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Meredith Pace*

THE PUBLIC POLICY EXCEPTION TO THE RECOGNITION AND ENFORCEMENT OF FOREIGN JUDGMENTS: IGNORING THE PUBLIC POLICY EXCEPTION IS A DETRIMENT TO U.S. LITIGANTS

Abstract

As United States citizens and foreign nationals engage in transnational civil litigation, one approach to warrant fairness among litigants and nations is the public policy exception to the recognition and enforcement of foreign judgments. Yet, the pursuit of fair justice that embodies this exception has failed U.S. litigants who are regularly denied foreign judgment enforcement in the face of public policy, all the while U.S. courts continually embrace notions of comity in disregard of reciprocity. This is because, unlike foreign nations, the United States is not a signatory to a multilateral foreign judgment agreement and seeks a leveraging tool. As a result, foreign tribunals retain a significant advantage in transnational litigation.

This note will address the prejudice U.S. litigants face in foreign tribunals and how U.S. courts are to blame for impractical and timeworn solutions. Furthermore, this note will explore how justice for U.S. litigants begins with federalization of the public policy standard followed by a blueprint of its own foreign judgment agreement. Until the United States assumes this position however, the public policy exception must be reaffirmed through principles of reciprocity. The United States has essentially lost its bargaining power to the detriment of U.S. litigants, and its time to take it back.

Annotasiya

ABŞ vətəndaşları və əcnəbilərin iştirak etdiyi beynəlxalq xarakterli mülki məhkəmə işlərində tərəflər və müxtəlif millətlərə mənsub şəxslər arasında ədaləti təmin etməyin bir üsulu da xarici məhkəmə qərarlarının məcburiliyi və tanınması ilə bağlı ictimai maraqlar istisnasıdır. Bu istisnanı təcəssüm etdirən ədalət mühakiməsinin həyata keçirilməsinə yönəlmiş bir sıra məhkəmə işləri ictimai maraqlar ilə üzləşdikdə, öz işlərinə dair müntəzəm olaraq xarici məhkəmə qərarlarının məcburiliyindən imtina edən ABŞ çəkişmə tərəflərini pis vəziyyətdə qoymuşdur. Bütün bu müddət ərzində ABŞ məhkəmələri davamlı olaraq qarşılıqlı məhkəmə qərarlarının tanınmasında ikitərəfliliyə məhəl qoymamışdır. Bu səbəbdən digər dövlətlərdən fərqli olaraq ABŞ çoxtərəfli xarici məhkəmə işlərinə dair razılaşmanın imzalayan tərəfi olmur və səmərəli istifadə vasitəsi axtarır. Son nəticədə xarici məhkəmələr beynəlxalq xarakterli çəkişmələrdə əhəmiyyətli üstünlüklərini qoruyub saxlayır.

Bu məqalə ABŞ çəkişmə tərəflərinin xarici məhkəmələrə münasibətdə zərərə uğraması və ABŞ məhkəmələrinin məqsədəuyğun olmayan və səriştəsiz həll üsullarının tənqidinə yönəlmişdir. Bundan əlavə, məqalə ABŞ çəkişmə tərəfləri üçün ədalət mühakiməsinin, özünün xarici məhkəmə qərarlarına dair razılaşma layihəsi ilə müşayiət olunan ictimai maraqlar standartının müəyyən olunması vasitəsilə necə başlamasını aşkara çıxaracaq. ABŞ bu mövqeyi qorusa da, ictimai maraqlar siyasəti istisnası qarşılıqlı prinsiplər əsasında yenidən öz təsdiqini tapmalıdır. Amerika Birləşmiş Ştatları çəkişmə tərəflərinin məruz qaldığı ziyana qarşı sövdələşmə gücünü itirir və artıq bunu yenidən əldə etmək vaxtıdır.

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INTRODUCTION

The recognition and enforcement of foreign judgments is a fresh topic.[1] Conventionally, foreigners were subject to local laws because the notion of sovereignty prevented enforcement of foreign judgments beyond their territories.[2] Thus, a conflict of laws question arose as nations began engaging one another in foreign courts.[3] To combat the conflict, Dutch jurists sought a more pragmatic approach "that would reinforce the idea of sovereign independence."[4] The approach envisioned by the Dutch, comity and reciprocity, were later defined by U.S. courts.[5] The idea was that nations will recognize and enforce foreign judgments to the extent that their own judgments will be recognized and enforced.[6] However, problems can and do arise. Nations are reluctant to act first, which punishes litigants.[7] The reverse also suggests truism. Nations acting as a trailblazer to recognize and

[1] Ralf Michaels, *Recognition and Enforcement of Foreign Judgments, in* Max Planck Encyc. of Public Int'l Law at p. 2 (Rüdiger Wolfrum ed., 2009) available at http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2699&context=faculty_scholarship.

[2] Joel R. Paul, *The Transformation of International Comity*, 71 Law and Contemp. Probs. 19, at p. 22 (2008) available at http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1477&context=lcp.

[3] *Id.*

[4] *Id.* The idea theorized by the Dutch arose during the 1600s as the Dutch sought to "unify the Dutch provinces and create a post hoc rationalization for the application of Spanish law in Dutch courts" before independence, *id.* at p. 22.

[5] Michaels, *supra* note 1, at p. 2. *See Hilton v. Guyot*, 159 U.S. 113 (1895) (defined principle of comity and denied French judgment).

[6] Michaels, *supra* note 1, at p. 2.

[7] *Id.*

enforce foreign judgments can negatively impact their own litigants, as evident in the United States.[8]

U.S. courts are increasingly positioning American litigants at the mercy of foreign tribunals. The reason stems from U.S. courts willingness to enforce foreign judgments, namely European judgments, while reciprocity in foreign courts remains extraneous.[9] Foreign nations readily apply the public policy exception to the recognition and enforcement of U.S. judgments, while the United States ignores this protection in favor of foreign judgments.[10] The public policy exception serves as a defense for foreign judgments that are contrary to an enforcing nation's public policy.[11] Because European nations are members to agreed conventions, recognition and enforcement of member judgments is often not questioned.[12] To the contrary, the United States is not party to any agreed upon convention.[13] Although a justification for reciprocity is to persuade nations to enter conventions, the United States has abused this position to the detriment of its litigants.[14]

This note will explore the public policy exception to the recognition and enforcement of foreign judgments, and attempt to explain how the United States has historically approached the exception when recognizing and enforcing foreign judgments and how the current state of affairs remains. The content of the research will focus on pertinent questions surrounding the public policy exception in the United States, such as: Where did the public

[8] *Id.*

[9] *Id.* at p. 3. European nations agree that comity is vague and reciprocity is "too hard to determine to provide firm foundations, *id.*" Additionally, obligation theories or vested rights to the enforcement of foreign judgments begs the question of "when such obligations or rights have been duly acquired, *id.*" As such, European nations enter conventions that detail requirements of jurisdiction, notice, and "compatibility with the enforcing [nation's] public policy, *id.*" Paul, *supra* note 2, at p. 28. The United States took the opposite approach. Although abandoning principles of vest-rights in favor of interest-balancing, the United States continued to shape the meaning of comity. Courts were not obligated in applying foreign law that conflicted with U.S. public policy, but "principles of interest-balancing … constrained the courts, *id.*" Thus comity shifted "from a doctrine of deference based upon courtesy to a doctrine of deference based upon obligation," *id.*

[10] Nadja Vietz, *Will Your U.S. Judgment be Enforced Abroad?*, Wash. State Bar News, Mar. 2009, p. 15. Problems with U.S. judgments typically arise in Europe when "the U.S. court lacked jurisdiction, when the defendant was not properly served, or when there are public policy concerns," *id.* at p. 16. Nadja Vietz is a partner at Harris & Moure, PLLC, *id.* at p. 18. She specializes in international commercial litigation and arbitration, *id.* Additionally, she is licensed to practice law in Germany, Spain, and Washington, *id.*

[11] Michaels, *supra* note 1, at p. 7. Nations allowed to "deny recognition to foreign judgments that violate the enforcing [nation's] public policy," *id.*

[12] *Id.* Conventions often contain specific application and sources of public policy that trigger the exception. Because these sources are clearly defined and agreed to, signatory nations have notice of enforceable and non-enforceable judgments, *id.*

[13] Vietz, *supra* note 10, at p. 15.

[14] *Id.*

policy exception stem from and is it important? What factors indicate that the United States has strayed from implementing the public policy exception? Why has the United States disregarded the public policy exception? What does enforcement of U.S. judgments look like abroad? In conclusion, the note will offer a practical solution for the United States that guarantees U.S. litigants a better seat at the transnational litigation table. Specifically, the United States must federalize the public policy standard to create a single, workable application. Additionally, congressional action must be sought to draft a foreign judgment agreement that requires foreign nations to sign under the principle of reciprocity. Until the United States adopts this position, U.S. courts must increase endorsement of the public policy exception and of the principle of reciprocity. This solution provides the United States with leverage to increase its bargaining power as it attempts to safeguard U.S. litigants in transnational civil litigation.

