

In addition to its state tort claims, the School District tried to amend its complaint to allege that this was an act of monopolization under Section 2 of the Sherman Act.¹¹⁸ The School District claimed that the publication of the article was an attempt to monopolize the ratings market.¹¹⁹ In denying the motion to amend, the district court held – and the Tenth Circuit affirmed – that Moody's statements about the bond issue were opinions, immunizing Moody's from federal antitrust claims.¹²⁰ The Circuit Court went on to hold that antitrust claims could not be predicated on speech protected by the First Amendment.¹²¹

This reasoning leads to a bizarre result. If an issuer does not wish to pay one of the Big Three to rate its bonds, the snubbed CRA may then publish a rating or article that negatively influences the bond issue with virtually no repercussions. The *Jefferson County* court looked to prior Supreme Court precedent with respect to applying the laws of defamation to media defendants.¹²² The Tenth Circuit held that the article did not constitute a

¹¹⁴ See *Jefferson County*, *supra* note 102.

¹¹⁵ 175 F.3d at 850.

¹¹⁶ *Id.* Note that although the unsolicited “negative outlook” was in an article published by Moody's, the same analysis would apply to an unsolicited rating since, as CRAs acknowledge, these ratings are a symbolic representation of this same kind of analysis.

¹¹⁷ *Id.* at 851.

¹¹⁸ *Id.*

¹¹⁹ *Id.* at 860.

¹²⁰ *Id.* at 860.

¹²¹ 175 F.3d at 860.

¹²² See *id.* at 852 (citing 497 U.S. 1 (1990); *New York Times v. Sullivan*, 376 U.S. 254 (1964); *Curtis Publishing Co. v. Butts*, 388 U.S. 130 (1967); *Philadelphia Newspapers, Inc. v. Hepps*, 475 U.S. 767 (1986)).

provably false factual assertion, either expressed or implied, and that the statements deserved protection under the First Amendment.¹²³

The court in *Jefferson County* uses a markedly flawed reasoning. While the First Amendment affords the highest protection for media defendants, it does not immunize them from liability when they use their position to attempt to monopolize. Even news organizations are subject to scrutiny under the antitrust laws. “The First Amendment does not Preclude Application of the [Sherman] act to a news gathering organization, nor does freedom of the press authorize a newspaper to attempt to monopolize in violation of it.”¹²⁴ The fact that a particular publisher handles news while others trade in goods does not afford the publisher the constitutional privilege to violate the antitrust laws with impunity.¹²⁵ As discussed in the previous section, CRAs’ statements regarding the creditworthiness of a municipality are not typical media reports.¹²⁶ In addition, methodological transparency makes ratings somewhat verifiable as facts and not purely opinions that deserve full constitutional protection. The ratings system and other possibly monopolistic actions of CRAs should, therefore, be subject to antitrust scrutiny.

If the monopolization claim in *Jefferson County* had survived the motion to dismiss, a jury may have found Moody’s actions to be anticompetitive. Section 2 of the Sherman Act states: “Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce . . . shall be deemed guilty of a felony.”¹²⁷ In *Spectrum Sports, Inc. v. McQuillan*,¹²⁸ the Supreme Court noted that in order to succeed in an attempted monopolization claim a plaintiff must prove that: (1) the defendant has engaged in predatory or anticompetitive conduct with both (2) a specific intent to monopolize and (3) a dangerous probability of achieving monopoly power.¹²⁹ If the *Jefferson County* court allowed a jury to evaluate Moody’s conduct under these criteria, it may very well have found a Section 2 violation.

First, Moody’s conduct with respect to the School District’s bond issue was potentially predatory. By giving poor evaluations of bonds for which Moody’s has no contract to rate, Moody’s is able to discourage bond issuers from utilizing its main competitors, S&P and Fitch. At the very least, they are able to coerce bond issuers into engaging Moody’s. In other words, Moody’s extorts issuers into hiring them or having their bond issue and reputation

¹²³ *Id.* at 860.

¹²⁴ 58 AM. JUR. 2D *Newspapers, etc.* § 57 (2013).

¹²⁵ *See, e.g.,* *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951) (holding that a newspaper’s efforts to harm its competitors constituted a violation of the Sherman Act); *Associated Press v. United States*, 326 U.S. 1 (1945) (holding that a news gathering association’s practices, which prevented members from sharing news with non-members, were monopolistic).

¹²⁶ *See infra* Section A.

¹²⁷ 15 U.S.C.A. § 2 (West 2004).

¹²⁸ 506 U.S. 447 (1993).

¹²⁹ *Id.* at 456.

harmful. In *Lorain Journal v. United States*,¹³⁰ a newspaper refused to publish ads from companies who advertised with a competing radio station.¹³¹ The Supreme Court held that a “publisher may not accept or deny advertisements in an ‘attempt to monopolize’”¹³² The conduct in that case, as in *Jefferson*, discouraged clients from purchasing services from a competitor.¹³³ While *Lorain Journal* involved a mere refusal to deal with clients of a competitor,¹³⁴ Moody’s actions in *Jefferson County* were even more egregious. They took overt actions to harm a consumer who did not seek their services.¹³⁵ Further evidence of the pernicious nature of this act is that Moody’s previously gave the School District a high rating.¹³⁶ Any factors that would have significantly changed the risk of the Jefferson County bond would have been reflected in the S&P or Fitch ratings.

The next step in evaluating an attempted monopolization claim would be determining if a specific intent to monopolize existed. The Supreme Court has acknowledged that when a defendant engages in predatory conduct, the conduct itself is evidence of an attempt to monopolize.¹³⁷ The same factors that are relevant to the predatory nature of the action are also evidence of Moody’s intent. The timing and other circumstances surrounding the article indicate Moody’s intent to both punish the School District for not using their service and discourage others from doing the same. Moody’s would likely argue that it published the article to convey to investors its opinion on the School District’s credit risk. Investors, however, would have a more accurate evaluation of this risk based on the ratings of the two CRAs that had up-to-date information. Moody’s article contradicting its competitors could only serve to undermine the School District’s ratings and confuse potential investors.

The final step in evaluating an attempted monopolization claim is to determine whether there was a possibility of achieving monopoly power. One of the difficulties in evaluating CRAs under antitrust law is that two major companies dominate the market. Together, S&P and Moody’s control the bulk

¹³⁰ 342 U.S. 143 (1951).

¹³¹ *Id.* at 146-47.

¹³² *Id.* at 156 (quoting 15 U.S.C.A. § 2 (West 2004)).

¹³³ *Id.* at 149-50.

¹³⁴ *Id.* at 152 (“The publisher’s attempt to regain its monopoly of interstate commerce by forcing advertisers to boycott a competing radio station violated [Section 2 of the Sherman Act].”).

¹³⁵ See 175 F.3d, at 850-51 (10th Cir.1999) (Moody’s issued an unsolicited negative outlook for the bond issue, only two hours into the bond issue, without garnering the most up-to-date and accurate information).

¹³⁶ *Jefferson Cnty. Sch. Dist. No. R-1 v. Moody’s Investor’s Servs., Inc.*, 988 F. Supp. 1341, 1343 (D. Colo. 1997) (“Moody’s had an outstanding rating on the School District’s Series 1985C Bonds.”).

¹³⁷ See, e.g., *Spectrum Sports, Inc.*, 506 U.S. at 458 (1993) (stating that when a “defendant has engaged in ‘unfair’ or ‘predatory’ tactics, [s]uch conduct may be sufficient to prove the necessary intent to monopolize.”) (quoting *McQuillan v. Sorbothane, Inc.*, 907 F.2d 154 (9th Cir. 1990)).

of the market with Fitch a distant third.¹³⁸ Given this market structure, it is tough to understand how one of these companies could be close to obtaining monopoly power. As previously discussed, however, the norm for bond issuers is to obtain two ratings.¹³⁹ As an illustration of this tradition's influence on the market, investors may become suspicious if issuers only obtain one rating.¹⁴⁰ Moody's and S&P reinforce this two-rating norm as Moody's did in *Jefferson County*. As Claire Hill stated:

Should the two-rating norm show some sign of eroding, Moody's and Standard & Poor's can reinforce it by threatening to issue ratings the issuer has not solicited, using only the information publicly available. The implicit threat is always that without an issuer's active participation in (and payment for) the rating, the issuer will not be given an opportunity to rebut any negative inferences that might be made from the public information.¹⁴¹

With this two-rating norm, ratings by S&P and Moody's are complements, not substitutes. A successful attempt to drive out Fitch, the only other large competitor, would essentially give Moody's and S&P a duopoly. In other words, the two-rating norm effectively gives both Moody's and S&P each the possibility of achieving monopoly profits.

2. Conscious Parallelism

Conscious parallelism is another potential antitrust theory under which to evaluate CRAs, specifically the municipal bond rating scale. Under Section 1 of the Sherman Act, every contract, combination, or conspiracy in restraint of trade is illegal.¹⁴² In *Monsanto v. Spray-Rite*,¹⁴³ the Supreme Court interpreted this phrase as requiring "a conscious commitment to a common scheme designed to achieve an unlawful objective."¹⁴⁴ In other words, there must be some sort of agreement in order to find a Section 1 violation.¹⁴⁵ Finding an agreement with concrete evidence is inherently difficult in antitrust litigation simply because of the nature of the crime. Conspiracies are typically implicit agreements that the parties do not want to write in ink. In addressing this issue, the Supreme Court

¹³⁸ See Darcy, *supra* note 17, at 612-13 ("Fitch, Moody's, and S&P hav[e] issued almost 99% of all outstanding ratings . . . commentators have traditionally considered Moody's and S&P as the most prominent agencies, ranking Fitch a distant third.").

¹³⁹ See *id.* at 613 ("[A] two rating norm has historically existed where issuers usually try to obtain ratings from Moody's and S&P.").

¹⁴⁰ Hill, *supra* note 30, at 61 (indicating that the second rating often pays for itself in the form of better sales because of the suspicion surrounding instruments sold with only one rating).

¹⁴¹ *Id.*

¹⁴² 15 U.S.C.A. § 1 (West 2004).

¹⁴³ 46 U.S. 752 (1984).

¹⁴⁴ *Id.* at 768.

¹⁴⁵ See, e.g., *Eastern States Retail Lumber Dealers' Ass'n v. United States* 34 S.Ct. 951, 954 (1914) ("[I]n order to show a combination or conspiracy within the Sherman act some agreement must be shown under which the concerted action is taken . . .").

noted that “conspiracies are seldom capable of proof by direct testimony, and may be inferred from the things actually done”¹⁴⁶ Moreover, a formal agreement is unnecessary to show an unlawful conspiracy and circumstantial evidence is admissible, including the business practices of the alleged conspirators.¹⁴⁷ In order to prove that an antitrust agreement exists, a plaintiff must show “evidence that tends to exclude the possibility of independent action” on the part of the defendant.¹⁴⁸

Each of the Big Three CRAs rates bonds using similar criteria and very similar numerical symbols.¹⁴⁹ The Supreme Court has indicated that parallel business practices, such as this, may not necessarily prove an antitrust agreement exists.¹⁵⁰ Without an explicit agreement, competitors may find it in their best interest to have the same business practices as a competitor.¹⁵¹ This type of parallel business practices becomes more troublesome when the particular behavior would not be in the unilateral self-interest of one of the businesses without an agreement among them. In *Interstate Circuit v. United States*,¹⁵² the Supreme Court found an implicit agreement when several movie theaters complied with a movie distributor’s request to raise prices without evidence that they explicitly agreed with each other.¹⁵³ The court reasoned that unless each movie theater knew that its competitors would raise prices, it would not be in their unilateral self-interest to do so.¹⁵⁴

Without an implied or expressed agreement, the Big Three CRAs would face a prisoner’s dilemma.¹⁵⁵ They would each have an incentive to be the first to provide more accurate, verifiable ratings and gain market share. On the other hand, if they all do so, the industry as a whole will not be quite as profitable since their illicit practices may be impossible. With an agreement in place, each of the Big Three will continue with the status quo so that they can all extract higher profits without the risk of a competitor dropping the practice and cutting into their market share. The lesson from utilizing the prisoner’s dilemma in

¹⁴⁶ *Id.*

¹⁴⁷ Gregory Werden, *Economic Evidence on the Existence of Collusion: Reconciling Antitrust Law with Oligopoly Theory*, 71 ANTITRUST L.J. 719, 734-35 (2004) (citing *Norfolk Monument Co. v. Woodlawn Mem’l Gardens, Inc.*, 394 U.S. 700, 704 (1969) (per curiam)).

¹⁴⁸ 465 U.S. at 768 (1984).

¹⁴⁹ See Hunt, *supra* note 1, at 115-16.

¹⁵⁰ See *United States v. Int’l Harvester Co.*, 274 U.S. 693, 708-09 (1927) (“And the fact that competitors may see proper, in the exercise of their own judgment, to follow the prices of another manufacturer, does not establish any suppression of competition or show any sinister domination.”) (citing *United States v. United States Steel Corp.* 251 U.S. 417, 448 (1920)).

¹⁵¹ See *id.*

¹⁵² 306 U.S. 208 (1939).

¹⁵³ *Id.* at 226-27.

¹⁵⁴ *Id.* at 223 (“But we are unable to find in the record any persuasive explanation, other than agreed concert of action, of the singular unanimity of action on the part of the distributors by which the proposals were carried into effect . . .”).

¹⁵⁵ See Werden, *supra* note 147 at 727-28 (explaining the prisoner’s dilemma game thoroughly).

evaluating the possible CRA cartel “is that cooperation cannot be expected to just happen.”¹⁵⁶ Put simply, there must be an agreement, expressed or implied, for this practice to continue.

3. The Municipal Bond Rating Scale as an Unfair Trade Practice

CRA's have some oversight over the bond market by controlling the bonds that will receive high ratings. CRA's also have incentives to give high ratings to certain financial products. In *Abu Dhabi Commercial Bank v. Morgan Stanley*, the court noted that CRA's often receive compensation contingent upon an investment receiving a desired rating.¹⁵⁷ The *Abu Dhabi* court recognized the potential conflict of interest because of this compensation scheme.¹⁵⁸ Municipal bonds compete with these other securities when trying to attract investors. CRA's give other securities a distinct advantage by using a deceptive ratings scale that undervalues municipal bonds. As a result, municipal bond issuers must buy costly – and often unnecessary – bond insurance to prop up their rating and compete for investors. Since municipalities are direct competitors with marketable securities in which CRA's have a vested interest, CRA's effectively increase the cost of their rivals by using a more difficult ratings scale. Raising rivals cost is a long-recognized predatory act under the Sherman Act.¹⁵⁹

The Supreme Court has found certain practices anticompetitive when they reduce the use of a rival's product “through something other than competition on the merits.”¹⁶⁰ In the case of CRA's, the municipal ratings scale reduced the incentives to purchase municipal bonds not because of their inherent value, but because of their rating compared to their competition. Thus, it is reasonable to argue that the bond's reduction in value is due to “something other than competition on the merits.”¹⁶¹ This reduction in value has significantly cost municipalities and taxpayers by making municipal bonds less marketable.