I. BACKGROUND

A. The Public Policy Exception Generally

With the advent of globalization and the increasing network of transnational business organizations, the prospect of litigation is inevitable. As such, it is imperative to ensure transnational litigation is conducted strategically and fairly for all parties involved. When judgments are awarded by one foreign court, the judgment will demand enforcement in a different foreign court. For example, a U.S. litigant is sued in Paris, France by a French business. The U.S. litigant has conducted business in Paris and has a relationship with the French organization giving the French litigant proper jurisdiction to sue in France. If the French court finds for the French litigant, the French litigant will take its French judgment to a U.S. court for enforcement against the U.S. litigant. On the surface, this seems logical and certainly fair. Nevertheless, problems arise when the foreign judgment, like the French judgment, is contrary to U.S. law or offends U.S. public policy.[15]

The public policy exception is an important defense to the recognition and enforcement of foreign judgments. As in the earlier example, when the French judgment is brought to the U.S. for enforcement, a U.S. court will determine whether the French judgment is subsequently enforceable against the U.S. litigant's assets. This is commonly known as the judgment enforcement doctrine.[16] Historically, U.S. courts have been pro-plaintiff in litigation

[15] Paul, *supra* note 2, at p. 24.

[16] Christopher Whytock, *The Enforcement of Foreign Judgments*, 111 Colum. L. R. 1444, p. 1462 (2011). The judgment enforcement doctrine begs the questions of "[s]hould a U.S. court enforce a judgment rendered by another country's court?," *id.* U.S. courts are constitutionally required to treat judgments of sister U.S. states with full faith and credit, *id*. There are no constitutional requires for foreign judgment however, *id*.

controversies, which resulted in the influx of foreign litigants suing in U.S. courts.[17] Foreign nations were just the opposite in that they were defendant friendly, giving U.S. litigants the desire to seek dismissal in U.S. courts for *forum non conveniens*.[18] However, in recent years, foreign nations have become more pro-plaintiff.[19] U.S. litigants have suffered the effects of this shift as they litigate on foreign soil with substantial judgments resulting against them.[20] A U.S. litigant may pursue alternative justice by asserting that the foreign judgment was the product of a deficiency and should be barred from enforcement.[21] One such deficiency may be that the foreign judgment would offend the enforcing nation's concept of public policy if the judgment were enforced.[22] Where enforcement of a foreign judgment would subsequently offend a nation's public policy, the enforcing court may deem the judgment unenforceable.[23]

The public policy exception is an identifiable principle in the United States. The Restatement (Third) of the Foreign Relations Law of the United States recognizes the public policy exception as one of six grounds for non-recognition of foreign judgments.[24] Additionally, a majority of U.S. states adopted the 1962 Uniform Foreign Money-Judgments Recognition Act (UFMJRA), which recognizes the public policy exception; later revised as the 2005 Uniform Foreign-Country Money Judgments Recognition Act (UFCMJRA).[25] Although, given the precedent established in *Erie R.R.*, U.S. federal courts apply state law and precedent to the enforcement of foreign judgments in diversity cases.[26] Yet, most state doctrines were heavily influenced by the decision handed down in *Hilton v. Chilton*.[27] However, recent U.S. court decisions have tended to shift away from *Hilton* precedent.[28]

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[17] *Id.* at p. 1446.

[18] *Id.* at p. 1447. Forum non conveniens doctrine "gives a U.S. court the discretion to dismiss a transnational suit in favor of a more appropriate and convenient foreign judiciary," *id.* at p. 1446.

[19] *Id.* at p. 1447.

[20] *Id.* This is deemed "forum shopper's remorse":

> Having obtained what they wished for—dismissal in favor of a foreign judiciary with a supposedly more pro-defendant legal environment—defendants are encountering unexpectedly pro-plaintiff outcomes, including substantial judgments against them. *Id.*

[21] *Id.*

[22] *Id.* at p. 1473. "The forum non conveniens doctrine does not address the possibilities of … a judgment repugnant to public policy," *id.*

[23] *Id.*

[24] *Id.* at p. 1467.

[25] *Id.* at pp. 1464-65.

[26] *Id.* at p. 1464.

[27] *Id.* at p. 1465.

[28] *See also* Paul, *supra* note 2 (an analysis on the shifting principles of comity in transnational litigation).

i. Hilton v. Guyot

In 1895, the United States Supreme Court acknowledged the principle of "comity" in *Hilton v. Guyot*.[29] Guyot, a French citizen, sought enforcement of a judgment against American citizen, Hilton, in the Southern District of New York.[30] French courts had awarded Guyot a judgment over Hilton.[31] The question before the court was whether or not Guyot's French judgment had a conclusive effect in the United States?[32] In order to address the issue, the Supreme Court first looked at the "conflict of laws" question that arises in cases of transnational law.[33] Because neither treaties nor statutes exist to guide a conflict of laws question, the responsibility is left to the discretion of judicial tribunals.[34] The rights of litigants moving freely across borders are often blurred by an unwillingness to recognize the rights of foreign nations.[35] As such, the Supreme Court opinioned that "no law has any effect, of its own force, beyond the limits of the sovereignty from which its authority is derived."[36] However, the extent to which rights and laws can, and do cross borders rests in the notion of "comity of nations."[37]

Comity is the recognition that one nation affords within its territory to the "legislative, executive, or judicial acts of another nation."[38] It is neither an absolute obligation, nor a courtesy.[39] Comity is granted to a judgment when "it is shown that the foreign court is a court of competent jurisdiction, and that the laws and public policy of the forum state and the rights of its residents will not be violated."[40] Some jurists might suggest that comity is a "matter of paramount moral duty" because otherwise courts would prefer the laws of their nation to that of another.[41] Chief Justice Story, adopting the words of Chief Justice Taney, summarized the idea of comity as:

> The comity thus extended to other nations is no impeachment of sovereignty. It is the voluntary act of the nation by which it is offered,

[29] *Hilton v. Guyot*, 159 U.S. 113 (1895).
[30] *Id.* at p. 114.
[31] *Id.*
[32] *Id.* at pp. 162-63.
[33] *Id.* at p. 163. Monrad G. Paulsen and Michael I. Sovern, *Public Policy in the Conflict of Laws*, 56 Colum. L. Rev. 969, 969 (1956). Conflict of law questions arise in transnational litigation when the law of one country does not agree with the law of another country, *id*. Deciding which law to implement, as between a forum nation and an enforcing nation, is often limited by a public policy exception, *id*.
[34] *Hilton*, 159 U.S. at p. 163.
[35] Paulsen, *supra* note 33, at p. 969.
[36] *Hilton,* 159 U.S. at p. 163.
[37] *Id.*
[38] *Id.* at p. 164.
[39] *Id.* at p. 163.
[40] *Cunard S.S. Co. Ltd. v. Salen Reefer Servs. AB*, 773 F.2d 452, 457 (2d Cir. 1985).
[41] *Hilton*, 159 U.S. at p. 165.

> and is inadmissible when contrary to its public policy, or prejudicial to its interests. But it contributes so largely to promote justice between individuals, and to produce a friendly intercourse between the sovereignties to which they belong, that courts of justice have continually acted upon it as a part of the voluntary law of nations.[42]

Before comity is applied, however, it is necessary to consider whether foreign judgments comport with jurisdiction, due notice, and are clear of fraud.[43] The comity of nations can be an intelligible and practical principle. Difficulty may arise however when comity is not afforded, leaving foreign judgments challenged and unresolved. Namely, questions arise as to whether or not the cause of action will be tried anew?[44] Additional concerns might include: (1) Is justice really served if the defendant is left to try the merits of the case? (2) Will evidence be preserved? (3) Have witnesses passed? While these questions trigger alarm in many nations, others are hardly disturbed.

According to the June 15, 1629, French royal ordinance, judgments rendered in foreign nations will have no effect in their [France] nation.[45] Defendant Hilton cited the French royal ordinance in his U.S. appeal, reasoning that the French court would have tried the case anew had roles been reversed.[46] Justice Story proclaimed, "if a civilized nation seeks to have the sentences of its own court of any validity elsewhere, they ought to have a just regard to the rights and usages of other civilized nations …"[47] Additionally, Justice Cooley suggested, "true comity is equality. We should demand nothing more and concede nothing less."[48] The United States therefore reasoned that since a similar U.S. judgment would not be enforced in France, then the French judgment ought not be enforced in the United States.[49] The Supreme Court ultimately ruled in favor of mutuality and reciprocity when it failed to recognize the French judgment.[50] However, notwithstanding the importance of the *Hilton* decision, some scholars suggest "reciprocity is no longer a widespread requirement for enforcement of foreign judgments."[51] When reciprocity is lacking, the inquiry of whether or not the public policy

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[42] *Id.*

[43] *Id.* at p. 166.