The State of Connecticut made this argument in an effort to hold CRA's accountable for the additional costs they imposed on municipalities. In June of 2008, Connecticut Attorney General Richard Blumenthal sued each of the Big Three CRA's (“*Connecticut cases*”).¹⁶² The complaint alleged that the Big Three undertook the “unfair, deceptive, and illegal business practice of systematically

¹⁵⁶ *Id.* at 728.

¹⁵⁷ 651 F. Supp. 2d at 167.

¹⁵⁸ *Id.* at 178-79.

¹⁵⁹ *See, e.g.*, 342 U.S. at 149.

¹⁶⁰ *United States v. Microsoft Corp.*, 253 F.3d 34, 65 (D.C. Cir. 2001).

¹⁶¹ *Id.*

¹⁶² *Connecticut v. Fitch, Inc.*, Compl., No. 08-4038926-S (Conn. Super. Cr. 2008) available at <http://www.ct.gov/ag/lib/ag/antitrust/fitchcomplaint073008.pdf>; *Connecticut v. Moody's Corp.*, Compl., No. 08-4038928-S (Conn. Super. Cr. July 30, 2008) available at <http://www.ct.gov/ag/lib/ag/antitrust/moodycomplaint73008.pdf>; *Connecticut v. McGraw-Hill Co.'s, Inc.*, Compl. No. 08-4038927-S (Conn. Super. Ct. July 30, 2008) available at <http://www.ct.gov/ag/lib/ag/antitrust/s&pcomplaint7308.pdf>.

and intentionally giving lower credit ratings to bonds issued by states, municipalities, and other public entities as compared to corporate and other forms of debt with similar or even worse rates of default.¹⁶³ The complaint focuses on the ratings' symbols as a cause of confusion, stating "[b]ecause Moody's public and corporate bond ratings are identical on their face, consumers of Moody's ratings quite reasonably assume they mean the same thing."¹⁶⁴ The complaint further alleged that the CRAs colluded with bond insurance providers to keep municipal bonds rated on a more stringent scale but with the same symbols.¹⁶⁵ After bouncing between state and federal courts for three years on procedural grounds, the Connecticut Attorney General accepted a settlement agreement from the CRAs.¹⁶⁶ According to the settlement, the CRAs will give \$900,000 in credit to the state for future credit ratings from these agencies.¹⁶⁷

CRAs have given a procompetitive justification for utilizing two distinct ratings scales.¹⁶⁸ They claim the separate scales are necessary to provide larger spreads when comparing municipal bonds.¹⁶⁹ If CRAs rated municipal bonds on the corporate scale, the bonds would likely remain bunched together in the Aaa or Aa range.¹⁷⁰ This argument is unpersuasive because it does not address why it is necessary for competing securities to use the same nomenclature. Perhaps policymakers should reconsider the ratings scales *in toto* to achieve finer gradation.¹⁷¹

¹⁶³ Connecticut v. Moody's Corp., Compl. at para. 1.

¹⁶⁴ *Id.* at para. 61.

¹⁶⁵ *See id.*, at paras. 68–71.

¹⁶⁶ Press Release, George Jepsen, Attorney Gen., Conn., Office of the Attorney General Settles Public Finance Lawsuits Against Moody's, Standard & Poor's, and Fitch (Oct. 14, 2011), available at <http://www.ct.gov/ag/cwp/view.asp?A=2341&Q=488608>.

¹⁶⁷ *Id.*

¹⁶⁸ *See, e.g.,* Board of Trade of City of Chicago v. U.S., 246 U.S. 231, (1918) ("The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts.").

¹⁶⁹ GLOBAL RATING SCALE, *supra* note 5, at 2 ("Because many municipal investors and issuers place a high value on the fine gradations of risk provided by the municipal rating scale, Moody's will continue to use this scale for our core U.S. municipal ratings.").

¹⁷⁰ *See* CORPORATE EQUIVALENT, *supra* note 51, at 3 ("[F]iscally sound issuers in these sectors [GO, water, and sewer municipal bonds] would likely map to a rating of Aaa or Aa on the corporate rating scale.").

¹⁷¹ An antitrust plaintiff could argue that the benefits from finer gradation in the separate scales is outweighed by the confusion in using the same nomenclature. *See, e.g.,* United States v. Microsoft Corp., 253 F.3d 34, 64 (D.C. Cir. 2001) ("[I]f the monopolist's procompetitive justification stands un rebutted, then the plaintiff must demonstrate that the anticompetitive harm of the conduct outweighs the procompetitive benefit.").

While these cases venture into unexplored legal territory, it is not first time a practice of those controlling a financial market has come under antitrust scrutiny. In the class-action suit *In re NASDAQ Market-Makers Antitrust Litigation*,¹⁷² private plaintiffs alleged that several so-called market makers engaged in unfair conduct that inflated the price of certain investments.¹⁷³ The practice was improper because the defendants agreed by implicit agreement to disallow quoting prices in “odd-eights” on the NASDAQ exchange.¹⁷⁴ That practice, like the municipal bond scale, affected the pricing of some of the securities in the market.¹⁷⁵ The settlements in *In re NASDAQ* totaled over \$1 billion.¹⁷⁶ This case was “the largest recovery, class action or otherwise, in the hundred-year history of the state and federal antitrust laws.”¹⁷⁷

Compared to the *In re NASDAQ* case, the settlement agreement of the *Connecticut Cases* seems inadequate. In the *Connecticut Cases*, the alleged damages totaled over \$6.2 Million.¹⁷⁸ Extrapolating across the fifty states and thousands of bonds issued, the potential for liability could be enormous. In light of this fact and the sizeable settlement in *In re NASDAQ*, it is likely that the settlement reached in the *Connecticut cases* was largely symbolic. The aftermath of the 2008 financial crisis highlighted the need for reform in this area. According to the settlement announcement, the reform sought by the lawsuits has been implemented since the suits were filed.¹⁷⁹ Since this reform is what was truly sought, the cases were never adjudicated on their merits.

¹⁷² 894 F.Supp. 703 (S.D.N.Y. 1995).

¹⁷³ *Id.* at 705-07.

¹⁷⁴ *Id.* at 707.

¹⁷⁵ *Id.* at 707-09.

¹⁷⁶ *In re Nasdaq Market-Makers Antitrust Litigation*, 187 F.R.D. 465, 472-73 (S.D.N.Y. 1998) (“The Proposed Settlements provide for aggregate payments by all 37 defendants, which, including interest, will total approximately \$1,027,000,000.00 (before deductions for fees and expenses) by the anticipated time of distribution in 1999.”).

¹⁷⁷ *Id.* at 471.

¹⁷⁸ Each complaint gave examples of the cost of bond insurance on municipal bonds rated by the respective CRAs. *Connecticut v. Fitch, Inc.*, Compl. at paras. 8-10 No. 08-4038926-S (Conn. Super. Ct. July 30, 2008) available at <http://www.ct.gov/ag/lib/ag/antitrust/fitchcomplaint073008.pdf> (giving examples of the cost of bond insurance on Fitch rated municipal bonds); *Connecticut v. Moody's Corp.*, Compl. at paras. 8-9 (Conn. Super. Ct. July 30, 2008) available at <http://www.ct.gov/ag/lib/ag/antitrust/moodycomplaint73008.pdf> (giving examples of the cost of bond insurance on Moody's rated municipal bonds); *Connecticut v. McGraw-Hill Co.'s, Inc.*, Compl. at paras. 6-8 (Conn. Super. Ct. July 30, 2008) available at <http://www.ct.gov/ag/lib/ag/antitrust/s&pcomplaint7308.pdf> (giving examples of the cost of bond insurance on Fitch rated municipal bonds).

¹⁷⁹ Jepsen, *supra* note 166.

III. DODD-FRANK AND OTHER LEGISLATION

In July 2010, President Obama signed Dodd-Frank into law.¹⁸⁰ Subtitle C of Title IX of Dodd-Frank addresses CRAs, implementing reforms through various measures.¹⁸¹ The act emphasizes that “credit rating agencies are central to the capital formation, investor confidence, and the efficient performance of the United States economy.”¹⁸² It specifically addresses the areas of reliance, oversight, accountability, conflicts of interest, and the risks of inaccuracy.¹⁸³

A. *Reducing Reliance on CRAs*

As previously discussed, CRAs are an integral part of the financial regulation.¹⁸⁴ Dodd-Frank tries to reduce regulatory dependence on CRAs. Specifically, it removes references to CRAs and rating in the Federal Deposit Insurance Act, the Federal Housing Enterprises Financial Safety and the Soundness Act of 1992, the Investment Company Act of 1940, and the Securities and Exchange Act of 1934, among others.¹⁸⁵ Dodd-Frank also requires each federal agency to review its regulations that reference credit ratings or CRAs¹⁸⁶ to create their own uniform standards of creditworthiness, removing any reference to credit ratings.¹⁸⁷ The goal behind reducing the regulatory reliance is ultimately to reduce investor reliance on ratings and prevent another financial collapse. If investors are not as reliant on the rating system, they will likely place more weight on the strong history of municipal bonds. While the effect of these measures remains unseen, municipalities and taxpayers should benefit from the reduced cost of borrowing.

B. *Conflicts of Interest*

Dodd-Frank also looks to enhance oversight of CRAs. It requires the SEC to establish an Office of Credit Ratings to conduct an annual examination of CRAs.¹⁸⁸ The purpose of the new office is to: “(i) to protect[] . . . users of credit ratings . . . ; (ii) to promote accuracy in credit ratings . . . , and (iii) to ensure that

¹⁸⁰ BINGHAM MCCUTCHEN LLP, DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT: A SUMMARY intro. (2010).

¹⁸¹ Dodd-Frank, Pub. L. No. 111-203, §§ 931–939, 124 Stat. 1376, 1872–83 (codified in scattered sections of 12, 15, 22 U.S.C. (2010)).

¹⁸² § 931(1), 124 Stat. at 1872.

¹⁸³ § 931(1)-(5), 124 Stat. at 1872-83.

¹⁸⁴ See *supra* note 7 and accompanying text.

¹⁸⁵ Dodd-Frank § 939, 124 Stat. at 1885–87.

¹⁸⁶ § 939A(a), 124 Stat. at 1887.

¹⁸⁷ § 939A(b), 124 Stat. at 1887.

¹⁸⁸ §932(a)(8), 124 Stat. at 1885.

such ratings are not unduly influenced by conflicts of interest.”¹⁸⁹ Other provisions include a review of former employees and the establishment of an industry code of ethics.

CRAAs have experienced major criticism due to this transparency problem. The concern is that CRAAs lack accountability for inaccuracies without transparency in their ratings. A SEC study of CRAAs in 2008 concluded that “the agencies did not always fully disclose significant components of the ratings process and methodologies for rating[s] . . . despite claims from the CRAAs that they disclosed their ratings process.”¹⁹⁰ In light of the transparency concerns, which arose from the 2008 financial crisis, Dodd-Frank is intended “to enhance the regulation of NRSROs by imposing new reporting disclosure, and examination requirements.”¹⁹¹ The heart of the transparency problem is the inherent conflict of interest in ratings agencies. In an effort to increase transparency, Dodd-Frank authorizes the SEC to establish rules requiring NRSROs to disclose information relating to their rating methodology and track the performance of their ratings.¹⁹²

This increased transparency should help to alleviate some of the problems associated with CRAAs, such as the motivation behind unsolicited ratings. In *Jefferson County*, Moody’s published an unsolicited article giving the School District a negative outlook.¹⁹³ This kind of unsolicited rating – and other articles like it – is commonplace in the ratings industry. The suspicion that CRAAs are behaving in a monopolistic manner should reduce with increasing transparency. If Moody’s chose to disclose its methodology in *Jefferson County*, the School District would not be able to claim that Moody’s actions were predatory. This increase in transparency, therefore, would not only protect issuers from predatory actions by CRAAs but also protect CRAAs from defamation claims. Further, increased transparency would give greater legitimacy to the ratings as investors would not have reason to question the motives of the CRAAs.

A SEC study released in 2011 indicated similar transparency problems persist even after Dodd-Frank. The study found that one of the Big Three “had failed to follow its methodology” in rating certain securities and that this “error resulted in the issuance of ratings that were inconsistent with the [CRAAs] methodologies.”¹⁹⁴ The study went on to find that “[a]ll of the [CRAAs] failed to follow their ratings procedures in some instances.”¹⁹⁵ When CRAAs fail to follow the published methodology for ratings, it is difficult for investors to determine exactly how a rating was established. Moreover, with thousands of ratings being

¹⁸⁹ § 932, 124 Stat. at 1885.

¹⁹⁰ Darcy, *supra* note 17, at 628-29 (2009) (citing SEC, SUMMARY OF ISSUES IDENTIFIED IN THE COMMISSION STAFF’S EXAMINATION OF SELECT CREDIT RATING AGENCIES 1, 13 (2008)).

¹⁹¹ SEC EXAMINATION OF NRSROs, *supra* note 29, at 2 (citing Dodd-Frank, § 923, 124 Stat. 1376, 1849 (2010)).

¹⁹² *Id.*

¹⁹³ 175 F.3d at 850-51.

¹⁹⁴ SEC EXAMINATION OF NRSROs, *supra* note 29, at 11.

¹⁹⁵ *Id.* at 13.

issued, it is nearly impossible for an investor to determine which ratings are accurate and which are based on poor methodology or biased by subjective components.

C. *Universal Ratings Symbols*

Universal rating symbols could be a major win for municipalities, especially since the Connecticut Attorney General cited it as a factor in the decision to settle the case against the Big Three.¹⁹⁶ As stated in the press release announcing the settlement, the “Dodd-Frank Act now requires rating agencies to clearly define the meaning of their rating symbols and to apply such symbols consistently across all securities, including public and corporate bonds, for which the symbols are used.”¹⁹⁷ In addition, Moody’s implemented its “Global Scale” in order to compare municipal and other bonds on an equal manner.¹⁹⁸ Celebrating a victory may be premature at this point because Moody’s declared that it will still use the normal municipal bond rating scale unless the issuer requests otherwise.¹⁹⁹ Moreover, two different scales for evaluating municipal bonds may only add to the confusion associated with municipal bond ratings.

D. *Accountability*

Dodd-Frank has addressed the state of mind requirement for private action suits against CRAs for money damages,²⁰⁰ but it is unclear how this requirement will affect CRA liability. Dodd-Frank amends the Securities and Exchange Act of 1934 with regard to pleading purposes so that the state of mind required by the complaint is whether the rating agency knowingly or recklessly failed either to “conduct a reasonable investigation of the rated security with respect to the factual elements . . .” or “obtain reasonable verification of such factual elements”²⁰¹ This “knowing or reckless” requirement is similar to the “actual malice” standard that courts typically apply. It also seems to place some burden on the CRAs to investigate the truth of their rating. Instead of requiring knowledge or reckless disregard with respect to the rating itself, this standard requires only that the CRA know about either reasonable investigations undertaken or facts that have not been verified. In this sense, the legislation seems to define what will be considered reckless on the part of CRAs.

Dodd-Frank creates another potential form of liability for CRAs, or at the very least, it reduces potential defenses. Ratings should be verifiable to a greater

¹⁹⁶ Jepsen, *supra* note 166.

¹⁹⁷ *Id.*

¹⁹⁸ GLOBAL RATING SCALE, *supra* note 5, at 1.

¹⁹⁹ *Id.* at 2.

²⁰⁰ Dodd-Frank, Pub. L. no. 111-203 § 933(b), 124 Stat. 1367, 1883–84 (2010).

²⁰¹ *Id.* (amending Securities and Exchange Act of 1934 at 15 U.S.C. 78u-4(b)(2)(B)(i–ii)).

degree because Dodd-Frank requires that CRAs disclose their methodology and adhere to those methods. As discussed in Section II, CRAs can avoid liability by arguing that they deserve protection under the First Amendment as journalists expressing opinion. The Dodd-Frank transparency requirements now offer the potential to recreate or verify a particular rating, making the nature of ratings more formulaic and thereby tipping the scales closer to fact than opinion.

Finally, Dodd-Frank addresses the state of mind requirement for private actions under the Securities and Exchange Act.²⁰² While the requirement is not necessarily intended to offer First Amendment protections, it addresses the state of mind and provides a standard for liability similar to the actual malice standard. Unlike the actual malice standard, however, the requirements of Dodd-Frank targeted the investigation and verification of the factual elements that the CRA relied upon. Moody's actions in *Jefferson County*, for instance, may potentially constitute this requisite state of mind. In evaluating the School District, Moody's did not have the latest financial information and did not seek to verify the information upon which it based its negative opinion.²⁰³ The effect of this lack of verification was a discrepancy between S&P's and Fitch's positive ratings and Moody's negative outlook for the same bond. If the court heard this case today, it may have come out differently.

CONCLUSION

CRAs have clear alternatives to their current ratings systems. First, they could use a system similar to Moody's Global Ratings Scale as the published rating system for all bonds. This alternative would have the effect of clarifying the comparison between types of bonds.²⁰⁴ CRAs could also calculate loss given default in the municipal bond scale, which would have the same effect as using the "global scale."²⁰⁵ The problem with this type of scale is that the gradation is not fine enough to show the distinctions within each category of bonds. As Moody's noted, GO bonds would largely receive the highest ratings. CRAs

²⁰² The Dodd-Frank Wall Street Reform and Consumer protection Act, Pub. L. no. 111-203, § 933, 124 Stat. 1367, 1884 (2010) ("In the case of an action for money damages brought against a credit rating agency or a controlling person under this title, it shall be sufficient, for purposes of pleading any required state of mind in relation to such action, that the complaint state with particularity facts giving rise to a strong inference that the credit rating agency knowingly or recklessly failed – (i) to conduct a reasonable investigation of the rated security with respect to the factual elements relied upon by its own methodology for evaluation credit risk; or (ii) to obtain reasonable verification of such factual elements (which verification may be based on a sampling technique that does not amount to an audit) from other sources that the credit rating agency considered to be competent and that were independent of the issuer and underwriter.").

²⁰³ 175 F.3d at 850–51 ("The School District further maintains that the most recent financial information that it had sent Moody's was more than a year old.").

²⁰⁴ GLOBAL RATING SCALE, *supra* note 5, at 1.

²⁰⁵ *See id.* ("The product of the default rate and the loss severity results in an expected loss value for each rating by sector. We then use the expected loss value of the municipal rating to map to its equivalent rating on the global scale.").

could also take the opposite approach by creating a symbolic scale that is distinct for the risk associated with each type of investment they analyze. In other words, it would help investors compare apples to apples and oranges to oranges. Another alternative would be to depart from the somewhat arcane letter grading system and use a numerical scale. If the ratings represent a measure of risk, a 1-100 scale, based on percentages, would provide a natural, intuitive solution with plenty of gradation for all types of securities. This proposed scale would also reduce confusion, create variation between the agencies, and reduce the weight of one particular rating.²⁰⁶

Ratings agencies' incentives are often misaligned. Partly due to the "issuer pays" conflict, ratings agencies have substantially decreased the ratings of municipal bonds compared to corporate bonds or other types of securities, which vie for top ratings. As a result, municipalities must pay higher interest rates or pay for costly bond insurance. The systematic decrease of municipal bond ratings is a profitable situation for credit ratings agencies, resulting in an inefficient use of tax dollars. Though often protected by the First Amendment, CRAs will lose this protection if ratings are verifiable facts, and the door will be open for various types of litigation, including antitrust. Dodd-Frank addressed many of the issues surrounding CRAs, which should have a positive effect on the ratings systems for municipal bonds. It has also potentially opened the door to greater accountability. Ultimately, it is up to the courts to properly understand the nature of credit ratings and hold CRAs accountable for their actions.

²⁰⁶ If a percentage scale is used and there are two or more ratings given by different CRAs, it would be easy to estimate that the real risk of the investment would be somewhere between the numbers given. Currently, with the increments being so large, bonds usually receive similar ratings from two or more agencies.

DOMINATION V. DIPLOMACY: COMPARING THE EFFECTIVENESS OF
THE UNITED STATES' JOHN DOE SUMMONS WITH THE UNITED
KINGDOM'S 2011 TAX TREATY WITH SWITZERLAND

*Alfred Bender**

INTRODUCTION

"In this world nothing can be said to be certain, except death and taxes."¹ While Benjamin Franklin's words certainly ring true today, time has shown that the quotation is missing a third crucial part. It should read, "In this world nothing can be said to be certain, except death, taxes, and people avoiding paying taxes."² There are many reasons why a person would resist paying taxes, from political protest to personal greed. Regardless of the reason, there have been tax evaders as long as there have been taxes. One of the earliest recorded instances of tax evasion occurred in the 1st century A.D., when many Jews in Judea refused to pay the poll taxes instituted by the Roman Empire.³ In fact, Jesus faced charges for, among other things, promoting tax resistance before his execution.⁴ Historical methods of tax resistance have ranged from the violent, such as the Whiskey Rebellion in 1789,⁵ to the colorful, like Lady Godiva's naked ride in the 11th century,⁶ to the downright bizarre, like the "Jack-a-Lents" of 1735, who dressed in women's clothing and blackface and destroyed tollbooths in Ledbury, England.⁷ Whatever their techniques, these tax resisters always received a response from their respective governments. Sometimes that response was as hoped, as in Lady Godiva's case, which ended in a cessation of taxes.⁸ Other times, however, the response was far worse than originally paying the taxes would have been, like in Danegeld in 1041, when King Harthacnut burned the entire city to the ground.⁹

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¹ BENJAMIN FRANKLIN, *THE WORKS OF BENJAMIN FRANKLIN* (1817).

² This is not actually a quotation; it is merely used for dramatic effect.

³ See DAVID M. GROSS, *WE WON'T PAY: A TAX RESISTANCE 1-2* (2008).

⁴ See *Luke 23:2* ("And they began to accuse him, saying, 'We have found this man subverting our nation. He opposes payment of taxes to Caesar and claims to be Messiah, a king'").

⁵ Saul Cornell, *Mobs, Militias and Magistrates: Popular Constitutionalism and the Whiskey Rebellion*, CHI.-KENT L. REV. 883, 894 (2006).

⁶ See DAVID F. BURG, *A WORLD HISTORY OF TAX REBELLIONS: AN ENCYCLOPEDIA OF TAX REBELS, REVOLS, AND RIOTS FROM ANTIQUITY TO THE PRESENT 77-78* (2004).

⁷ See *DAILY GAZETTEER* (Oct. 8, 1735).

⁸ See Burg, *supra* note 6, at 77-78.

⁹ *Id.* at 71-72.

For all the different reasons for evasion, tactics of evasion, and government responses to evasion that were utilized throughout history, tax evaders could generally count on the government coming after them with all the power at their disposal. In all likelihood, very few people long for the days when the government could burn down a city to punish tax evaders. Nevertheless, many feel that the United States has now gone to the opposite extreme, expending minimal effort in attempting to corral this problem, which accounts for \$100 billion in lost revenue annually.¹⁰

Part of the difficulty the United States faces in collecting taxes is that the days when all taxpayers lived, worked, and stored their money inside the same kingdom are over. Instead, globalization has led to international banks that serve clientele in many countries, meaning that they owe taxes to many countries and are subject to many countries' tax laws. Sometimes these laws are fundamentally incompatible with each other. International banking freedom has made the confrontational style of tax resistance of years past virtually unnecessary. Instead, the increased difficulty of identifying tax resisters has made the subtler act of tax evasion available to a broader, non-weapon-wielding audience.

This issue took center stage in 2009, when the United States negotiated a \$780 million deferred prosecution agreement with Swiss banking giant UBS, which was under threat of United States criminal and civil prosecution for assisting American tax evaders.¹¹ One of the settlement's conditions was that UBS turn over the identities of roughly 200-300 United States accountholders who had failed to declare themselves for taxation purposes, but UBS then reneged on the deal.¹²

Immediately afterward, the United States filed for a John Doe summons against UBS. A John Doe summons is an order issued by a United States court to turn over information, based on a reasonable suspicion of wrongdoing, even though the names of the parties suspected of wrongdoing are unknown.¹³ For UBS, turning those names over to the United States would have been in clear violation of Switzerland's banking secrecy laws, which protect accountholders from the disclosure of their identities to their countries of residence.¹⁴

¹⁰ STAFF OF S. COMM. ON HOMELAND SEC. AND GOVERNMENTAL AFFAIRS, PERM. SUB. COMM. ON INVESTIGATIONS, 110TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 1 (2008).

¹¹ See Bruce Zagaris, *U.S. and Switzerland Settle UBS Document Request*, 25 NO. 10 INT'L ENFORCEMENT L. REP. 389 (2009); see also, Laura Szarmach, *Piercing the Veil of Bank Secrecy? Assessing the United States' Settlement in the UBS Case*, 43 CORNELL INT'L L.J. 409, 438 (2010).

¹² Szarmach, *supra* note 11.

¹³ THE UBS "JOHN DOE" SUMMONS, SP017 ALI-ABA 929, 932.

¹⁴ See Bruce Zagaris, *supra* note 11; see also, Szarmach, *supra* note 11 (The United States, via tax treaty, has negotiated an exception to these laws for when they reasonably believe a specific person is committing tax fraud; however, the treaty has been interpreted to only cover acts of concealment, and thus, does not directly cover tax evasion).

While the John Doe summons was eventually dropped, UBS would have had two choices if a United States court had ordered it to disclose its accountholders' information: first, disclose the information to the United States and be subject to criminal prosecution for violating Switzerland's banking secrecy laws, or second, refuse to disclose the information to the United States and be found to be in contempt of court.¹⁵ In addition to causing contempt charges, failing to turn over the names would have been a violation of the deferred prosecution agreement the United States had just signed with UBS.¹⁶ The United States would then have been able to bring criminal charges for the bank's participation in domestic tax evasion.¹⁷ Luckily for UBS, the Swiss legislature agreed to process the dissemination of 4,450 accountholders' information to the United States as a treaty request, in exchange for the United States withdrawing its John Doe summons.¹⁸

One result of the settlement and the subsequent actions of the Swiss legislature is that we do not know what legal weight the summons would have carried. While the legal ramifications are certainly an important aspect of the John Doe summons, the primary intention of this article is to look at the summons holistically, weighing its complete value, legal and diplomatic, and to compare it to a different strategy for recovering lost taxes: the tax treaty recently negotiated between the United Kingdom and Switzerland.¹⁹ This article intends to assess which of these recent tactics is a more feasible long-term tax recovery strategy for the United States.

The first section of analysis will start with explanations of the tax evasion problem in the United States, the John Doe summons, and the United States' use of the summons in political negotiations. Section two will focus on the tax treaty approach by explaining how tax treaties work and what makes the recent U.K. treaty with Switzerland potentially so effective. Finally, the analysis will conclude with a prediction about how effective each strategy will be at recuperating lost tax revenue, look at the potential implications both strategies may have for international business, and answer the ultimate question of whether the John Doe summons or the recuperative tax treaty is a more viable long-term strategy for the United States.²⁰

¹⁵ Beckett G. Cantley, *The UBS Case: The United States Attack on Swiss Banking Sovereignty*, 7 B.Y.U. INT'L L. & MGMT. REV. 1, 19-20 (2011).

¹⁶ *Id.* at 20.

¹⁷ *Id.* at 20-21 .

¹⁸ See Zagaris, *supra* note 11.

¹⁹ *Tax deal With the Swiss Defended by UK Minister*, BBC NEWS (Aug. 25, 2011), available at <http://www.bbc.co.uk/news/business-14662950>.

²⁰ This comment will speak extensively about tax evaders. For the purpose of this comment, "tax evaders" refers to any person who engages in illegal concealment of taxes as defined by the IRS. This comment has no intention of asserting what should be considered tax evasion and what should be considered legal tax avoidance; its goal is merely to analyze it from the legal framework already established by the United States government.

I. THE TAX-EVASION PROBLEM

Tax evasion has become a very large problem in the United States, both financially and politically. Congressional investigations indicate that the United States loses approximately \$100 billion in tax revenue annually to offshore tax havens.²¹ International banks frequently assist American taxpayers with tax evasion by structuring accounts and services to avoid disclosure to the Internal Revenue Service (“IRS”).²² To combat this practice, the IRS established the Qualified Intermediary (“QI”) program to encourage international banks to withhold taxes and report tax information on American income deposited in foreign accounts.²³ Banks are encouraged to sign a QI agreement and join the program. In exchange for upholding the terms of the QI agreement, United States law frees international financial institutions from having to disclose the names of accountholders.²⁴ Evidence suggests, however, that international financial institutions use “manipulative and deceptive” tactics to avoid compliance with the terms of the QI agreements.²⁵

These issues have become more prominent because of the financial hardship the United States has faced in recent years. Bailouts, stimulus spending and slow economic growth left the United States with massive debts, causing policymakers to seek ways to increase revenue without cutting essential spending or raising taxes.²⁶ These hardships make offshore tax recuperation a primary focus of tax authorities and the rest of the executive branch.²⁷ This shift is evident in the IRS’s August 2010 renaming and expansion of the Large and Midsize Business Division, which is now the Large Business and International Division.²⁸ The new division will allocate an additional 600 employees to focus on reining in offshore tax evasion by corporations and wealthy individuals.²⁹

Unlike in the executive branch, however, crackdowns on offshore tax evasion remain relatively unpopular within Congress.³⁰ A prime example is Congress’s handling of the Stop Tax Haven Abuse Act, which was most

²¹ STAFF OF S. COMM. ON HOMELAND SEC. AND GOVERNMENTAL AFFAIRS, PERM. SUB. COMM. ON INVESTIGATIONS, 110TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 1 (2008).