[44] Brandon B. Danford, *The Enforcement of Foreign Money Judgments in the United States and Europe: How Can We Achieve A Comprehensive Treaty?*, 23 Rev. Litig. 381, p. 382 (2004).

[45] *Hilton,* 159 U.S. at p. 118.

[46] *Id.* If the United States had heard the case and issued judgment in favor of Hilton, once Hilton took this judgment to France, French courts would have refused to enforce the U.S. judgment and tried the case over, *id.*

[47] *Id.* at p. 191.

[48] *Id.* at p. 214.

[49] *Id.* at p. 228.

[50] *Id.*

[51] Whytock, *supra* note 16, at p. 1468.

exception will nullify a foreign judgment becomes important. Because U.S. courts no longer utilize the reciprocity holding of *Hilton*, the public policy exception serves as a critical defense for U.S. litigants in transnational litigation. Issues still are raised as to proper standards or measures of public policy offenses that would trigger use of the exception.

ii. Standards for the Public Policy Exception

The recognition and enforcement of foreign judgments is not governed by a common treaty or statute.[52] Nations have identified and agreed to common principles -that include defenses for recognition and enforcement of foreign judgments.[53] First, the court rendering the judgment must maintain proper jurisdiction.[54] The rendering court typically decides the law determining whether or not proper jurisdiction exists.[55] However, just because one nation exerts jurisdiction by its law, does not make it binding on another.[56] Second, a judgment must be "valid, final, and on the merits" so as to protect res judicata proceedings.[57] Third is the understanding that foreign judgments will be void when the rendering court violates fundamental procedures.[58] Important fundamental procedures include adequate notice, proper service, and the opportunity to be heard.[59] Finally, states can deny recognition and enforcement of foreign judgments when enforcement would violate public policy.[60]

The public policy exception exists for many reasons. One reason being that the requested court will not practice "*revision au fond*".[61] Therefore, limitations or guidelines must be adopted to restrict judgments that violate public policy. For example, Middle Eastern conventions, such as the 1983 Arab Convention on Judicial Co-operation ("Riyadh Convention") and the 1995 Protocol on the Enforcement of Judgments Letters Rogatory and Judicial Notices ("the GCC Protocol"), provide member states with the right of refusal when judgments diverge from Islamic laws.[62] Other regimes specify judgments that

[52] *Hilton*, 159 U.S. at p. 163.
[53] Michaels, *supra* note 1, at p. 6.
[54] *Id.*
[55] *Id.*
[56] *Id.*
[57] *Id.* at p. 7.
[58] *Id.*
[59] *Id.*
[60] *Id.*
[61] *Id.* The "requested court" is the court asked to recognize and enforce a foreign judgment, *id*. "Revision au fond" is the practice of the requested court to review a foreign judgment, either under their own laws or under the laws of another state, convention, or treaty, *id*.
[62] *Id.* Pieter Sanders, *Quo Vadis Arbitration?: Sixty Years of Arbitration Practice* 56 (Kluwer Law Int'l 1999). The Riyadh Convention was signed by the 21 members of the Arab League, *id*. However, only 12 ratified the convention: Iraq, Jordan, Libya, Mauritania, Morocco, Palestine, Saudi Arabia, Syria, Tunisia, and the Yemen Republic, *id*. Ilias Bantekas, *An Introduction to*

automatically violate public policy, such as punitive damages.[63] Further, in South Africa and British Columbia, judgments that are contrary to domestic industry practices are said to violate public policy.[64] One principle typically remains the same across the board; "[j]udgments that violate international law must not be enforced or even recognized."[65]

In the United States, a foreign judgment is said to violate public policy when recognition "injure[s] the public health, the public morals, the public confidence in the purity of the administration of law, or…undermine[s] the sense of security for individual rights, whether of personal liberty or of private property, which any citizen ought to feel."[66] The United States is not concerned with foreign judgments that merely differentiate from local public policy.[67] Rather, refusal is tolerated when the foreign judgment "contravenes a crucial state public policy affecting a fundamental interest of the forum."[68] Few scholars have explored the public policy exception in depth. However, one scholar, Karen Minehan, does identify three common categories in which U.S. courts are likely to apply the public policy exception.[69]

First, recognition and enforcement of foreign judgments will fail for want of public policy when the judgment rewards a wrongdoer under the criminal justice system.[70] In *Jaffe v. Snow*, a wife's Canadian tort judgment was denied given her husband's status as a fugitive of justice.[71] The court held that

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International Arbitration p. 243 (Cambridge Uni. Press 2015). The Riyadh Convention guides signatory nations in the recognition and enforcement of foreign awards, *id*. Specifically, any award that contradicts "the Islamic sharia, the public order or the rules of conduct of the requested party" will fail for want of public policy, *id*. The reasoning stems from the recognition that Muslim public policy is distinguished from that of non-Muslim nations, *id*. Gulf Cooperation Council, Encyc. Britannica. The GCC members include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates, *id*. Richard Clark, *The Dispute Resolution Review* p. 669 (4th ed. 2012). The GCC Protocol was issued by the Courts of the Member States of the Arab Gulf Cooperation Council, *id*. The GCC Protocol allows a signatory nation to refuse enforcement of an award from another nation if the award sough is contrary to shariah law or public order, *id*.

[63] *Id.*

[64] *Id.*

[65] *Id.*

[66] Karen E. Minehan, *The Public Policy Exception to the Enforcement of Foreign Judgments: Necessary or Nemesis*, 18 Loy. L.A. Int'l & Comp. L. Rev. 795, p. 799 (1996). *See also Goodyear v. Brown,* 155 Pa. 514 (1893) (holding that public policy was violated when the secretary of internal affairs commissioned his own land warrant).

[67] Minehan, *supra* note 66, at p. 799; *See Sw. Livestock & Trucking v. Ramon*, 169 F.3d 317 (5th Cir. 1999) (holding that the district court is not permitted to refuse recognition of a judgment just because that judgment offends Texas public policy).

[68] Minehan, *supra* note 66, at pp. 799-800.

[69] *Id.* at p. 804.

[70] *Id.* at p. 805.

[71] *Id. Jaffe v. Snow*, 610 So.2d 482 (Fla. Dist. Ct. App. 1992).

allowing the wife to recover for loss of consortium would permit recovery of a wrongdoer, and thus violate public policy.[72]

Second, recognition and enforcement will fail for want of public policy when judgments are contrary to the United States Constitution.[73] For instance, in *Matusevitch v. Telnikoff*, a British libel judgment was denied because the standard for libel in England not only contravened Maryland public policy, but also the First and Fourteenth Amendments.[74] Under Constitutional law, a plaintiff is required to prove actual malice in a libel suit.[75] British law requires the reverse; the defendant bears the burden to prove the truth behind the statements.[76] Refusal of foreign judgments is thus "constitutionally mandatory" when judgments are contrary to laws guaranteed under the Constitution.[77]

Finally, recognition and enforcement will fail for want of public policy when judgments reflect penal sanctions.[78] In *Republic of Phil. v. Westinghouse Elec. Corp.*, the Republic of Philippines sought recovery from a U.S. corporation's alleged interference with the Republic president's fiduciary duty.[79] The Republic's judgment was considered penal even under New Jersey's narrow public policy definition.[80] The penal test in New Jersey concerns "whether the wrong sought to be redressed is a wrong to the public or a wrong to the individual."[81] The Republic sought public damages as deterrence for the president's prior wrongdoings and exploitation.[82] The holding affirmed this motive was against state public policy because New Jersey had no intention of crippling the corporation with sanctions for actions that would never reoccur.[83] Even so, "courts of no country execute the penal laws of another."[84]

Although the United States has successfully applied the public policy exception, application of the exception becomes more problematic when

[72] *Id.* at p. 488.

[73] Minehan, *supra* note 66, at 805.

[74] *Id.* at 806. *Matusevitch v. Telnikoff*, 877 F. Supp. (D.D.C. 1995).

[75] *N.Y. Times v. Sullivan*, 376 U.S. 254, 280 (1964).

[76] *Matusevitch*, 877 F. Supp. at p. 4. *See also Abdullah v. Sheridan Square Press, Inc.*, 154 F.R.D. 591 (S.D.N.Y. 1994) (British libel judgment denied for contravening First Amendment protections).

[77] *Bachchan v. India Abroad Publications*, 154 Misc. 2d 228, p. 231 (N.Y.S. 1992) (U.S. court denied English libel judgment on the grounds that the libel standards differed from those guaranteed under the First Amendment).

[78] Minehan, *supra* note 66, at p. 807.