²² *Id.* at 3.

²³ *Id.*

²⁴ *Id.* at 4.

²⁵ *Id.*

²⁶ See President Barack Obama, Speech to Congress on Jobs (Sept. 8, 2011).

²⁷ *Id.*

²⁸ Lynnley Browning, *I.R.S. Shifts to Combat Tax Evasion*, N.Y. TIMES (Aug. 4, 2010), available at <http://www.nytimes.com/2010/08/05/business/05irs.html>.

²⁹ *Id.*

³⁰ David Cay Johnston, *Crackdown on Tax Cheats Not Working, Panel Says*, N.Y. TIMES (Oct. 20, 2003), available at <http://www.nytimes.com/2003/10/20/business/20tax.html?ex=1067668075&ei=1&en=6b03f4565758bcb4>.

recently introduced during the 112th Congress.³¹ Senator Carl Levin introduced the act five separate times, most recently in 2011, and while Congress enacted some of its provisions in other bills, the primary aspects of Sen. Levin's bill have gained little traction.³² In addition to the funding issues discussed next, this lack of Congressional support could become an issue if the United States seeks to revamp its international tax treaties because ratification requires the advice and consent of the Senate.³³

Limited Congressional support means limited resources for the IRS because Congress allocates the IRS's funding.³⁴ This limitation can make it difficult to pursue all existing leads for lost tax revenue, let alone find new ones.³⁵ After the financial scandals of the early 21st century, certain Congressional leaders were hopeful that the outcry would translate into more vigorous prosecution of offshore tax evasion.³⁶ To their chagrin, despite the myriad of changes to financial regulatory schemes in the aftermath of the scandals, the IRS received no additional funding and Congress passed no laws to combat abusive tax shelters.³⁷

The Obama administration has experienced similar difficulty, as the March 2011 budget debates substantially reduced the proposed \$1.15 billion increase in funding for the IRS.³⁸ The domestic fiscal situation of the United States could potentially play a major role in the country's recuperation tactics moving forward, as it could force the United States into larger amnesty programs and limit the tactics' effectiveness.

If the IRS does not have the finances to prosecute a large number of offshore evaders, the gap between the amount of taxes owed on offshore accounts and the amount paid on those accounts will continue to widen.³⁹ Weak IRS enforcement will lead current and future evaders to have little fear of being caught and thus be further incentivized to evade taxes.⁴⁰ Given these constraints, it is incumbent upon the IRS to utilize their most cost-efficient strategies.

³¹ See S. 1346, 112th Cong. (2011).

³² See Levin Unveils Stop Tax Haven Abuse Act, LEVIN.SENATE.GOV, (July 12, 2011) <http://levin.senate.gov/newsroom/press/release/levin-unveils-stop-tax-haven-abuse-act/?section=alltypes>; see also, Edward Tannenbaum, *The Annual Stop Tax Haven Abuse Act Show*, THE BUREAU OF INTERNATIONAL AFFAIRS (Sept. 12, 2011).

³³ UNITED STATES CONST. art. II, § 2, cl. 2 (requiring a two thirds majority for ratification).

³⁴ See Bernie Becker, *Boehner: Budget Deal Means No New IRS Funding*, THE HILL (Apr. 9, 2011), available at <http://thehill.com/blogs/on-the-money/domestic-taxes/155063-boehner-budget-deal-means-no-new-irs-funding>.

³⁵ See Johnston, *supra* note 30; see also, Becker, *supra* note 34.

³⁶ See Johnston, *supra* note 30.

³⁷ *Id.*

³⁸ Becker, *supra* note 34.

³⁹ See Jonathan Berr, 10 Worst Countries for Tax Evasion, INVESTORPLACE (Dec. 23, 2011), available at <http://www.investorplace.com/2011/12/10-worst-countries-for-tax-evasion/>.

⁴⁰ Michelle Hirsch, Tax Cheats Aren't Crying 'Uncle' This Time, THE FISCAL TIMES (Aug. 17, 2011), available at <http://www.thefiscaltimes.com/Articles/2011/08/17/Tax-Cheats-Arent-Crying-Uncle-This-Time.aspx#page1>.

One such cost-effective strategy for the IRS is to grant amnesty, thereby recuperating as much money as possible without having to go through costly prosecutions. The IRS has already employed this strategy several times in recent years, granting individuals amnesty if they come forward with unpaid taxes and pay some of the penalties owed.⁴¹ This strategy also allows the IRS to speak loudly without disclosing the size of its stick and provides a carrot in the form of lessened penalties. This carrot-and-stick method will only be successful if tax evaders believe that the IRS really has the stick to back up its talk, which seems increasingly less likely. Without increased funding for the IRS commensurate to the size of the desired increased enforcement, tax evaders will remain skeptical about whether the United States' carrot is actually a good deal. In other words, if the risks of being caught evading taxes offshore, together with the potential resulting criminal charges, are so low that they may not outweigh the value of the penalty saved, the reduced penalties become an ineffective economic incentive.

Furthermore, future incentives are likely to become even less enticing, as they are likely to come with steeper conditions. The amnesty program that ended on September 9, 2011 required the payment of all owed taxes and interest from 2003 to present and a penalty of 25% of the value of the account, measured at its highest point during that time span.⁴² IRS Commissioner Doug Shulman hinted that any future amnesty programs will be more severe, claiming that the program ending on September 9 was "the last, best chance for people to get back into the system."⁴³

The IRS claims to have received a larger-than-expected turnout, with roughly 18,000 people declaring their accounts since the previous amnesty program began in March of 2009.⁴⁴ Currently, however, only 2,000 of those accounts have seen any recuperation.⁴⁵ Despite the IRS's claimed success, the illumination of 18,000 accounts, which thus far has culminated in the recuperation of approximately \$400 million, is a drop in the bucket compared to the estimated \$800 billion in tax revenue the United States has lost to undeclared accounts in offshore tax shelters since 2003.⁴⁶ The latter figure does not even

⁴¹ See Frequently Asked Questions OVCI, IRS WEBSITE <http://www.irs.gov/businesses/international/article/0,,id=235699,00.html> (Last visited Oct. 8, 2011).

⁴² *Id.*

⁴³ See Laura Saunders, *IRS Sets Offshore Amnesty, Part II*, WALL STREET JOURNAL (Feb. 9, 2011), available at <http://online.wsj.com/article/SB10001424052748704364004576132431503110852.html>.

⁴⁴ *Id.*

⁴⁵ *See id.*

⁴⁶ *See id.*; STAFF OF S. COMM. ON HOMELAND SEC. AND GOVERNMENTAL AFFAIRS, PERM. SUB. COMM. ON INVESTIGATIONS, 110TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 1 (2008) (finding that approximately \$100 billion dollars in tax revenue from undeclared offshore bank accounts. The \$800 billion estimate is a cumulative estimate from 2003-2011).

include interest or penalties, which are included in the \$400 million figure.⁴⁷ A 0.0005% recuperation rate may be better for the IRS than a 0% recuperation rate, but if the IRS could afford full prosecution, it could reap a considerably larger return on its investment, both from the prosecutions themselves and from increased voluntary disclosures under future amnesty programs.⁴⁸ This same issue has stymied recuperations from the UBS settlement; to date, there have only been 29 successful prosecutions of UBS accountholders.⁴⁹ If the IRS decides to implement another amnesty program in the future, the decision will not solely be the result of underfunding, but underfunding certainly limits other options for enforcement and the IRS's collection bottom line.

II. THE JOHN DOE SUMMONS EXPLAINED

To determine whether the John Doe summons is a viable option for future United States use, we must first explore what the summons is, how it works, and whether it is likely to be enforceable in offshore tax evasion cases. As previously stated, the John Doe summons is an order issued by a United States court to turn over information, based on a reasonable suspicion of wrongdoing, even if the names of the parties suspected of wrongdoing are unknown.⁵⁰

The statutory basis for the IRS to issue summonses comes from several sections within the Internal Revenue Code.⁵¹ I.R.C. § 7601 gives the IRS the authority to investigate those who may owe taxes.⁵² I.R.C. § 7602 details the IRS's investigatory authority and outlines its ability to issue summonses to effectuate its investigatory authority under § 7601.⁵³

The United States Supreme Court authorized the use of the John Doe summons for the first time in the *United States v. Bisceglia*.⁵⁴ The Court held that the IRS's authority under I.R.C. §§ 7601, 7602 was broad enough to justify enforcing a summons, even when the IRS did not know the identity of the wrongdoer.⁵⁵ I.R.C. § 7609(f) later codified this authority, granting the IRS a statutory authorization for the John Doe summons.⁵⁶ I.R.C. § 7609(f) established three additional criteria that the IRS must meet when the summons does not identify the person to whom it seeks to attach liability. The summons must: (1)

⁴⁷ See Saunders, *supra* note 43.

⁴⁸ .0005% is a mathematical calculation of the numbers cited in note 45.

⁴⁹ *Offshore Tax Avoidance and IRS Compliance Efforts*, IRS WEBSITE <http://www.irs.gov/newsroom/article/0,,id=110092,00.html> (last visited Jan. 4, 2012).

⁵⁰ THE UBS "JOHN DOE" SUMMONS, SP017 ALI-ABA 929, 932.

⁵¹ Emily Ann Busch, Note, *To Enforce or Not to Enforce? The UBS John Doe Summons and a Framework for Policing U.S. Tax Fraud Amid Conflicting International Laws and Banking Secrecy*, 83 TEMP. L. REV. 185, 198-201 (2010).

⁵² I.R.C. § 7601.

⁵³ I.R.C. §§ 7601, 7602.

⁵⁴ 420 U.S. 141, 151 (1975).

⁵⁵ *Id.*; Busch, *supra* note 51, at 195.

⁵⁶ *Id.*; I.R.C. § 7609(f).

relate to the investigation of a “particular person,” “ascertainable group” or “class of persons;” (2) include a reasonable basis for believing the person, group or class of people have or will have failed to comply with any provision of IRS law; and (3) seek information that is not readily available elsewhere.⁵⁷

Once the government has made a *prima facie* case in support of the John Doe summons, the burden shifts to the petitioner to either rebut the IRS’s “good faith” behavior or challenge the summons on other “appropriate grounds.”⁵⁸ “Appropriate grounds” include “abuse of process,” “over broadness” and “international comity.”⁵⁹ Of these grounds, the only one that is relevant to this discussion is international comity because it could substantially influence the long-term efficacy of the John Doe summons.⁶⁰ Unlike abuse of process and over broadness, which are procedural issues of United States domestic law, international comity is a substantive issue that will continue to arise as these jurisdictions continue to issue summonses to corporations.⁶¹

United States courts have stated that when there is conflict between domestic and foreign law, courts should seek “a reasonable accommodation...that considers the foreign interests, the interests of the United States, and the mutual interests of all nations in a smoothly functioning international legal regime.”⁶² While identifying a conflict in legal regimes is easy, finding a balance can be extremely difficult and usually results in diverse and inconsistent applications of the balancing approach.⁶³

The Supreme Court has held that courts possess “wide discretion” in determining how to weigh issues of international comity.⁶⁴ The circuit courts

⁵⁷ I.R.C. § 7609(f).

⁵⁸ Busch, *supra* note 51, at 195 (citing *United States v. Powell* 379 U.S. 48, 57-58 (1964)) (concluding that Powell establishes four requirements for good faith: “(1) the investigation serves a legitimate purpose; (2) the information might be relevant to the purpose; (3) the IRS does not already possess the information summoned; and (4) the IRS complied with § 7609(f)”).

⁵⁹ *Id.* (citing *United States v. LaSalle Nat’l Bank*, 437 U.S. 298, 316 (1978); *Mollison v. United States*, 481 F.3d 119, 122-23 (2d Cir. 2007) *United States v. Leventhal*, 961 F.2d 936, 939-40 (11th Cir. 1992)).

⁶⁰ The requirements established in *Powell*, as well as the requirements for “abuse of process” and “overbroad,” are issues that focus on individual facts of a particular summons and are not likely to broadly impede the use of the John Doe Summons in the future.

⁶¹ See *United States v. Powell* 379 U.S. 48 (1964).

⁶² *Société Nationale Industrielle Aérospatiale v. United States District Court*, 482 U.S. 522, 555 (1987) (Blackmun, J., concurring in part and dissenting in part). See *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 817-19 (1993) (explaining that jurisdiction of domestic laws should only be exercised when relating to a foreign sovereign, when that exercise would be reasonable after taking into consideration the foreign sovereign’s interest). See also *In re Maxwell Comm. Corp. plc* by Homan, 93 F.3d 1036, 1053 (2d Cir. 1996) (holding that when issues of choice of law are unclear, issues of comity must be decided by weighing the interests of the United States against “the mutual interests of all nations in a smoothly functioning legal regime”).

⁶³ Donald Earl Childress III, *Comity as Conflict: Resituating International Comity as Conflict of Laws*, 44 U.C. DAVIS L. REV. 11, 79 (2010).

⁶⁴ See *Societe Internationale Pour Participations Industrielles Et Commerciales, S. A. v. Rogers*, 357 U.S. 197, 213 (1958).

have dealt with different factual scenarios and utilized different rationales to arrive at different conclusions about the weighing of priorities.⁶⁵ While trying to create a single rule to encompass all these decisions would be a fool's errand, it is important to find some commonalities in an attempt to analyze the likelihood of success for the United States in the future.

Those circuits that have generally endorsed the John Doe summons on nations with banking secrecy laws have based their opinions largely on fact-specific issues. Courts are more likely to endorse the summons if: (1) the privacy interest the foreign state seeks to protect is that of an American citizen, as opposed to a non-consenting domiciliary; (2) the venue was deliberately chosen to avoid following United States law and the conflict could have been avoided by following United States law from the onset; and (3) duress is a defense to the domestic law in conflict.⁶⁶

Of the circuits that have addressed the issue, the 11th Circuit thus far has been the staunchest supporter of the John Doe summons, and it is therefore no surprise that the United States filed the UBS John Doe summons in the Southern District of Florida in the 11th Circuit.⁶⁷ The fact that the United States can choose to invoke the forum with most favorable laws in the future means that the 11th Circuit's precedent is the most likely to be applied to future John Doe summons, as the United States will likely file cases involving similar factual scenarios in the 11th Circuit.⁶⁸ However, this choice advantage could be short-lived if the Supreme Court chooses to render a more specific judgment on the issue.

Should the Supreme Court render a decision, it could be in support of one of the circuits that have been less favorable to the John Doe summons. Those circuits that have generally declined to enforce the John Doe summons are more inclined to do so under the following conditions: (1) the information being sought through the summons is available through means that do not require the breaking of a foreign sovereign's law; (2) the foreign law's protection arose

⁶⁵ Compare *In re Grand Jury Proceedings, United States v. Bank of Nova Scotia* 740 F.2d 817 (11th Cir. 1984) (holding that United States citizens may not rely on foreign banking secrecy laws because their duty to disclose their account information to the IRS substantially limits their right to privacy), with *United States v. First National Bank of Chicago*, 699 F.2d 341 (7th Cir. 1983) (holding that Greece's banking secrecy interests prevail over the IRS's interest in enforcing a summons when the amount due is comparatively small).

⁶⁶ See *Busch*, supra note 51, at 201-203 (citing *In re Grand Jury Proceedings, United States v. Bank of N.S.* 740 F.2d 817, 827-29 (11th Cir. 1984) [*hereinafter Bank of Nova Scotia*]; *United States v. Hayes* 722 F.2d 723, 726 (11th Cir. 1984); *United States v. Vetco Inc.*, 691 F.2d 1281, 1289-91 (9th Cir. 1981)); see, e.g., RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965).

⁶⁷ *Bank of Nova Scotia*, F.2d at 827-29.

⁶⁸ As will be discussed later in the text, different circuits are more favorable for certain factual scenarios.

naturally, as opposed to as a result of an attempt to evade United States law; and (3) the party being served acted in good faith.⁶⁹

Although the divergent holdings between the circuits might lead one to believe that there is a circuit split, in actuality, a closer analysis of the facts demonstrates that this may not be the case. Any review by the Supreme Court could ultimately conclude that the cases at issue are factually dissimilar enough not to qualify as a conflict of law. The appearance of a circuit split could be the result of stronger evidence of wrongdoing on the part of the foreign actor in the decisions against the John Doe summons.

While it would be impossible to predict what a Supreme Court decision would hold, as an academic exercise, crystallizing the considerations most important across the circuits may provide valuable insight into the long-term value of the John Doe summons as a tool for piercing banking secrecy and recuperating revenue lost to offshore tax havens. Comparing the different precedents of the circuits, the five factors that appear most important to the courts are: (1) the substantiality of the violation and the feasibility of accessing the information sought in the summons through another means; (2) whether the person holding the information chose the foreign state as a shield from United States law; (3) whether there truly is a conflict in law; (4) the nationality of the citizen or corporation about or from whom the information is being sought; and (5) whether either party is acting in bad faith, including an original failure to follow United States law.⁷⁰

Of the five factors, the fourth factor is likely to be the most controversial, as future examples of the John Doe summons are likely to mirror the situation present in UBS: a summons served on a company with foreign nationality and with holdings in the United States to obtain information about United States citizens.⁷¹ In this situation, there appears to be a genuine split; the 9th Circuit focuses on the party forced to turn over the information while the 11th Circuit focuses on the party with sought-after information.⁷² This uncertainty could eventually lead to a Supreme Court clarification narrowing the scope of the John Doe summons. Currently, the circuit split allows for a broad usage of the summons, as the IRS can choose the venue most sympathetic to the factual

⁶⁹ See *Busch*, supra note 51, at 203-204 (citing *Cochran Consulting, Inc. v. Uwatec USA, Inc.*, 102 F.3d 1224, 1230 (Fed. Cir. 1996); *In re Sealed Case 825 F.2d 494, 499* (D.C. Cir. 1987); *United States v. First Nat'l Bank of Chi.*, 699 F.2d 341, 346 (7th Cir. 1983)).

⁷⁰ See *Cochran Consulting, Inc.*, 102 F.3d at 1230; *In re Sealed Case*, 825 F.2d at 499; *Bank of Nova Scotia*, 740 F.2d. at 827-29; *Hayes*, 722 F.2d at 726; *First Nat'l Bank of Chi.*, 699 F.2d at 346; *Vetco*, 691 F.2d. at 1289-91.

⁷¹ See *Cantley*, supra note 15, at 14.

⁷² See *Vetco*, 691 at 1289, 1291 (9th Cir. 1981) (holding that Switzerland's privacy interest was diminished because the summons was being served on a United States corporation, and Switzerland's privacy interests only extend to a non-consenting domiciliary); see also, *Bank of Nova Scotia*, 740 at 827, 832 (11th Cir. 1984) (holding that United States citizens may not rely on foreign banking secrecy laws because their duty to disclose their account information in an American court proceeding to the IRS substantially limits their right to privacy).

scenario of the case. If the Supreme Court does someday limit the parameters of the John Doe summons, it will be a less useful tool for the United States.

Until such a narrowing occurs, however, the IRS has shown a commitment to using the John Doe summons to the fullest extent legally allowed. The IRS has been tacitly exploiting this circuit split, as it recently filed for a John Doe summons against the Hong Kong and Shanghai Banking Corp (HSBC) Bank USA, N.A., in the United States District Court for the Northern District of California, to investigate “U.S. residents who may be using accounts at HSBC’s branches in India to evade federal income taxes.”⁷³ HSBC Bank USA, N.A., a United States corporation, fits snugly within the 9th Circuit’s precedent of supporting John Doe summonses issued to American companies operating abroad when the subjects of the investigation are American citizens.⁷⁴ This ensures that the two circuits continue to evaluate the John Doe summons under their current precedents. If the IRS were to file a case with a factual scenario not settled by the circuit’s precedent, the court could force a new decision, validating a circuit split and inviting the scrutiny of the Supreme Court.

III. THE UNITED STATES’ DIPLOMATIC APPLICATION OF THE JOHN DOE SUMMONS: TOEING THE LINE BETWEEN HARD AND SOFT POWER

The John Doe summons has become one of the most feared and divisive tools of United States foreign policy. Unlike traditional soft-power methods of diplomacy, the John Doe summons enters the discussion purporting to be binding law.⁷⁵ The summons operates as a less aggressive use of hard power, replacing military action with legal procedure.

Use of hard power during negotiations is similar to placing a gun on the negotiating table and saying pointedly to the other party, “Your cooperation would be appreciated.”⁷⁶ When international corporations face a John Doe summons, they find themselves facing a choice between violating their own

⁷³ Bruce Zagaris, Justice Department Obtains the Right to Issue John Doe Summons for HSBC India, 27 NO. 6 INT’L ENFORCEMENT L. REP. 726 (2011) (quoting Press Release, U.S. DOJ, Justice Dep’t Asks Court to Allow IRS to Seek HSBC India Bank Account Records (Apr. 7, 2011) available at <http://www.justice.gov/tax/txdv11439.htm>).

⁷⁴ HSBC BANK USA, N.A., *HSBC Bank USA, National Association Corporate Fact Sheet*, HSBC BANK USA, N.A. WEBSITE (Dec. 2012), available at http://www.us.hsbc.com/1/PA_1_083Q9FJ08A002FBP5S00000000/content/new_usshared/shared_fragments/pdf/hbus_factsheet_0912.pdf (last visited Mar. 6, 2013); see *Vetco*, 691 F.2d. 1281.

⁷⁵ See Anand Sithian, Comment, “*but the Americans Made Me Do It!*”: How United States v. UBS Makes the Case for Executive Exhaustion, 25 EMORY INT’L L. REV. 681, 687, 690–91 (2011).

⁷⁶ Compare *Hard Power Definition*, OXFORD DICTIONARIES, http://oxforddictionaries.com/definition/hard+power#DWS-m-en_gb-msdict-00002-053789 (last visited Mar. 6, 2013) (defining hard power as “a coercive approach to international political relations, especially one that involves the use of military power”) with *Soft Power Definition*, OXFORD DICTIONARIES, http://oxforddictionaries.com/definition/soft+power#DWS-m-en_gb-msdict-00002-044614 (last visited Mar. 6, 2013) (defining soft power as “a persuasive approach to international relations, typically involving the use of economic or cultural influence”).

nations' laws or dealing with enormous liabilities and possible criminal charges in the United States.⁷⁷

The John Doe summons also leverages soft power through its use as a bargaining chip. The beauty of the use of a John Doe summons as a negotiating tactic is that it is likely to bring the home nation of the financial institution's government to the negotiating table. Even though the United States has no legal leverage over foreign countries, it may have legal leverage over one of the foreign countries' corporate entities.⁷⁸ This is especially important in nations with banking secrecy laws: if the United States can compel a financial institution to violate those laws under pain of worse penalties, the future uncertainty caused by the disclosure will have a severe impact on that nation's economy.⁷⁹ This fact means that the John Doe summons is also a tool of soft power; it allows the United States to wield softer, indirect economic pressure as a tool of diplomatic leverage.

For nations that contain massive banking centers but lack a widely diversified economy, the success of the nation depends on the success of their banks. Switzerland in particular has built its economy on its banking sector, which makes up 12% of its national gross domestic product (GDP).⁸⁰ By comparison, in 2008 and 2011, the United States, which has the world's largest finance sector and an economy clearly tied to the financial sector's success, derived 7.3% and 7.7%, respectively, of its GDP from banking and insurance.⁸¹

It would be easy to presume that the United States' primary interest is in manipulating Swiss banks, but the reality is that because Swiss banking secrecy laws bar those banks from releasing client information, there is no guarantee that these foreign institutions will cooperate with the IRS's requests. As a result, the real target of the United States' soft power is the Swiss government, which has the ability to release names and end its banking secrecy regime all together. Applying pressure to Switzerland's banking sector is like applying pressure to the jugular vein of the Swiss economy; by doing this, the United States presumably hopes to force the Swiss government to cooperate with the IRS's tax agenda in the future.

Of course, this is a catch-22 for Switzerland, as its large market share of the banking industry is primarily a result of its reputation for banking secrecy.⁸²

⁷⁷ Sithian, *supra* note 75, at 682.

⁷⁸ *See id.*

⁷⁹ *See, e.g.,* Matthew Lynn, *Swiss Banks Won't Survive the Age of WikiLeaks*, MONEY WEEK (Feb. 22, 2011), available at <http://www.moneyweek.com/news-and-charts/economics/europe/swiss-banks-wil-not-survive-wikileaks-threat-52522>.

⁸⁰ *Future Financial Center Switzerland*, SWISS BANKERS ASSOCIATION, <http://www.swissbanking.org/home/dossier-zukunft.htm> (last visited Jan. 4, 2012).

⁸¹ *Interactive Access to Industry Economic Accounts Data*, BUREAU OF ECONOMIC ANALYSIS, <http://www.bea.gov/iTable/iTable.cfm?ReqID=5&step=1> (choose "GDP-by-Industry Accounts" option; then follow "Next Step" hyperlink; then follow "Value Added by Industry" hyperlink; then follow "Value Added by Industry as a Percentage of Gross Domestic Product" hyperlink).

⁸² Lynn, *supra* note 79, at para. 8.

Despite the claims of Swiss banks that their customers come to them for “excellent service” and “in-depth personalized investment advice,” it is a poorly kept secret that a history of secrecy and laws that protect it are the main reason wealthy clients go to Switzerland for their banking needs.⁸³ If customers can no longer rely on Swiss banks to keep their account information secret, they may very well take their business elsewhere.⁸⁴ UBS has already taken a hit since turning over its accounts to the United States. After reaching \$62.23 per share in 2007 before the settlement with the United States, UBS’s stock price was \$15.19 on April 19, 2013, never having recovered from the settlement.⁸⁵ Obviously, numerous factors could be responsible for the economic woes of UBS – most notably the global banking crisis – but, while other banks seem to be returning to their prior glory, Swiss banks in general seem stuck in a rut.⁸⁶

The economic value these banks provide to their home nations is so great that, in some cases, those nations are singularly reliant on the banks’ well-being for economic growth. Swiss banks have 9.1% of the world’s assets under management, totaling \$7.3 trillion, and have a GDP that amounts to less than one tenth of their assets under management.⁸⁷ Furthermore, Swiss banking relies on the offshore banking market, as Swiss banks hold 28% of the world’s assets held offshore, a global market estimated to be worth USD 11.5 trillion.⁸⁸ Many of these assets have no direct connection to tax evasion, but the instability brought to a bank by a John Doe summons could have a large effect on even legal accountholders’ willingness to bank there. Many clients do not wish to break the law, but they seek Swiss banks because of the way they aggressively interpret the United States tax code, promising to help the accountholder achieve the lowest possible tax rate. If clients face charges of tax evasion, this may spook those who seek legitimate services out of fear that the Swiss banks’ aggressive tactics could go too far.

With the Swiss economy this closely tied to the country’s banking sector, the John Doe summons presents more than an inconvenience for the Swiss government. This vulnerability is precisely why Switzerland must be responsive to the United States’ economic soft power directed at its banking sector and why the John Doe summons places the United States in a favorable diplomatic bargaining position.

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ UBS AG Stock Summary, GOOGLE FINANCE, <http://www.google.com/finance?client=ob&q=NYSE:UBS> (last visited Jan. 13, 2012).

⁸⁶ Lynn, *supra* note 79, at para. 3.

⁸⁷ *Wealth Management in Switzerland*, SWISS BANKERS ASSOCIATION 4 (Jan. 2009) available at, http://www.kantonalbank.ch/pdf/d/mediencenter/publikationen/Wealthmanagement2009_sbv_g_0109.pdf.

⁸⁸ Lynn, *supra* note 79; STAFF OF S. COMM. ON HOMELAND SEC. AND GOVERNMENTAL AFFAIRS, PERM. SUB. COMM. ON INVESTIGATIONS, 110TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 1 (2008).

One of the potential downfalls of using hard power, or even indirect economic soft power, is that the United States' use of coercive tactics may sour future negotiations. The United States may already be seeing this unwanted fruit of the UBS settlement.⁸⁹ As of July 2011, the United States had indicted seven Credit Suisse bankers for helping wealthy Americans evade taxes.⁹⁰ These recent indictments have created a fear that a new round of John Doe summonses may be forthcoming.⁹¹ In light of the United States' handling of the UBS case, members of the Swiss parliament have vowed not to make another deal with the United States.⁹² One member of the Swiss parliament even went so far as to say, "If the U.S. is going to act in such a way Switzerland must break off negotiations for a political solution."⁹³

If that one member of the Swiss parliament ends up speaking for the majority, the United States may find itself in a position where it no longer has the ability to use the John Doe summons as a soft power tool (in this case, an economic bargaining chip for political negotiations). This would force the United States to use the John Doe summons' traditional hard power of legal enforcement, a tactic they have thus far been able to avoid. Whether the United States would be willing to endure the political and economic ramifications of a protracted legal battle with Switzerland is a question only time can answer.