[79] *Id. Republic of Phil. v. Westinghouse Elec. Corp.*, 821 F. Supp. 292, p. 298 (D.N.J. 1993).

[80] *Id.* at p. 296.

[81] *Id.* at p. 297.

[82] *Id.* at p. 298.

[83] *Id.* at p. 300.

[84] *Id.* at p. 295 (quoting Chief Justice John Marshall in *The Antelope*, 23 U.S. 66, 123, 6 L.Ed. 268 (1825)).

foreign judgments do not fall within one of these three categories. It is then, and more often than not, that the United States disregards the public policy exception for various reasons.

iii. The Modern Trend of the Public Policy Exception in the United States

The recognition and enforcement of foreign judgments in the United States appear in a variety of situations—both domestically and internationally. First, the United States recognizes and enforces the judgments issued by courts of other states. Full Faith and Credit is afforded to these judgments under the Uniform Enforcement of Foreign Judgments Act.[85] The Act recognizes in each state the judicial proceedings of another state.[86] Second and the primary focus of this note, the United States recognizes and enforces judgments issued by foreign nations. The United States has increasingly taken issue with this second type of enforceable judgment.

Unlike most foreign nations, the United States is not party to any multilateral agreement on the governing of foreign judgments.[87] Outside the United States, multilateral agreements such as The Brussels Convention, adopted in 1968, allow European nations to automatically recognize and enforce judgments of member nations.[88] U.S. judgments are not given reciprocity and "receive less favorable treatment in Europe than do judgments emanating from courts of Brussels Member States."[89] However, in 1992, the United States made a proposal to The Hague Conference on Private International Law to speak to this concern.[90]

The Hague Conference is composed of eighty member nations.[91] The Conference serves as a "melting pot" of legal systems attempting to develop legal security among its members and nonmembers.[92] Given the success of the Brussels Convention among European nations, the United States desired a similar feature, thus proposing an initiative in 1992 to the 17th Session of The Hague Conference.[93] The proposal sought a global convention on jurisdiction

[85] U.S.C.A. Const. Art. IV §1; Revised Unif. Enforcement of Foreign Judgments Act (1964).

[86] *Id.*

[87] Eric B. Fastiff, *The Proposed Hague Convention on the Recognition and Enforcement of Civil Commercial Judgments: A Solution to Butch Reynolds's Jurisdiction and Enforcement Problems*, 28 Cornell Int'l L.J. 470 (1995).

[88] Lindsay Loudon Vest, *Cross-Border Judgments and the Public Policy Exception: Solving the Foreign Judgment Quandary by Way of Tribal Courts*, 153 U. Pa. L. Rev. 797, p. 798 (2004).

[89] Danford, *supra* note 44, at p. 398 (the U.S. State Department likewise holds this view).

[90] Vest, *supra* note 88, at p. 806.

[91] Hague Conference, http://www.hcch.net/index_en.php?act=text.display&tid=1 (last visited Aug. 4, 2015).

[92] *Id.*

[93] Vest, *supra* note 88, at p. 806. *See also* Danford, *supra* note 44, at p. 392 (regarding the Brussels Convention as successful for the enforcement of judgments because it removed difficulty and uncertain litigation procedures).

and the recognition and enforcement of foreign judgments.[94] However, the United States did not estimate that over two decades would pass with little to no steps taken towards the initiative.[95]

The question then becomes, what is the United State's current system for the recognition and enforcement of foreign judgments and, is this technique advantageous and equitable? Given the shift away from reciprocity requirements, the public policy exception becomes an important safeguard for U.S. litigants. However, an interesting distinction exists between the United States' stance on the public policy exception in comparison with European nations. Is the United States weakening its application of the public policy exception to the detriment of its litigants? In order to answer in the affirmative, it is critical to analyze how U.S. judgments are enforced abroad in comparison with the enforcement of foreign judgments on U.S. soil.

II. ANALYSIS

A. The Concerning Nature of the Public Policy Exception in the United States

Since 1895, the United States has seemingly withdrawn from the principle of reciprocity established in *Hilton v. Guyot* and adopted a more general idea of comity.[96] The reason for this shift is important as it relates to U.S. litigants. Some scholars suggest that the shift comes at a time when "comity demands respect for the market."[97] Even so, the United States' desire to have its judgments enforced by foreign nations, regardless of how those nations treat U.S. judgments, is likely fixed on the idea of leveraging a common convention. Since the United States is not a member to any multilateral body, it does not have automatic recognition and enforcement, and often sees its judgments denied.[98] However, the United States is approaching the problem entirely wrong. It is as though the United States believes the idiom of "I'll scratch your back, if you scratch mine" applies to foreign judgments. Many factors contribute to this notion of the United States retreating from the concept of reciprocity.

i. State Centered Public Policy

In 1938, the United States Supreme Court held that "except in matters governed by Federal Constitution or by acts of Congress, the law to be applied

[94] *Id.*

[95] *Id.*

[96] *Hilton v. Guyot*, 159 U.S. 113 (1895). Juan Carlos Martinez, *Recognizing and Enforcing Foreign Nation Judgments: The United States and Europe Compared and Contrasted*, 4 J. Transnat'l L. & Pol'y 49, 53 (1995).

[97] *E.g.* Paul, *supra* note 2, at 37. "[T]he Court sacrificed an important U.S. public policy embodied in U.S. statutes to the requirements of the global market," *id.*

[98] Vietz, *supra* note 10, at p. 15.

in any case is law of the state."[99] The court was essentially rejecting the idea of a federal common law in favor of state law.[100] The application of state law to foreign judgments becomes complicated, however.

Currently, state courts are free to govern foreign litigation by their own definition.[101] For example, in New Jersey, the appellate court held that foreign money judgments may be filed and enforced without court authorization.[102] The foundation for enforcement comes from the Foreign Country Money-Judgment Recognition Act (FCMJRA).[103] Judge Yannotti, commenting on the Act, stated, "because judgments entitled to full faith and credit may be enforced in New Jersey without a prior determination by the Superior Court recognizing those judgments, the same procedure is available for judgments of foreign countries."[104] The New Jersey court noted that as long as due process is met, the recognition and enforcement is not improper.[105]

The Hague Conference proposal would certainly work to bind federal courts, but when litigation does not concern federal question or diversity of citizenship, matters become more complicated.[106] Having a dual system of foreign litigation, in which states enforced their own public policies, while federal courts recognized foreign judgments under a different standard, would create confusion and unpredictability; not to mention foreign nations would never support such a proposal.[107] It appears that a favorable seat at the multilateral table for the United States is contingent upon a federalized public policy standard.

In 2005, the American Law Institute developed a comprehensive project, The Proposed Federal Statute on the Recognition and Enforcement of Foreign Judgments.[108] The project initiated a federalization effort of foreign judgments.[109] Specifically, the project proposed: (1) the federal government,

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[99] *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, p. 78 (1938).

[100] *Id.*

[101] Vest, *supra* note 88, at p. 808.

[102] Robert G. Seidenstein, *Foreign Judgments Get Go-Ahead May be Filed Without Court Ok*, The NJ Lawyer Weekly Inc., June 6, 2005, at p. 3.

[103] *Id.*

[104] *Id.*

[105] *Id.*

[106] Vest, *supra* note 88, at p. 808.

[107] *Id.*

[108] The American Law Institute, *Recognition and Enforcement of Foreign Judgments: Analysis and Proposed Federal Statute*, (2005) available at, https://ali.org/publications/show/recognition-and-enforcement-foreign-judgments-analysis-and-proposed-federal-statute/#_tab-volumes. The American Law Institute is an independent organization that drafts and publishes scholarly work such as the Restatement of the Law, Model Codes, and Principles of Law, *id.*

[109] Ronald A. Brand, *Fed. Judicial Ctr. Int'l Litig. Guide: Recognition and Enforcement of Foreign Judgments* 29 (2012) available at http://www.fjc.gov/public/pdf.nsf/lookup/brandenforce.pdf/$file/brandenforce.pdf.

shared between Congress and the Executive, has the power to govern foreign judgments and, (2) a uniform federal statute is the best way to address relations with foreign nations.[110] As Justice Sutherland said, "in respect of our foreign relations generally, state lines disappear."[111] Still, the problem with this shift is the standard currently afforded to the public policy exception.

ii. Narrow Standards for Application

U.S. courts have narrowly defined the public policy exception, making its application difficult and rare.[112] For example, in *Ackerman v. Levine*, a West German plaintiff sought enforcement of a judgment against a New York defendant.[113] The defendant argued that the German judgment violated New York public policy.[114] The Court of Appeals for the Second Circuit held otherwise, narrowing the scope of the public policy exception.[115] The reason for this narrow scope rests upon a compromise between res judicata and fairness to litigants.[116] However, U.S. courts seem to distribute more weight to the notion of res judicata.