IV. TAX TREATIES EXPLAINED

The John Doe summons is a powerful tool of last resort, but what it has in brute strength, it lacks in finesse. For more typical tax exchanges between nations, the tax treaty is the preferred weapon. When a citizen of one country earns income in another country, both countries may be entitled to collect taxes from that citizen.⁹⁴ As a result of this quandary, nations engage in treaty negotiations to open global commerce and alleviate the fear of having the same income taxed by two different nations.⁹⁵ Tax treaties also play a valuable role by facilitating information sharing, allowing both nations to more effectively enforce domestic tax laws.⁹⁶

Unlike the unpredictable John Doe summons, bilateral income tax treaties are nearly standardized and are usually based on one of numerous international

⁸⁹ See generally Credit Suisse Unlikely to Get Help Over U.S. Tax Probe, FOX BUSINESS (July 24, 2011), available at <http://www.foxbusiness.com/industries/2011/07/24/credit-suisse-unlikely-to-get-help-over-us-tax-probe/>.

⁹⁰ *Id.* at para. 8.

⁹¹ See *id.* at para. 14.

⁹² *Id.* at para. 1.

⁹³ *Id.* at para. 10.

⁹⁴ Michael S. Kirsch, The Limits of Administrative Guidance in the Interpretation of Tax Treaties, 87 TEX. L. REV. 1063, 1070 (2009).

⁹⁵ *Id.*

⁹⁶ *Id.*

model tax treaties.⁹⁷ The most prominent of these model treaties is the Organization for Economic Co-Operation and Development (OECD) model treaty.⁹⁸ The OECD model treaty serves as the basis for over 1,500 bilateral tax treaties worldwide, including over 60 of the United States'.⁹⁹

The origins of the OECD lie in a group formed to implement the Marshall Plan in 1947. The OECD as it exists today, however, originated in 1961.¹⁰⁰ Since then, it has grown from 20 to 34 members, including the United States, Switzerland, and the United Kingdom.¹⁰¹ Some of the most commonly adopted aspects of the model treaty are the dispute settlement provisions found in Article 25.¹⁰² They explain that dispute settlement shall be placed in the hands of a tax authority, deemed the "competent authority," in each country."¹⁰³ In the United States, the Secretary of Treasury, or his agent, is the competent authority.¹⁰⁴ The competent authorities of each country have equal credence, and as a result, the dispute settlement provisions do not provide for a solution other than maintaining open diplomatic relations when a dispute arises.¹⁰⁵ Some treaties allow for arbitration if both signatories consent.¹⁰⁶

Dispute settlement regarding tax treaties is particularly difficult when it involves nations that have banking secrecy laws because the disputes typically occur over conflicting policy objectives.¹⁰⁷ One such problem of interpretation that recently existed between the United States and Switzerland was that the United States believed that facilitation of tax evasion should be subject to disclosure under the treaty, while Switzerland believed that only known tax fraud should be subject to disclosure.¹⁰⁸ Switzerland drew a distinction between tax evasion and tax fraud, believing only tax fraud to be a crime.¹⁰⁹ The United States, as well as many other countries, does not distinguish between tax fraud

⁹⁷ *Id.* at 1071.

⁹⁸ *See id.* at 1065, 1071.

⁹⁹ *Id.* at 1071.

¹⁰⁰ History, ORG. FOR ECON. CO-OPERATION AND DEV., <http://www.oecd.org/about/history/> (last visited Mar. 6, 2013).

¹⁰¹ *Members and Partners*, ORG. FOR ECON. CO-OPERATION AND DEV., <http://www.oecd.org/about/membersandpartners/> (last visited Mar. 6, 2013).

¹⁰² Robert A. Green, *Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes*, 23 YALE J. INT'L L. 79, 96 (1998).

¹⁰³ *Id.*

¹⁰⁴ *Embargoed Until Delivery: Hearing Before the S. Comm. on Foreign Relations*, 112th Cong. 3 (2011) (statement of Manal Corwin, Treasury Deputy Assistant Sec'y, Dep't of Treasury), available at <http://www.treasury.gov/resource-center/tax-policy/Documents/OTPTest-2011-6-7-Corwin-SenFR.pdf>.

¹⁰⁵ Green, *supra* note 103, at 96-99.

¹⁰⁶ *Id.* at 100-101.

¹⁰⁷ *See id.* at 96-99.

¹⁰⁸ Lynnley Browning, *Switzerland Agrees to Aid in Pursuit of Tax Cheats*, N.Y. TIMES (Mar. 13, 2009), available at <http://www.nytimes.com/2009/03/14/business/worldbusiness/14tax.html>.

¹⁰⁹ *Id.*

and tax evasion.¹¹⁰ This particular difference of opinion ended in March 2009, when Switzerland adopted the OECD standards on tax evasion to remove itself from the list of “uncooperative tax havens.”¹¹¹

Even though Switzerland adopted the OECD standards on the tax evasion question, it still requires the other signatory to have the name of the person they suspect is committing tax evasion before they will provide any assistance.¹¹² This is problematic for the United States and other nations suffering from tax evasion problems because, in most cases, their citizens can open an offshore bank account without their government’s knowledge. As a result, it is nearly impossible to know which citizens have offshore accounts and, more importantly, which citizens abuse that account. Requiring foreign governments to know the identities of suspected accountholders before the Swiss government will release any information places an impossible burden on any nation that supports its citizens’ freedom to participate in international banking and does not require registration of foreign accounts at the time of opening. Despite Switzerland’s policy change, billed as a massive move towards transparency, the requirement that the foreign government know the name of the tax evader practically moots the much-ballyhooed compromise.

V. U.K. TREATY WITH SWITZERLAND EXPLAINED

On October 6, 2011, the U.K. and Switzerland formally signed a new tax treaty that took effect on January 1, 2013.¹¹³ The treaty will facilitate the collection of revenue lost to tax evasion without infringing upon Swiss banking secrecy.¹¹⁴ This treaty requires Swiss banks to disclose to the Swiss government the taxes owed on accounts held by U.K. citizens, as well as taxes owed on money earned in the U.K. by non-U.K. citizens.¹¹⁵ It also will require Switzerland to collect those taxes and forward them to the U.K.’s competent authority.¹¹⁶ In exchange for the Swiss government’s assistance in collecting taxes, the U.K. government promises not to pursue the identities of the accountholders.¹¹⁷

¹¹⁰ *Id.*

¹¹¹ *Id.* (The OECD Model Treaty takes the position that tax evasion and tax fraud are both acts that should be subject to disclosure under bi-lateral tax treaties).

¹¹² *Id.*

¹¹³ *UK-Swiss Federation Taxation Cooperation Agreement*, HM REVENUE AND CUSTOMS, <http://www.hmrc.gov.uk/taxtreaties/swiss.pdf> (last visited Mar. 6, 2013) .

¹¹⁴ *See id.*

¹¹⁵ *See id.* at art.9.

¹¹⁶ *See id.*

¹¹⁷ Gerrit Wiesmann, *Swiss Lukewarm on Tax Treaty Calls*, FINANCIAL TIMES (September 15, 2011), available at <http://www.ft.com/cms/s/0/3ba0902e-deea-11e0-913000144feabdc0.html#axzz1aOgFtsfY>.

The treaty provides for the collection of past-due taxes, as well as tax liability that accrues after the treaty takes effect.¹¹⁸ When dealing with past-due taxes, the accountholder is given the choice to either have his or her account information disclosed to the U.K. or pay a one-time sum, usually 34% of the past-due taxes, to the U.K.'s competent authority.¹¹⁹ For the collection of future earnings, the treaty allows for variable tax rates based on different tax brackets, but generally, the Swiss government will collect 48% on income and 27% on capital gains from accounts not disclosed to the U.K. government.¹²⁰ As an initial good faith gesture, the Swiss government has agreed to make a 500-million-Swiss-franc down payment.¹²¹

The treaty also contains provisions facilitating the transfer of information to help reduce tax evasion.¹²² Under the treaty, the U.K. government will have the right to request the account information of up to 500 U.K. citizens a year, the number to be determined based on the success in identifying tax evaders the year before, for further investigation of tax evasion.¹²³ The treaty also somewhat preempts what is likely to be a future method of tax evasion: moving money to other branches of Swiss banks outside of Switzerland that are in jurisdictions not subject to this treaty.¹²⁴ To combat this, the treaty provides for Switzerland to give the U.K. the "top ten destinations" of account relocations but specifies that Switzerland will not provide individual accounts or accountholders' information.¹²⁵

Article 33 of the treaty, labeled the "anti-abuse" provision, contains several sub-provisions that could undercut the effectiveness of the treaty.¹²⁶ Article 33, paragraph 1 states that the contracting parties recognize that their citizens are free to bank in whichever nation or jurisdiction they see fit.¹²⁷ By limiting the U.K.'s ability to domestically regulate where its citizens can bank, this provision provides protection to those accountholders who do move their accounts to international branches of Swiss banks to evade taxes. It limits the U.K.'s ability to regulate them *ex ante* and track them *ex post*. The U.K. will have virtually no cause to receive information about accountholders who are moving their accounts to more secure jurisdictions to continue to evade taxes absent specific information about their citizens' accounts.

Furthermore, Article 33, paragraph 2 states that Swiss bankers will not "knowingly manage or encourage the use of artificial arrangements whose sole

¹¹⁸ U.K.-Swiss Taxation Cooperation Agreement, *supra* note 114, at art. 5.

¹¹⁹ *Id.*, at art. 9 (The 34% rate may change depending on the circumstances of the concealment).

¹²⁰ *Id.*, at art. 9, 14..

¹²¹ *See id.*, at art. 17.

¹²² *Id.*, at art. 32.

¹²³ *Id.*

¹²⁴ U.K.-Swiss Taxation Cooperation Agreement, at art. 18.

¹²⁵ *Id.*

¹²⁶ *Id.*, at art. 33.

¹²⁷ *Id.*

or main purpose is the avoidance of taxation.”¹²⁸ The purported purpose of this article is to prevent banks from assisting their clients in evading taxes. If banks are caught assisting in tax evasion that does not fall into one of the previously mentioned categories, they will be held financially responsible for the taxes and penalties due.¹²⁹ However, these banks will also retain a right to recover the full tax burden owed from the U.K. citizen who participated in the evasion.¹³⁰ This essentially moots the entire provision, as banks have no financial incentive to comply.

Article 38 of the treaty gives the Swiss government the ability to audit paying agents to ensure compliance with the agreement, but only a “representative group of Swiss paying agents” are subject to these audits.¹³¹ The treaty leaves the definition of this representative group unclear, shrouding the audits in secrecy. In addition, the treaty does not specify whether more audits will take place if a high proportion of the “representative group” failed to comply.¹³² If a conflict arises, Article 40 outlines the formation of a joint commission of representatives of both states to “examine the proper functioning” of the agreement.¹³³ This joint commission is simply an extension of the existing diplomacy options, and it does not have substantial investigatory or enforcement power.¹³⁴

VI. COMPARING SUCCESS OF RETURNING REVENUE

The John Doe summons and the treaty between the U.K. and Switzerland provide very different means of attacking the same problem. The John Doe summons relies on using United States law as a means of coercing assistance from a foreign nation by exercising leverage over its citizens, while the U.K. treaty uses diplomacy and compromise. The U.K. treaty cultivates international goodwill, while the John Doe summons has the potential to destroy it. Despite how much more palatable the treaty seems, the John Doe summons, though seriously flawed, will likely be more successful in recuperating offshore tax revenue and facilitating the long-term elimination of offshore tax evasion.

A. *The John Doe Summons: Strengths and Limitations*

The John Doe summons’s primary power lies in the leverage it wields over multinational corporations. Nations that are labeled as tax havens tend to be largely reliant on their banking sector for economic growth, since the secrecy of

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ U.K.-Swiss Taxation Cooperation Agreement, at art. 18..

¹³¹ *Id.* at art. 38.

¹³² *Id.*

¹³³ *Id.* at art. 40.

¹³⁴ *See id.*

their banks draws in so many customers.¹³⁵ The loss of credibility of one of these nations' major banks could be detrimental to a given country's economy.¹³⁶ This reality gives the United States two courses of action regarding the John Doe summons: (1) they can use it as leverage for political negotiations, or (2) in the event that option fails, they can pursue the summons to the fullest extent of the law. Conversely, the U.K.'s treaty essentially relies on the Swiss government's sense of moral obligation, as the U.K. retains no real oversight of the process. Furthermore, unlike the U.K.'s treaty, which has authority over one jurisdiction, the John Doe summons can have an effect on multiple jurisdictions simultaneously. It also prevents multinational banks from simply transferring assets to a different branch in another jurisdiction, something that will almost certainly be a problem under the UK's treaty.

One final advantage of the John Doe summons is that it can effectuate political negotiations through an existing treaty. This was the path the United States took during the UBS negotiations, leading to a settlement with the Swiss government negotiated through the United States' 1996 tax treaty with Switzerland.¹³⁷ Through various tax treaties, the United States and Switzerland can bilaterally negotiate through a treaty request. The John Doe summons therefore allows for a more efficient use of existing treaties and provides external leverage greater than that of the U.K.'s treaty.

However, the John Doe summons is not without its own limitations. The primary problem with the John Doe summons as a tool for international diplomacy is that it is the tax treaty equivalent of a nuclear option. Nations generally do not take kindly to foreign states asserting their domestic laws as dominant and ordering other nations to surrender their sovereignty. The John Doe summons may very well be treated in the future as it was by Switzerland, as a one-time bargaining chip that will be deemed so offensive that it will not move the needle in future discussions.¹³⁸

Knowing the displeasure the John Doe summons causes to foreign powers, it is important to question whether the United States' tax interest in these countries outweighs the other foreign policy objectives that could suffer as a result. It is possible that many of the nations colloquially referred to as tax havens are small enough and banking-focused enough that the United States is not likely to have other significant relations with them. On the other hand, the United States has significant relations with India, and recent inquiries into HSBC India's American accountholders could force the United States to choose between its tax and overall foreign policy goals.¹³⁹

¹³⁵ See Ahmed Zorome, Concept of Offshore financial Centers: In Search of an Operational Definition 6 (IMF, Working Paper No. 07/87, 2007).

¹³⁶ See Outlook for Swiss Economy Worsens, BBC NEWS (Mar. 17, 2009), available at <http://news.bbc.co.uk/2/hi/7947765.stm>.

¹³⁷ See Zagaris, *supra* note 11.

¹³⁸ See FOX BUSINESS, *supra* note 90.

¹³⁹ Zagaris, *supra* note 11.

Another potential problem with the John Doe summons is that its use as a bargaining chip for treaty negotiations may lead the United States to sacrifice it in the process. If the United States were to adopt a treaty similar to the one the U.K. adopted, using the John Doe summons as an oversight tool would likely be a direct violation of the treaty because it would not be handling the dispute through the appropriate channels outlined in Article 39.¹⁴⁰ Despite this issue, the John Doe summons would remain an option in nations the United States had not yet signed a treaty with. This allows the United States to prevent an international game of hide-and-go-seek where accountholders move their accounts to new jurisdictions to avoid falling under the authority of treaty.