Recently, the District Court of Columbia defined the public policy exception in *BCB Holdings Ltd. v. Gov't of Belize* as "extremely narrow" and applicable "only where enforcement would violate the forum state's most basic notions of morality and justice."[117] The public policy must be defined and dominant so as to reference laws and legal precedents, not alleged public interests.[118] The court went further to say that the public policy exception, although frequently raised as a defense, is hardly successful.[119] As such, foreign judgments hardly fall within the purview of the public policy exception making their enforcement more likely.

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[110] *Id.*

[111] Willis L. M. Reese, *The Status in This Country of Judgments Rendered Abroad*, 50, Colum. L. Rev. 783, 788 (1950) (quoting Justice Sutherland, *U.S. v. Belmont*, 301 U.S. 324 (1937)).

[112] Minehan, *supra* note 66, at p. 799. *See also* Danford, *supra* note 44, at p. 431 (noting that the public policy exception is so narrowly construed by the courts that "it now must be characterized as a defense without meaningful definition").

[113] 788 F.2d 830, p. 834 (2d Cir. 1986).

[114] *Id.*

[115] *Id.*

[116] *Id.* at p. 841.

[117] 110 F. Supp.3d 233, p. 250 (D.C. Cir. June 24, 2015). *See also Karen Maritime Ltd. v. Omar Intern., Inc.*, 322 F. Supp.2d 224, p. 226 (E.D.N.Y. 2004) (quoting *Europcar Italia, S.p.A. v. Maiellano Tours, Inc.*, 156 F.3d 310, p. 315 (2d Cir. 1998) public policy is applied "only where enforcement would violate our most basic notions or morality and justice").

[118] *BCB Holdings Ltd.*, 110 F.Supp.3d at p. 250.

[119] *Id. See also Asignacion v. Rickmers Genoa Schiffahrtsgesellschaft mbH & Cie KG*, 783 F.3d 1010 (5th Cir. 2015) (holding that the public policy defense of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards did not preclude enforcement of arbitral award).

B. The Effect of the United States' Public Policy Stance

The effect of U.S. courts enforcing foreign judgments absent reciprocity and in disregard of public policy is detrimental to U.S. litigants. The United States does not make it a practice to discriminate in favor of their citizens against foreign participants.[120] Rarely are foreign judgments denied on public policy grounds in the United States.[121] Thus, the concern becomes whether U.S. litigants receive fair and equitable justice in the realm of global litigation?

The U.S. Constitution finds no application in foreign tribunals. When U.S. courts elect to enforce a foreign judgment while the same proceeding abroad would fail, the United States has denied itself due process.[122] U.S. courts have generally adopted the notion that all foreign judgments will be enforced "regardless of the law under which acquired."[123] Although U.S. courts identify the public policy exception as a defense to comity, they have failed to apply the defense in comparison with foreign nations.[124]

The Brussels Convention allows European nations to recognize and enforce foreign judgments without public policy apprehension because these nations have existing relations.[125] The concern that one EU nation would enforce a judgment contrary to another EU nation's public policy is rare.[126] However, since the United States is not a party any multilateral agreement, like the Brussels Convention, foreign nations are more likely to apply the public policy exception against U.S. judgments.[127] European nations are guided by public policy standards outlined in Article 6 of the European Convention on Human Rights and case law from the European Court of Justice (ECJ).[128] Although the public policy exception is discretionary, and nations may choose to adopt their own national law when enforcing foreign judgments, most European nations abide by one common standard.[129] Historically, the ECJ has denied application of the public policy clause.[130] Yet, in recent cases, namely

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[120] Reese, *supra* note 111, at p. 785.
[121] Brand, *supra* note 109, at p. 21.
[122] Reese, *supra* note 111, at p. 796.
[123] *Id.* at p. 797.
[124] *Id.*
[125] Vest, *supra* note 88, at p. 800.
[126] Burkhard Hess and Thomas Pfeiffer, *Interpretation of the Public Policy Exception as referred to in EU Instruments of Private International and Procedural Law,* at 13 PE 453.189 (2011) available at, http://www.europarl.europa.eu/RegData/etudes/etudes/join/2011/453189/IPOL-JURI_ET(2011)453189_EN.pdf.
[127] Sarah Garvey, *Brussels Regulation (Recast): Are you Ready?*, allenovery.com, Mar. 18, 2015, http://www.allenovery.com/publications/en-gb/Pages/BRUSSELS-REGULATION-(RECAST)-ARE-YOU-READY.aspx (last visited May 9, 2016).
[128] Hess, *supra* note 126, at p. 13.
[129] *Id.*
[130] Aurelio Lopez-Tarruella, *The Public Policy Clause in the System of Recognition and Enforcement of the Brussels Convention*, The European Legal Forum 122 (2000).

Krombach v. Bamberski, the court has adopted an alternative trend, which seeks to establish principles of "ordre public" that national judges preserve.[131] While this new trend asserts reasonable application of the public policy exception within European member states, it is only rational to assume a heighten application of the exception to non-member states, i.e. the United States.

One of the leading public policy violations inhibiting enforcement of U.S. judgments is a punitive damage award.[132] According to Nadja Vietz, few European nations will enforce U.S. judgments because punitive damages attached to the judgment are excessive.[133] In addition, Vietz asserts that U.S. courts ignore international law and exercise "extraterritorial jurisdiction."[134] Whether a foreign nation will recognize and enforce a U.S. judgment is determinative of the local law in that nation, as well as international comity.[135] Most European nations will deny U.S. judgments that contravene their laws.[136] Conversely, U.S. courts may not deny a foreign judgment merely because it differs from a state's local policy.[137] U.S. litigants often feel the effect of these differing court values.

i. Reynolds v. The Int'l Amateur Athletic Federation

A leading case exhibiting this injustice is *Reynolds v. The Int'l Amateur Athletic Federation* (IAAF).[138] Butch Reynolds, Jr., an Olympian, tested positive in a French lab for a performance-enhancing drug, which prohibited him from competing in the 1992 Olympics.[139] Reynolds submitted a subsequent negative drug test but, IAAF later denied the result.[140] Reynolds sued IAAF in federal district court in Ohio, only to have his claim dismissed on appeal by

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[131] *Id.* "Ordre public" is a safeguard for European Member States when public policy becomes a concern, *id*. Case C-7/98, Krombach v. Bamberski, 2000 E.C.R. I-1956. The question concerning the recognition and enforcement of a foreign judgment pursuant to Article 27, Section 1 of the Brussels Convention arose between a French and German litigant, *id*. Article 27, Section 1 outlines the public policy exception if a judgment is contrary to local public policy, *id*. The court was seeking to interpret the term "public policy" and held:

> [W]hile it is not for the Court to define the content of the public policy of a Contracting State, it is none the less required to review the limits within which the courts of a Contracting State may have recourse to that concept for the purpose of refusing recognition to a judgment emanating from a court in another Contracting State.

Id. The court drew on common principles which member nations signed onto in the form of treaties, *id.*

[132] Vietz, *supra* note 10, at p. 15.

[133] *Id.*

[134] *Id.*

[135] *Id.*

[136] *Id.*

[137] Minehan, *supra* note 66, at p. 799.

[138] Fastiff, *supra* note 87, at 489. *Reynolds v. The Int'l Amateur Athletic Federation*, 23 F.3d 110 (6th Cir. 1994).

[139] Fastiff, *supra* note 87, at p. 489.

[140] *Id.*

the Sixth Circuit.[141] Reynolds proceeded to court a second time and was granted a temporary restraining order that prevented IAAF from banning him in competition.[142] Although Reynolds was able to compete, he lost significant funding.[143] Reynolds sought damages in the Southern District of Ohio; $6 million in compensatory and $18 million in punitive.[144] When Reynolds attempted to enforce his judgment in the United States, IAAF appealed and the Sixth Circuit reversed the judgment and dismissed the claim.[145]

Reynolds intentionally brought his judgment to the United States because foreign nations deny U.S. judgments with substantial punitive damages as it conflicts with their notion of public policy.[146] If the United States had been a party to a multilateral agreement, Reynolds would have faired better in having his judgment enforced abroad. Yet, Reynolds was wedged between valid and invalid U.S. and foreign judgment enforcement. For example, the United States would have recognized Reynolds' judgment, but could not enforce for lack of jurisdiction.[147] Additionally, jurisdiction was adequate abroad, however the judgment failed for public policy concerns.[148]

ii. Principle of Res Judicata

To understand why U.S. courts enforce foreign judgments absent reciprocity is to understand the principle of res judicata. Res judicata "is the policy favoring the enforcement and recognition of judgments of foreign nations."[149] In recent years, the United States has placed considerable weight on the principle of res judicata in the transnational litigation realm.[150] For U.S. justices, the real public policy concern is "that there be an end of litigation that those who have contested an issue shall be bound by the result of the contest, and that matters once tried shall be considered forever settled as between the parties."[151] Res judicata is engrained in the principles of common law, creating a substantial influence in the minds of U.S. justices.[152]

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[141] *Id.* at p. 490.

[142] *Id.*

[143] *Id.*

[144] *Id.*

[145] *Id.* at p. 491.

[146] Vietz, *supra* note 10, at p. 18. *See also* Hess, *supra* note 126, at 146 (citing Cass. Civ. 1ère, 1er décembre 2010, n° 09-13303, Recueil Dalloz 2011, 423 note Licari (French court denied recognition and enforcement of a U.S. judgment on the grounds that the judgment contained punitive damages contrary to French public policy)), at 147 (citing Junker in MüKo-BGB, 2010, Art. 26 Rom II-VO para 21, 23., (German legal literature refused excessive damages, such as treble damages that are recognized by U.S. courts)).

[147] Fastiff, *supra* note 87, at pp. 491, 493.

[148] *Id.*

[149] Reese, *supra* note 111, at p. 785.

[150] *Id.* at p. 800.

[151] *Id.* at p. 784.

[152] *Id.* at pp. 784-85.

Although limited scholarship, another theory attempting to explain U.S. court's foreign judgment enforcement practice is the United States desire to join a multilateral recognition and enforcement agreement.[153] If the United States were party to such an agreement, U.S. litigants would not only receive equitable justice in comparison to their European counterparts, but would likely see their judgments enforced more often than current trends.[154] However, before reaching an enforcement compromise, many foreign nations will require reciprocity from the rendering court.[155] A U.S. judgment must therefore show that similar effect would be granted to a foreign judgment in a U.S. rendering court.[156] Thus, the United States has continually enforced foreign judgments under the general comity notion with little to no reciprocity from other nations.[157]

Reciprocity is the countervailing policy to comity that was crucial to the Supreme Courts ruling in *Hilton v. Guyot*.[158] Reciprocity is the understanding that judgments rendered in one nation will be afforded the same effect in another nation.[159] In other words, the classic idiom of "ill scratch your back, if you scratch mine." U.S. courts appear to have exchanged the principle of reciprocity with comity and res judicata.[160] As a result, the United States continues to scratch at the backs of foreign nations by enforcing judgments that are counter to U.S. public policy. Yet, foreign nations do not reciprocate and currently enjoy their litigation advantage because let's face it, who doesn't enjoy a free favor? Lindsay Vest, quoting Professor Kevin Clermont, described the effect of this inequitable litigation practice on U.S. litigants:

> In short, Americans are being whipsawed. Not only are they still subject in theory to the far-reaching jurisdiction of European courts and the wide recognition and enforceability of the resulting European judgments, but also U.S. judgments tend in practice to receive short shrift in European courts.[161]

U.S. courts have taken to recognize the injustice faced by their litigants and have sought solutions, one being the 1992 proposal to The Hague

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[153] Danford, *supra* note 44, at p. 390. The Brussels convention has been regarded as "the single most important private international law treaty in history," *id*. It serves as a "federal system of recognition of judgments" within the European Community and moves judgments freely among member nations, *id*. The United States has grown envious.

[154] *Id.* at p. 400 (argues that "[m]ember [s]tates have a significant advantage over U.S. parties when it comes to judgment enforcement").

[155] *Id.* at p. 389.

[156] *Id*.

[157] *Id.* at p. 387.

[158] *Id.* at p. 785. *Hilton v. Guyot*, 159 U.S. 113, p. 162 (1895).

[159] Reese, *supra* note 111, at p. 785.

[160] Danford, *supra* note 44, at p. 387.

[161] Vest, *supra* note 88, at p. 806.

Conference.[162] The original proposal began in 1992, with preliminary work extending into 1996.[163] From 1997 to 1999, preparation for a preliminary draft was conducted.[164] 2003 marked the start of the Working Group's drafting process of the proposal into an agreeable document, which continues through present day.[165] Needless to say, work has sufficiently been stalled on any judgments project. Twenty-three years have passed and the proposal has yet to be ratified. Is there a satisfactory reason for this delay?

iii. Barriers to Ratification

The world is composed of many judicial systems. While organizations like The Hague Conference attempt to categorize each system into a useful global structure, nations will always remain reluctant.[166] One barrier to ratification of a multilateral convention is an enforcing nation's unwillingness to enforce a rendering nation's judgment that is counter to its concepts of right and wrong.[167] For the United States, ratification of a transnational agreement may mean recognizing conflicting and unfavorable foreign judgments.[168] This hesitation is combatable however as courts reserve the right to refuse judgments that conflict with their public policies.[169] Thus, the public policy defense becomes an integral part of multilateral conventions.[170] Still, a different category of barriers exists that triggers greater apprehension to ratification of a multilateral convention.[171]

First, procedural barriers can contravene public policies.[172] A procedural barrier that is typically triggered is jurisdiction.[173] Butch Reynolds met jurisdictional challenges in his claim against IAAF.[174] The judgment rendered to Reynolds was void because jurisdiction over IAAF was invalid.[175] U.S. courts have unanimously determined that jurisdiction and all procedural conditions must be satisfied to ensure fair trials for litigants.[176] Second, and

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[162] Danford, *supra* note 44, at p. 402.

[163] *The Judgments Project*, The Hague Conference on Private International Law, http://www.hcch.net/index_en.php?act=text.display&tid=150 (last visited Aug. 3, 2015).

[164] *Id.*

[165] *Id*. The Council on General Affairs and Policy is charged with operations of The Hague Conference, *id*. The Working Group on the Judgments Project is subgroup charged with drafting and implementing the judgments project, *id*.

[166] Danford, *supra* note 44, at pp. 404-05.

[167] Reese, *supra* note 111, at p. 785.

[168] Vest, *supra* note 88, at p. 799.

[169] *Id.*

[170] *Id*.

[171] *Id.* at p. 806.

[172] *Id.* at p. 807.

[173] *Id.*

[174] *Reynolds v. The Int'l Amateur Athletic* Federation, 23 F.3d 110 (6th Cir. 1994).

[175] *Id.*

[176] Michaels, *supra* note 1, at p. 7.

more complex, is substantive barriers.[177] Substantive barriers trigger the public policy concern, however, because the public policy exception is open to discretionary interpretation, the defense has the potential to be abused or ignored.[178]

Another reason for the delay in ratification is the fact that European nations may remain reluctant given the state of U.S. public policy standards.[179] Concern over the state centered public policy exception may give these nations apprehension as to a loose public policy exception.[180] Not to mention, foreign nations likely enjoy their present advantage in transnational litigation as U.S. courts continue to recognize and enforce foreign judgments.

C. A Solution for the United States

Although the public policy exception to the recognition and enforcement of foreign judgments is ultimately discretionary, U.S. courts have abused the system leaving U.S. litigants at a "severe disadvantage" in foreign tribunals.[181] The intent of the public policy exception was to function as a transnational safety net, with the understanding that nations should refuse recognition and enforcement of foreign judgments when public policy is violated.[182] However, overlooking the exception in an attempt to gain leverage in a transnational agreement has left U.S. litigants in a vulnerable position.[183] Perhaps twenty-three years ago, when the United States made its proposal to The Hague Conference, the idea of a transnational agreement seemed more plausible. Yet, foreign nations have maintained an advantage over the United States absent an agreement, making ratification seem irrelevant and frankly, not in their best interest.[184] Therefore, the United States needs a new solution.

The principle of comity and reciprocity identified in *Hilton v. Guyot* provides a critical framework in identifying a new tactic for the United States.[185] In *Hilton*, the court refused recognition and enforcement because the

[177] Vest, *supra* note 88, at p. 807.
[178] *Id.* at p. 808.
[179] *Id.* at p. 800.
[180] Danford, *supra* note 44, at p. 424.
[181] *Id.* at p. 400.
[182] *Id.* at p. 431 (The "public-policy exception in the Brussels Convention has been likened to building a machine with a safety valve.").
[183] *Id.* (argues that empirical data suggests that the U.S. has not "exhibited the rampant denial of enforcement that doubters of the public-policy exception fear"). This contention further supports the idea that the United States has ignored the exception. If the United States is not abusing the public policy as suggested, it is this note's author's opinion that they must be using the exception fairly, minimally, or not at all.
[184] *See also* Vest, *supra* note 88, at p. 800 ("[T]he U.S. is left without a key negotiating chip because, in comparison to other nations, the U.S. historically has been generous in recognizing and enforcing [foreign] judgments.").
[185] *Hilton v. Guyot*, 159 U.S. 113, p. 162 (1895).