B. *The U.K.-Switzerland Treaty, the QI Program and Future Prospects for Success*

While we cannot know how effective the U.K. treaty has been until there has been sufficient time to study its results, it functions in largely the same way as the United States' QI program, which does have a traceable history. Both the treaty and the QI program place tax collection in the hands of an international party in exchange for agreeing not to pursue accountholders' identities.¹⁴¹ As of 2008, more than 7,000 international banks had signed onto the QI program.¹⁴² However, the success has been highly limited.¹⁴³ Even with extremely limited oversight, more than 100 banks have left the QI program under pressure of noncompliance with the agreements.¹⁴⁴ Under the QI program, banks need to submit to audits once every three years; the auditors are not required, however, to notify the client or the IRS of fraud or other violations of the QI agreement.¹⁴⁵ The IRS has never formally reported its intake from the QI program, but "there are indications that the program brings in only a fraction of what it should, because the banks have found ways around its requirements."¹⁴⁶ The Government Accountability Office estimated that, in 2003, of the \$35 billion that was eligible for taxation, banks participating in the QI program withheld 5% for taxes; the standard tax rate for a United States citizen under these circumstances is 28%-30%.¹⁴⁷

¹⁴⁰ Agreement between the Swiss Confederation and the United Kingdom of Great Britain and Northern Ireland on cooperation in the area of taxation, UK-Switz., art. 39, Oct. 6, 2011, available at <http://www.hmrc.gov.uk/taxtreaties/ukswiss.htm>.

¹⁴¹ Lynnley Browning, *I.R.S. Aims to Give Teeth to a Program Meant to Counter Offshore Tax Avoidance*, N.Y. TIMES (July 15, 2008), available at <http://www.nytimes.com/2008/07/15/business/15tax.html>; *Tax Evasion 'Net is Tightening' After Swiss Deal*, BBC NEWS (Oct. 7, 2011), available at <http://www.bbc.co.uk/news/business-15215867>.

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *Id.*

1. Oversight: Potential Strengths and Weaknesses

The U.K.'s treaty lacks many of these comically ineffective provisions, but fundamental similarities between the programs render them both lacking. Both the U.K.'s treaty and the QI program place the responsibility of collecting taxes on a foreign institution in exchange for not requesting the identities of their accountholders. They operate on the fundamentally flawed premise that institutions that are incentivized to protect secrecy will voluntarily collect tax revenue and hand it over to a government without any real oversight. The failure of the QI program so far demonstrates that unless the Swiss government can exercise a degree of oversight in its enforcement of the U.K. treaty that is stronger than the United States' enforcement of the QI program, the U.K. treaty will ultimately be ineffective.

The primary difference between the two is that the QI program places the responsibility on private businesses with no oversight from their domestic governments, while the treaty places the responsibility on the Swiss government to audit the payments of the financial institutions. This can have advantages and disadvantages.

In theory, one large advantage that the treaty has over the QI program is that the Swiss government acts as a more effective guarantor of enforcement because it has the authority of domestic law to enforce the provisions of the treaty. If the Swiss government finds that a bank has not met its obligation under Article 33, it can use the power of Swiss law to pierce the veil of banking secrecy and to ensure that the U.K. receives its money.¹⁴⁸

Unfortunately, from an enforcement standpoint, forcing the banks to turn over the account information to the Swiss government could be tricky. The Swiss constitution does not explicitly state whether a statute or a treaty takes priority when there is a domestic conflict of law.¹⁴⁹ This lack of clarity could potentially lead to a lawsuit between the banks and the Swiss government over which is the higher authority, slowing the U.K.'s recovery process and potentially limiting the treaty's overall effectiveness. Despite this concern, the recent revelation of accountholder information to the United States, processed as a treaty request, is a positive indication that the Swiss parliament sees its secrecy laws as voidable in the wake of a legitimate treaty request.¹⁵⁰ On the other hand, Switzerland's agreement with the United States was the result of cooperation

¹⁴⁸ Agreement between the Swiss Confederation and the United Kingdom of Great Britain and Northern Ireland on cooperation in the area of taxation, UK-Switz., art. 33, Oct. 6, 2011, available at <http://www.hmrc.gov.uk/taxtreaties/ukswiss.htm>.

¹⁴⁹ VIRGINIA A. LEARY, INTERNATIONAL LABOUR CONVENTIONS AND NATIONAL LAW: THE EFFECTIVENESS OF THE AUTOMATIC INCORPORATION OF TREATIES IN NATIONAL LEGAL SYSTEMS 118 (1982).

¹⁵⁰ See FOX BUSINESS, *supra* note 90.

from UBS, who physically held the accounts.¹⁵¹ Should the banks protest this new treaty arrangement, the Swiss parliament may need to amend the banking secrecy law to state that the treaty supersedes its provisions. This could greatly slow initial recovery.

Another potential disadvantage of the Swiss government acting as the collector is that, unlike under the QI program, where the United States can penalize the corporation for violating United States law, the U.K. will have very little recourse if they believe Switzerland is not upholding its end of the treaty.¹⁵² The treaty outlines that disputes should be settled diplomatically and that, when they cannot be settled through diplomacy, they should be settled through the joint committee, which is made up of an inherently diplomatic body of representatives from the U.K. and Switzerland.¹⁵³ While the U.K. has recourses such as nullifying the treaty and taxing the Swiss income of U.K. residents, neither of these actions are practical solutions if Switzerland violates the treaty.¹⁵⁴ As long as Switzerland provides them with a reasonable disbursement, the U.K. will not know the extent of compliance, only that the taxes they receive are more substantial than they likely would have been otherwise.

Unfortunately, this limitation exists for both the treaty and the John Doe summons, as neither the Swiss government nor the United States government can ensure that the banks provide them with accurate information. Because neither the Swiss nor the Americans have specific information relating to accountholders (if they did, they would not need the treaty or the John Doe summons), they cannot independently verify the veracity of the bank's disclosure.

2. Pareto Efficient, But Not Without Serious Flaws

Other than the nuclear option of cancelling the treaty, the U.K. has limited recourse and will likely continue to uphold the treaty as long as the returns outweigh the opportunity cost of pursuing other tax recovery efforts. One of the brilliances of the treaty for the Swiss is that it will likely remain Pareto efficient, and thus stable, even if not upheld to the fullest extent possible. This lack of oversight incentivizes Switzerland to do just enough enforcement to ensure the U.K. does not cancel the treaty.

One positive aspect of the U.K. treaty that leads to Pareto efficiency is that it could keep more accounts in Switzerland, where the U.K. has a far greater likelihood of recovering unpaid tax revenue than in another offshore tax haven. Switzerland's concession in the UBS settlement allowed other nations to smell

¹⁵¹ *See id.*

¹⁵² Browning, *supra* note 142.

¹⁵³ *See* U.K.-Swiss Taxation Cooperation Agreement, *supra* note 114, at arts. 39-40.

¹⁵⁴ *Id.* at art. 44.

the blood in the water, and clients to see the writing on the wall, that it would soon become open season on tax evaders hiding in Switzerland.¹⁵⁵ On the other hand, the U.K. treaty may stymie the flow of U.K. accountholders taking their accounts elsewhere by setting reassuring ground rules for the distribution of information. This is, of course, beneficial for the Swiss banking industry. It also bolsters the treaty's effectiveness because more accounts in Switzerland means a greater likelihood of recovering unpaid tax revenue. Even if the treaty is only minimally effective at recovering money lost to tax evasion in Swiss banks, it presents a greater likelihood of success than trying to recover unpaid taxes from another offshore haven with no treaty in place.

Despite being Pareto efficient, there are numerous reasons the treaty may not optimize the U.K.'s revenue intake. Because of the banking freedom clause in Article 33, the Swiss government can easily claim that the low return is a result of U.K. accountholders moving their accounts to different jurisdictions. Even if this is the case, the treaty does not obligate the Swiss government to help stop the problem of account transfers unless they are the result of "artificial arrangements" with the sole or main purpose to evade taxes.¹⁵⁶

This is especially problematic given the lengthy grace period before the Swiss government begins collection. Despite the announcement in October 2011, the one-time payment that will be assessed for back taxes owed will be based on the calculated value of the account on April 1, 2013.¹⁵⁷ In contrast, United States levies penalties against accountholders based on the highest value of the account at any time during tax delinquency.¹⁵⁸ The massive, clearly delineated grace period in the U.K. treaty made it easy for accountholders to transfer their income to another jurisdiction, or even temporarily remove it until the date passed to avoid penalties.

Again, another reason it will be difficult for the Swiss government to recover all the tax revenue owed to the U.K. is that there are limited incentives for Swiss banks to follow this rule. Under Paragraph 3 of Article 33, the punishment for violating Paragraph 2 is that the bank will become responsible for the taxes owed; this is barely an incentive, however, because Paragraph 3 also preserves the right of recovery from the U.K. citizen. Furthermore, because the bank knows the identity of the evader, and knows that he or she has assets to cover the debt, they will have little trouble recovering.¹⁵⁹ In sum, this clause does not provide adequate incentives for bankers to disavow tax evasion strategies, as the only risk to the bank is losing its client and the only risk to the evader is paying the taxes he or she already owes.¹⁶⁰

¹⁵⁵ Lynn, *supra* note 79.

¹⁵⁶ U.K.-Swiss Taxation Cooperation Agreement, *supra* note 114, at art. 33.

¹⁵⁷ *Id.* at art. 39.

¹⁵⁸ Frequently Asked Questions OVCI, IRS WEBSITE, <http://www.irs.gov/businesses/international/article/0,,id=235699,00.html> (Last visited Oct. 8, 2011).

¹⁵⁹ U.K.-Swiss Taxation Cooperation Agreement, *supra* note 114, at art.33.

¹⁶⁰ *Id.*

Furthermore, there are no incentives for banks to investigate their bankers under the treaty. Paragraph 2 states that “Swiss paying agents shall not *knowingly manage* or *encourage* the use of artificial arrangements whose sole or main purpose is the avoidance of taxation (emphasis added).”¹⁶¹ This language only holds banks accountable, under this treaty, when they are aware of or are encouraging their bankers to assist in tax evasion. Furthermore, there is no requirement that banks must counsel their bankers not to engage in artificial arrangements with clients, leaving open the distinct possibility that bankers may simply continue the status quo.¹⁶²

Perhaps the most problematic aspect of this treaty is that it creates no fear. The U.K., like the United States, has been engaging in an amnesty program for those who have been hiding their wealth abroad.¹⁶³ Unlike the John Doe summons, which creates uncertainty and deterrence, the U.K.-Switzerland treaty creates an atmosphere of calm complacency that gives bankers, tax attorneys, and would-be tax evaders a new set of rules in which to find loopholes. This rigidity will ensure that the tax evaders continue to move their money faster than Her Majesty’s Revenues and Customs can find it. With the John Doe summons, bankers, tax attorneys, and accountholders never know when the United States will strike next and if their accounts are safe, and that instability will allow the United States’ amnesty program to continue to reveal new accounts. Many of these problems could theoretically be alleviated if the U.K. were to sign a similar treaty with all the major finance nations, but, even then, its recovery would still be subject to the same limitations it currently faces with this treaty. Even though the U.K. will receive revenue from its treaty with Switzerland, would it really be surprising if that value were offset by the amount the U.K. loses in voluntary amnesty disclosures worldwide?

3. Evaluating the Likely Effect of the Treaty

The treaty between the U.K. and Switzerland is a step in the right direction toward solving the global evasion problem; however, it is not without significant flaws. Both sides sacrifice a little bit of what they could have for the mutual benefit of both parties and, in that sense, it is a sound decision for both parties. Each party’s perception of success of this treaty may largely depend on the following question: how much of a crackdown on tax evasion is enough? From a strictly economic viewpoint, enough is when a government maximizes its return relative to its effort and opportunity cost. The treaty is a positive for the U.K. in that the U.K. will likely recuperate more money from the treaty than it will lose through enforcement and opportunity cost in the short term. However, signing

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ Laurence Norman, Britain Extends Tax-Amnesty Deadline, WALL STREET JOURNAL (Nov. 27, 2009), available at <http://online.wsj.com/article/SB125927526335765507.html>.

the treaty came with long-term opportunity costs and sacrifices that may ultimately make it a better deal for Switzerland than the U.K. Furthermore, if a government places a moral value on punishing tax evaders, then this treaty may be found to be lacking. By agreeing not to seek the identity of the tax evaders, the U.K. is sacrificing an opportunity to prosecute tax evaders for past wrongs, in exchange for a promise of future lawfulness. Regardless of one's perspective on that question, for the Swiss, this treaty is a brilliant public relations move – it combats the criticism that Switzerland is an uncooperative tax haven, while simultaneously allowing them to continue to bank in its most economically profitable way: in secret.¹⁶⁴

C. *The John Doe Summons is a More Dynamic Tax Recovery Tool Than the U.K.-Switzerland Tax Treaty*

Despite its many flaws, the John Doe summons provides several powerful options for both hard and soft power approaches to offshore tax evasion. The U.K. treaty, on the other hand, provides several meaningful advantages, but ultimately is not as dynamic a tool for cracking down on offshore tax evasion as the John Doe summons.

From a pure tax evasion enforcement standpoint, the John Doe summons is a more powerful tool for enforcement than the treaty. It allows the United States to exercise leverage over a foreign nation through a third-party private enterprise. This leverage places the United States in a superior bargaining position to where it would have been during normal tax treaty negotiations. However, the downside to this tactic is similar to the downside of any use of hard power: it creates enemies. The United States' relationship with Switzerland has been strained as a result of the altercation involving UBS, meaning that Switzerland is already less likely to cooperate with the United States in the future. In July 2011, the United States indicted three Credit Suisse bankers for helping wealthy Americans evade taxes, a similar opening gesture to their investigation of UBS.¹⁶⁵ This time, the Swiss government has stated that there will be no deal with the United States and that Credit Suisse is on its own.¹⁶⁶ How much teeth these words have remains to be seen. If Switzerland refuses to bargain with the United States, it will be interesting to see how Credit Suisse handles the tension between the two nations' laws. We may finally see the full legal force of the John Doe summons in action.

As for the treaty approach, its primary weakness is the lack of oversight. By limiting itself to a treaty, a nation places full enforcement ability in the hand

¹⁶⁴ Browning, *supra* note 109 (explaining that before Switzerland adopted the OECD standards on tax evasion, the nation was briefly labeled an “un-cooperative tax haven” by the OECD).

¹⁶⁵ Credit Suisse Tax Evasion Probe: Bankers Unlikely to Get Help From Switzerland, HUFFINGTON POST (July 24, 2011), available at http://www.huffingtonpost.com/2011/07/24/credit-suisse-tax-evasion-switzerland_n_908020.html.

¹⁶⁶ *Id.*

of a foreign government – in particular, one that profits from tax evasion. Knowing this, it would be hard for the United States to feel completely comfortable giving full tax-collecting control to a banking secrecy nation. While it is true that the John Doe summons also has ineffective oversight over international banks that are incentivized to withhold information, the treaty requires the U.K. to go through not only the same banks as it would with a John Doe summons but also through the Swiss government, an agency over which it has no authority. At least in the case of the John Doe summons, the United States has a legal recourse on banks that have assets in the United States and, therefore, has the ability to affect real incentives. The U.K., under the treaty, must depend on the Swiss government to both create and enforce the incentives for participation on the Swiss banks.

A second key weakness is that a single treaty with a single nation could simply result in those tax evaders moving to another country that is not subject to the treaty. Treaties will only be successful if formed with every jurisdiction that protects banking secrecy. Compared to the John Doe summons, which can follow any bank with United States clients into any jurisdiction, the treaty route is likely to be highly limited in its effectiveness. Even though the John Doe summons does not have complete legal effect in foreign courts, it does give the United States two viable options for recovery. A John Doe summons gives the United States control over assets held in the United States and also, like in the UBS case, may reveal information that the United States can take to the foreign government for assistance.¹⁶⁷ For the United States to enforce the John Doe summons, it must have assets upon which to exert its authority. As a result, for regulating the smaller banks that do not hold assets in the United States or have bankers traveling to the United States, the treaty, which covers all banks in the jurisdiction, is more effective than the John Doe summons. If the market sees more banking parity in the future, the treaty could become more effective.

Finally, the treaty approach creates a complacent environment for tax evaders. Compared to the chaos the John Doe summons creates, the treaty fosters very little fear. Even though the treaty does allow for information to be requested on up to 500 persons, those requests still require the U.K. to know the identity of each accountholder and, in order to reach the maximum of 500, the U.K. will have to find violations in excess of 10,000 British pounds on more than two-thirds of all requests for many years.¹⁶⁸ The difficulty of processing treaty requests will limit the number of actual requests processed and, as a result, will lead to fewer voluntary disclosures and a less successful amnesty program in the long term.

The John Doe summons is the shotgun to the U.K.'s scalpel, capable of inflicting massive damage, but incapable of surgical precision. The United

¹⁶⁷ Once a private bank has admitted wrongdoing, it is much harder for a foreign nation to defend it than if that wrongdoing is never discovered, which is the fear with the treaty.

¹⁶⁸ U.K.-Swiss Taxation Cooperation Agreement, *supra* note 114, at art.32.

States loses over \$100 billion annually to tax evasion.¹⁶⁹ For the United States, the tax evasion problem is more like the Wild West than a sterile operating room.¹⁷⁰ Eventually, the United States will likely, and should likely, move to a treaty-based approach such as the U.K.-Switzerland treaty because it is more sustainable in the long term. Until the United States can corral what is not just a Swiss problem, but also a global problem, the treaty will not be as effective as the John Doe summons.

VII. COMPARING IMPLICATIONS FOR INTERNATIONAL BUSINESS

Recovering revenue lost to offshore tax havens is certainly an important aspect of increasing the United States government's tax intake; the government's recovery efforts do not exist in a vacuum. While it may be contrary to conceptions of justice not to pursue everyone who evades taxes, one of the United States' main objectives is to recuperate the maximum amount of revenue it can, even if that means limiting its search for offshore accounts. With this understanding, it is important to look at the implications for business, because if either the John Doe summons or the U.K. tax treaty changes the way major corporations do business, the United States could lose more in tax revenue from foreign investment than it receives discovering offshore withholdings.

A. *The John Doe Summons and International Business*

The first important question to answer is whether the use of the John Doe summons is likely to affect foreign corporations' willingness to invest and hold assets in the United States. Early indications suggest that this may be the case. Swiss Banks Sarasin and Julius Baer recently responded to the investigation of Credit Suisse by placing a moratorium on all staff visits to the United States.¹⁷¹ Based on the way the Department of Justice has handled UBS and Credit Suisse bankers, the United States has a strategy of criminally charging foreign bankers and then using that leverage to force them to disclose the identity of accountholders.¹⁷² The Swiss banks' recent moratorium is likely to prevent the United States from employing this strategy. If this strategy proves successful for Sarasin and Julius Baer, other banks may adopt similar travel moratoria. If banks

¹⁶⁹ STAFF OF S. COMM. ON HOMELAND SEC. AND GOVERNMENTAL AFFAIRS, PERM. SUB. COMM. ON INVESTIGATIONS, 110TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 1 (2008), available at http://hsgac.senate.gov/public/_files/071708PSIR_eport.pdf.

¹⁷⁰ See *id.*

¹⁷¹ See FOX BUSINESS, *supra* note 90.

¹⁷² The DOJ has been arresting Swiss bankers and then offering deferred prosecution agreements contingent upon the turnover of the identities of United States account holders. See Bush *supra* note 51.

become unwilling to travel to the United States, they will be unlikely to do the same level of businesses that they had previously done.

Moreover, recent events hint that the United States may be more aggressively pursuing foreign bankers who assist Americans in committing tax evasion.¹⁷³ In January 2012, three Swiss Bank A bankers faced charges for helping Americans hide more than \$1.2 billion from the United States government.¹⁷⁴ The United States is pursuing the charges even though all three bankers reside in Switzerland.¹⁷⁵ There is no word yet on whether the United States government will seek extradition.¹⁷⁶

The concern here, beyond criminal prosecution, is that the United States will use the John Doe summons to enter a default judgment against the bank should they not comply with the account disclosure. If the bank retains assets in the United States, the IRS may foreclose upon those assets without winning a civil trial. There are two ways this could happen: (1) if the United States files criminal charges and wins, any assets that were used in the crime or the result of its commission can be confiscated; and (2) if the government suspects that property or assets have been used in the commission of a crime, it can obtain *in rem* jurisdiction, allowing it to file a claim against the property or asset, and then, upon a preponderance of the evidence standard, seize the property.¹⁷⁷ Should the United States pursue a full-scale civil suit, a court may enter a judgment finding that the bank bears civil liability for the lost tax revenue, allowing the United States to foreclose on the bank's domestic assets.¹⁷⁸ The fact that the bank has domestic assets to foreclose upon alleviates the concern that a foreign court may not enforce a judgment that forces a corporation to break its domestic law.

While this may sound like a boon for the United States in terms of its enforcement capabilities, it could potentially cause more financial harm than the value of the taxes recuperated. The fear of having their assets seized in response to their employees' actions may cause so many companies to pull out of United States investments that it not only hurts the United States economy, but also causes the United States to lose out on more legitimate tax revenue than what they can recuperate.

Even though the cracking down on tax evasion may have a short-term negative impact on investment, however, allowing companies and high-net-

¹⁷³ James O'Toole, *Swiss Bankers Charged in 1.2 Billion Tax Fraud*, CNN MONEY (Jan. 4, 2012), available at http://money.cnn.com/2012/01/03/news/swiss_bankers_charged/index.htm?hpt=hp_t2.

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *See A Truck In the Dock*, THE ECONOMIST (May 27, 2010), available at <http://www.economist.com/node/16219747>.

¹⁷⁸ *See David Voreacos, Switzerland Says it May Seize UBS Data Sought by U.S.*, BLOOMBERG (July 8, 2009), available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a5YQivGDnNjA>.

worth individuals to game the system and pay no taxes is not a long-term solution. If the United States does see decreased investment as a result of the crackdown on offshore tax evasion, the appropriate solution will be for the United States government to reconsider its tax rate in a way that allows for robust investment but does not reward those who break the law.

Whether or not the United States sees decreased investment, a policy that combats offshore tax evasion must be part of any long-term solution for the United States. By collecting a higher percentage of the taxes owed, the United States may be able to afford to lower its tax rates to a level that is friendlier to international investment. Attracting investment with its tax rates and growth opportunities, instead of its lax tax enforcement, should allow the United States to see more sustainable growth in the future.

As for the potential loss to the retail banking industry, there is also a legitimate concern that foreign banks will be less likely to open branches in the United States or maintain their current ones. It is worth noting, however, that foreign banks with assets in the United States make up a comparatively small percentage of the U.S banking market.¹⁷⁹ As of 2004, foreign banks with operations in the U.S accounted for only 211 of the 7,630 commercial banks in the United States, or slightly less than 3% of all banks in the United States.¹⁸⁰

Another potential concern about the United States' use of the John Doe summons relates to the way that damaged banks affect the global economy. The Swiss minister of economic affairs, Doris Leuthard, trumpeted this argument during the UBS settlement negotiations, claiming that it could not be in the best interest of the United States to create banking instability. He implied that the bankruptcy of Lehman Brothers Holdings should be a cautionary tale to the United States "not to push UBS to the brink."¹⁸¹ While there are valid economic implications to this statement the United States cannot allow foreign banks to hold its economy hostage, not just as a matter of principle, but also as a matter of long-term economic policy. Increased instability may be an unavoidable by-product of using the John Doe summons.

B. *The U.K.–Switzerland Treaty and International Business*

The U.K. treaty with Switzerland is considerably more favorable to international business, as it only minimally affects the status quo. The biggest financial impact that international banks will see as a result of this treaty is increased costs in monitoring the domiciliary status of their clients, collecting

¹⁷⁹ PRICEWATERHOUSECOOPERS, REGULATORY GUIDE FOR FOREIGN BANKS IN THE UNITED STATES (2005-2006), available at www.pwc.com/en_US/us/banking-capital.../regguide_0506.pdf.

¹⁸⁰ *Id.*

¹⁸¹ See David Voreacos, Switzerland Says it May Seize UBS Data Sought by U.S., BLOOMBERG (July 8, 2009), available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a5YQivGDnNjA>.

the taxes owed from their clients, and submitting to Swiss oversight.¹⁸² Compared to the strain the John Doe summons will likely place on international business, these costs are practically negligible. An additional cost of the U.K. treaty is that these banks will likely lose some revenue as those clients whose primary goal was tax evasion take their money elsewhere. However, this is not as extreme as under the John Doe summons, when banks could be subject to both loss of clients and penalties. In addition, banks allowing customers to transfer their accounts to other branches of the same bank in jurisdictions that not subject to the treaty could offset part of this loss under the U.K. treaty.¹⁸³

One distinct business advantage the treaty has over the John Doe summons is that the treaty is predictable. The risk of investing in the U.K. is measurable, while the John Doe summons regime is more difficult to quantify. The same unpredictability that makes the John Doe summons so dangerous to tax evaders also makes it difficult for businesses to evaluate the risk inherent in an investment.

In the coming years, Swiss banks will likely increase the numbers of branches they have in foreign jurisdictions; it is there they are likely to see their greatest growth. The U.K. will likely try to offset this by signing treaties with other banking secrecy nations. It remains to be seen whether the U.K. or the international banks will win the race to lock down favorable jurisdictions. One would suspect that the economic process is likely to be more efficient than the political one, at least in the near future. Another factor that may slow the treaty process is that other nations, even those actively looking to cooperate, may wish to wait to see how effective the U.K.-Switzerland treaty is before adopting a similar one.

One problem that international banks may see in the future from the U.K.-Switzerland treaty is increased regulation aimed at stopping money laundering. This increased regulation will mean less secrecy for the banks' clients. The German government, which recently agreed to a treaty with Switzerland similar to the one the U.K. signed, is considering backing out because of fear that putting collections in the hands of the Swiss will lead to uncontrolled money laundering.¹⁸⁴ If the treaty does not prove to be effective in its policing of money laundering, it could lead to future regulations that infringe upon the secrecy of accounts. Luckily for international banks, the U.K. treaty does allow the U.K. to investigate suspected instances of money laundering.¹⁸⁵ The treaty does not, however, allow fishing expeditions: investigations with no significant factual basis for inquiry.¹⁸⁶ Even though the U.K. does not need to know the names of the parties involved, it must be able to present specific evidence to the Swiss

¹⁸² See U.K.-Swiss Taxation Cooperation Agreement, *supra* note 114, at arts. 5, 8, 9, 19.

¹⁸³ See *id.* at art. 33.

¹⁸⁴ Wiesmann, *supra* note 118.

¹⁸⁵ See U.K.-Swiss Taxation Cooperation Agreement, *supra* note 114, at art. 2.

¹⁸⁶ *Id.* at art. 32.

government that money laundering is occurring for the Swiss to disclose the information.¹⁸⁷ Under this arrangement, the banks can rely on the Swiss government to weed out the fishing expeditions, thus resulting in maximum privacy for their clients.

C. *Which is Better for International Business?*

Looking at this comparison from an international bank's perspective, the treaty between the U.K. and Switzerland is clearly preferable to the John Doe summons, as it allows maximum continuity, privacy and opportunity for sustained economic growth. On the other hand, the John Doe Summons best serves the economic bottom line of the United States government. While there is no doubt a correlation between the success of international banks and the United States economy, it is not significant enough to demand a parallel outcome. The lost tax revenue and stymied economic growth from John Doe summonses' effects on direct foreign investment and sustained operations of foreign banks in the United States will most likely be less than the potential \$100 billion a year the IRS could recover through the use of the summons. The obstacle to foreign investment in the United States that the John Doe summons creates will also become less prevalent as time passes. The smaller the tax evasion problem becomes, the less likely the United States will be to use the John Doe summons, and the more likely foreign investors will feel secure holding assets in the United States.

CONCLUSION

All in all, though not without weaknesses, at this moment the John Doe summons appears to be the more effective tool for recuperating revenue lost to offshore tax evaders. The John Doe summons allows the United States to pursue evaders in many jurisdictions, while the treaty approach is limited to those nations with whom the U.K. has signed a treaty. The summons also allows the United States to exercise direct oversight over the complicit bank, rather than needing to first go through a foreign government. Finally, the John Doe summons creates fear and will allow for a robust voluntary disclosure program, unlike the treaty approach, which forecloses the use of alternate means of recovery in that jurisdiction.

Even though the John Doe summons is more effective at this moment, the United States cannot turn a blind eye to the damage the summons can do to the United States' international relationships. Because of this issue, the John Doe summons should be part of a comprehensive multi-step process. The John Doe summons' initial uses can make significant progress into offshore tax evasion, paired with an amnesty program that will allow the U.S to discover evaders

¹⁸⁷ *Id.*

while limiting the use of the summons. Once a significant reduction in tax evasion occurs, the United States should engage major nations, seeking treaties similar to the one signed by the U.K. and Switzerland, though ideally with some of the loopholes closed. Meanwhile, the United States should continue to wield the John Doe summons as a backup plan for evaders that move to other jurisdictions to avoid the treaty. All treaties will have some loopholes, which is why it is critical for the United States to first address the underlying problem. It is in the United States' best interest to remain on good terms with banking secrecy nations, and there must be concessions made to achieve that end. The United States needs to demonstrate to tax evaders, however, that evasion is a serious crime with serious punishment. Only through broadcasting this message will the United States be in a position to achieve long-term success through treaties.