French court would not have recognized a reciprocal U.S. judgment.[186] Following *Hilton*, the court in *Johnston v. Compagnie Generale Transatlantique* rejected the reciprocity standard and adopted a more general application of comity.[187] Many states agreed with the *Johnston* court, reasoning that the reciprocity requirement punished the judgment holder "for the policy of his government."[188] States did not entirely disregard the *Hilton* court, but rather adopted the requirements of jurisdiction, proper service and notice, fair trial procedures, and clear of fraud.[189] While these requirements are decent, U.S. litigants continue to remain defenseless in foreign litigation because foreign nations are not simultaneously adopting these practices. Instead, foreign nations apply the public policy exception, which U.S. courts have become reluctant to do.

In order for U.S. litigants to fair evenly in transnational litigation, the United States must federalize the public policy standard.[190] Under *Erie R.R. Co. v. Tompkins*, states sitting in diversity jurisdiction apply state law.[191] States have differing notions of public policy standards, which compromises any uniform enforcement standard.[192] Foreign nations will be more inclined to sign a recognition and enforcement agreement under a single U.S. public policy standard.[193] Therefore, the United States requires congressional action to draft a federalized public policy standard. Subsequently, the United States can implement its own foreign judgment agreement requiring nations to sign under the principle of reciprocity.[194] Clearly, an agreement under the existing

[186] *Id.*

[187] Martinez, *supra* note 89, at p. 53. *Johnston v. Compagnie Generale Transatlantique*, 242 N.Y. 381, 383-84 (N.Y. 1926).

[188] Martinez, *supra* note 89, at p. 53.

[189] *Id.* at pp. 53-4.

[190] Danford, *supra* note 44, at p. 426.

[191] *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938).

[192] Yuliya Zeynalova, *The Law on Recoginition and Enforcement of Foreign Judgments: Is It Broken and How Do We Fix It?* 31 Berkeley J. Int'l L. 150, p. 195 (2013) (argues that States applying their own public policy standards is inconsistent with *Hilton's* notion of comity). Although Hilton was decided before Erie, the idea of comity resided within a federal structure, *id.*

[193] See Danford, *supra* note 44, at 425. With current state centered public policy standards, foreign nations must assess fifty-one matters of law, *id.* If a single federalized application controlled the enforcement of judgments, "it is believed that Congress would better facilitate the movement of U.S. judgments abroad and increase their value," *id.*

[194] Zeynalova, *supra* note 192, at 172. There is no "empirical data on the need for [or against] a judgments convention," *id.* However, the 1998 Study Group for the U.S. Department of State opinion that no "great need for a convention" exists is outdated, *id.* Scholars generally opinion that U.S. judgment suffer great risk abroad; this given the substantial rise in transnational litigation disputes between 2000-2010, *id.* at 172-73. The U.S. Department of Commerce and Justice claim to have received "frequent inquiries from litigants having enforcement problems," *id.* at 174. Still, research on current U.S. foreign judgment treatment is lacking, *id.* at 173.

Hague Conference has proved ineffective. The United States demands a written document that will: (1) alert foreign nations of its federalized public policy standard; (2) outline the boundaries in which the U.S. is willing to agree to foreign judgments pursuit to public policy concerns; (3) regain a credible litigation reputation, while quashing the notion of a liberal court; and (4) reaffirm U.S. litigants that their judiciary is concerned with the disposition of its litigants in transnational litigation.[195] In the meantime, U.S. courts should reaffirm the principle of reciprocity established in *Hilton*.[196] Eliminating general comity will not only protect U.S. judgment holders, but will also guarantee fairness and equity to all transnational litigants.

CONCLUSION

In terms of recognizing and enforcing foreign judgments, the United States has continually disregarded the public policy exception as compared to foreign tribunals. In doing so, the United States has crippled its own litigants in transnational litigation. The United States has moved away from the standard established in *Hilton* in favor of generalized comity. The expectation was to achieve ratification of a multilateral agreement that would curb judgments in violation of public policy. Although the United States recognized the necessity for an agreement, the approach towards acquisition has proved unfavorable to U.S. litigants. Enforcing foreign judgments contrary to public policy while reciprocity abroad is absent, has resulted in the United States losing any bargaining power for a multilateral agreement—the U.S. has effectively created its own gridlock. A solution for the United States begins with the federalization of the public policy standard, creating uniform and predictable public policies nationwide. U.S. courts cannot continue to disregard public policy in favor of foreign judgments. The overall goal is to abandon the notion of general comity and cultivate a system of judgment recognition between the United States and foreign nations that afford equal justice to U.S. litigants without discounting U.S. public policy considerations.

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[195] *See also* Danford, *supra* note 44, at 432. (argues that incorporating a public policy exception into a multilateral judgments convention is imperative for without "likely would spell doom").

[196] *See also* Danford, *supra* note 44, at 417. Commentators argue in favor of reviving the reciprocity requirement in order for the United States to gain leverage in ascending to a multilateral agreement, and ending the "free ride" foreign nations currently enjoy, id. Still, others oppose the revival of reciprocity arguing that it would "diminish the likelihood of a judgment convention being concluded," *id.* at 419. The overall results are inclusive. However, it is this note's author's opinion that a reciprocity requirement will not stifle a judgments convention. The majority of European nations retain such requirements and "they are not routinely enforced," *id.* at 417-18. As such, the reciprocity requirement is likely tactical and may just be that extra punch that the United States needs.

Tao Li & Zuoli Jiang***

DOES CHINA FOLLOW THE WEST? A PERSPECTIVE OF STATE-CITIZEN INTERACTION IN FOREIGN TRADE GOVERNANCE

Abstract

China's emergence onto the world is one of the most eye-catching events in the past decades, but it remains unclear to what extent the diffusing western liberalism has changed Chinese society and how a rising China will, in turn, impact the evolving global governance order. Focusing on the perspective of the interaction between the Chinese government and its citizens in foreign trade governance, this article explores China's deviation from the constitutionalisation pathway for global economic governance. As China rises, China is likely to add its own values to the evolving global governance order. Likewise, some Chinese thoughts deserve being added to the theorization of global economic governance.

Annotasiya

Çinin dünya üzərində əhəmiyyətinin ortaya çıxması son onilliklərin ən gözə çarpan hadisələrindən biri olmuşdur. Lakin sürətlə yayılan Qərbi liberalizminin Çin cəmiyyətini nə dərəcədə dəyişməyi və onun qlobal idarəetmədə yenidən rolunun nə cür artmağı anlaşılmaz olaraq qalır. Bu məqalə beynəlxalq ticarətin idarə olunmasında Çin hökuməti və onun vətəndaşları arasında qarşılıqlı fəaliyyətin perspektivlərinə diqqəti yönəldərək Çinin qlobal iqtisadi idarəetmə üçün konstitusional yoldan yayınmasından bəhs edir. Çin yüksəlməsi ilə yanaşı, öz dəyərlərini inkişaf edən qlobal idarəetmə qaydalarına əlavə etməyə meyil edir. Onu da vurğulamaq lazımdır ki, bəzi Çinə xas ideyalar dünya iqtisadi idarəetmə qaydaları nəzəriyyəsinə əlavə edilməyə layiqdir.

* PhD Candidate, Shandong University; Formerly an attorney-at-law practising in Beijing (email: lawyerlitao@126.com). This article was completed on 17 March 2016. All websites are current of this date. Frequently used abbreviations in this paper include: CCP, for "Chinese Communist Party"; CCCCP, "Central Committee of the CCP"; NPC, "National People's Congress"; SCNPC, "Standing Committee of the NPC"; WTO, for "World Trade Organization"; GATT, for "General Agreement on Tariffs and Trade".

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INTRODUCTION

Beijing exhibits a far-reaching influence over the world in recent years. The Beijing-inspired Asian Infrastructure Investment Bank, with memberships not only from Asian countries but also many western countries,[1] was declared open for business on 16 January 2016, which is considered by some media as China's challenge to the international financial order. The Belt and Road Initiative unveils Beijing's more ambitious determination to advance international economic integration.[2] In late 2015, Beijing entered into a whirlwind diplomacy mode, with President XI Jinping consecutively sending out strong Chinese voices on global and regional economic cooperation at various occasions of state visits and multilateral meetings.[3] From the then *Tao Guang Yang Hui*" diplomatic strategy to the

[1] From June 29, 2015 to December 31, 2015, a total of 57 countries, 37 from Asia and 20 from outside, signed the AIIB's Articles of Agreement. By the end of 2015, 30 countries have ratified the Articles. *See*, Signing and Ratification Status of the AOA of the AIIB, http://www.aiib.org/html/aboutus/introduction/Membership/?show=0 (last visited Mar. 17, 2016)

[2] The Silk Road Economic Belt and the 21st-century Maritime Silk Road, also known as the Belt and Road Initiative, is a development strategy and framework that focuses on connectivity and cooperation among countries primarily in Eurasia. The strategy underlines China's push to take a bigger role in global affairs.

[3] From September to the end of 2015, XI Jinping attended the UN 70th anniversary, G20 Antalya summit meeting, APEC Pasay summit meeting, and Paris climate change conference, and visited the US and the UK, among other diplomatic trips. He expressed for many times

current high profile on the world stage,[4] the Chinese government has played an increasingly significant role in world affairs. As an increasingly powerful China stands up from the earth, the world indeed has realized that China starts to make the rules.

China's ascendance goes in together with the permeation of a raft of western liberal values into China, including individualism, freedom, private property, unrestricted commerce, popular sovereignty, and rule of law. All seem to be committed to enlarging human freedom and enhancing democratic control of public power. Partly owing to the pervasion of this individual-oriented liberal thoughts, Chinese citizens indeed have gained some visible welfare increment: More and more Chinese people are going abroad for study or tourism, making China the largest source of outbound students and tourists[5]; A variety of commodities with world-widely well-known trademarks are domestically available to Chinese consumers - with an LVMH bag in hand, a Chinese woman expresses luxury, elite excess, celebrity culture and all other things that the brand stands for ubiquitously throughout the world.[6] However, China is still generally deemed as an authoritarian state by the academic circle; so some questions remain to be answered: To what extent have those western values transformed Chinese society? In which way can Chinese citizens genuinely exert their control over the public power? And, as China rises, will China add its own values to global economic governance in the future?

Undoubtedly, it is overwhelmingly difficult for this article to answer the above grand questions. So it is expedient to focus on a narrower perspective and then shed light on them. Considering that China's ascendance owes much to its deliberate utilization of the open world market, this article is thus confined to China's distinctive mode of state-citizen interaction in foreign trade governance and its implication for China's contribution to the evolving global economic order.

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some Chinese understandings, such as win-win cooperation, mutual learning, and common development, regarding the future of global governance.

[4] "Tao Guang Yang Hui", meaning not to show off one's capability but to keep a low profile, was a strategic thought advocated by many ancient Chinese theorists. It was recommended for those who were in plight and could gain advantage by refraining from show-off and improving themselves unobtrusively. It was proposed by the late leader DENG Xiaoping as China's diplomatic strategy in late 1980s and early 1990s.

[5] Our Country has Become the Largest Exporter of Students (2014), http://www.jsj.edu.cn/n2/7001/12107/537.shtml (last visited Mar. 17, 2016); UNWTO Annual Report 2014, p. 83 (2014), http://www.dtxtq4w60xqpw.cloudfront.net/sites/all/files/pdf/unwto_annual_report_2014.pdf (last visited Mar. 17, 2016).

[6] Sonia K Katyal, *Trademark Cosmopolitanism*, 47 University California Davis L. Rev. 875, p. 879 (2014)

I. THE EVOLUTION OF CHINA'S FOREIGN TRADE GOVERNANCE

China was the original contracting member of the GATT, but left it in 1950 for some reasons pertaining to the CCP's rise to power. When it was again admitted into the WTO, more than a half century elapsed. It is generally accepted that if China had continuously complied with GATT rules since its original GATT membership, Chinese citizens could have gone out of poverty far earlier.[7] Also, some Chinese scholars have pointed out that during the total 15 years for negotiating GATT-WTO re-accession, less attention was paid to the rights of individuals and enterprises.[8] It is, therefore, meaningful to have an in-depth review of the development of China's foreign trade system.

A. 1949-1978: State-monopoly

In the early time of the CCP's administration, China was suffering from economic hardship plus the all-round blockade and embargo imposed by the United States and other Western countries. The CCP, therefore, adopted a model of economic management featuring comprehensive central planning and control. In line with this economic tactic, a foreign trade policy emphasizing state control came into being. The founding leader MAO Zedong once addressed, "It is impossible for the People's Republic to recover and develop its national economy without the control over foreign trade".[9]

The Common Programme promulgated in 1949, on the eve of the founding of the PRC, made it clear that control shall be exercised over foreign trade and a protective trade policy shall be adopted.[10] Based on this ideology, private trading organizations were gradually eliminated as part of a programme of economic transformation, so that all foreign trade transactions were ultimately handled by state corporations under the direct control and supervision of the government pursuant to a master plan.[11] State-controlled foreign trade corporations were, in essence, an arm of the government performing a state function, while individuals and private corporations are

[7] *See, e.g.*, Ernst-Ulrich Petersman, *International Economic Law in the 21st Century: Need for Stronger "Democratic Ownership" and Cosmopolitan Reforms*, 31 Polish Y.B. Int'l L. 9, p. 32 (2011)

[8] *See, e.g.*, SHEN Muzhu, WTO Yu Zhongguo Fazhi [WTO and Chinese Legal System], p. 203 (2002); CAI Congyan, *A Paradigm Shift of China's Foreign Trade Administration Law*, 2 Xiamen Daxue Xuebao [Xiamen University Journal] 116, p. 119 (Art & Soc., 2004).

[9] MAO Zedong, MAO Zedong Xuanji [Selected Essays of MAO Zedong], p. 1433 (Vol. 4, 1991)

[10] The Common Program of Chinese People's Political Consultative Conference 1949, Art. 37.

[11] In 1950, there was 7 state-owned imp. & exp. corporations. In 1953, the former state-owned foreign trade corporations were reorganized into 16 foreign trade corporations according to the broad commodity categories, which had subsidiary foreign trade corporations in various local places. In 1978, after several times of reorganization, there were 11 foreign trade corporations. *See* Ma Fengqin, Zhongguo Duiwai Maoyi Zhengce Yu Guanli [China's Foreign Trade Policies and Management], pp. 11-12 (1995)

completely deprived of the right to foreign trade engagement. A state-monopoly foreign trade system based on high centralization was thus established.

Foreign trade was considered by the then Chinese leaders as a mean to achieve diplomatic objectives. An extreme of this policy is that in many years of this period China provided many other countries with tremendous economic aid that were far beyond China's affordability, even when China was suffering from extreme economic difficulties.[12]

This stringent central control policy was the cornerstone of China's foreign trade system until 1978. It indeed made great contributions for the new government to combat western embargo and to recover national economy in its early ages. However, when the international environment had favorable changes to China later, it became a stumbling-block, hampering the development of China's economy and the improvement of Chinese people's living standard.

B. 1978-1992: Tentative Reform

The 3rd Plenary Session of the 11th CCCCP convened in December 1978 brought China into a new era accentuating reform and development. The gazette of this session pointed out: "The state will actively develop equal and mutually beneficial economic cooperation with various countries on the basis of self-independence, and strive to acquire worldly advanced technologies and equipment".[13] Later in 1982, HU Yaobang, the then General Secretary of the CCCCP gave a speech on foreign economic relations, saying that:

> Our socialist modernization should make use of both domestic resources and overseas resources, open both domestic markets and international markets, and learn the abilities both to organize domestic construction and to develop foreign economic relations.[14]

From then on, the former diplomacy-oriented trade policy was replaced by the opening-up policy, and comparative advantage theory became the underpinning ideology for China to advance foreign trade development.

As the economy were dragged carefully away from the former stringent planning system, foreign trade policy became less rigid as well. A series of measures, including power degradation, profit sharing, operation dispersal, and contracting, was implemented to reform the foreign trade system and therefore to encourage export. The reform went through two phases. The first phase run from 1979 to 1986 with an emphasis on diversification of operation

[12] YANG Hongxi, *A Review of the Development of China's Foreign Aid*, 11 Xuexi Yuekan [Study Monthly], p. 40 (2009)

[13] Gazette of the 3rd Plenary Session of the 11th CCCCP (2009), http://www.gov.cn/test/2009-10/13/content_1437683.htm (last visited Mar. 17, 2016)

[14] The History Research Office of the CCCCP, Zhongguo Gongchan Dang Lishi Dashi Ji [Chronicle of Events of the CCP], pp. 169-170 (2009)

organs, devolvement of foreign trade operational right, and severance between government and enterprises. The second phase, from 1987 to 1992, stressed abandoning the practice of having everybody "*Chi Daguo Fan*" (eat from the same big pot) by implementing the contract managerial responsibility system.[15] Under the precondition that foreign trade were still controlled by the central government, provincial and municipal authorities have more independence in foreign trade matters, and foreign trade corporations were injected with more incentives to pursue economic interests. Also, new trade organs were established in a number of municipalities and provinces for the purposes of promoting foreign trade and improving foreign trade management.[16]

By granting economic incentives to foreign trade apparatus, China's foreign trade had sizable expansion, and the operation regime for foreign trade were better off.[17] However, the legal status of foreign trade corporations remains unchanged. Individuals and private corporations were not allowed to engage foreign trade business. Traditional restrictive measures, such as tariffs, license, and quota were still prevailing. Hence, trade policy still featured formidable state protectionism in this period.

C. 1992-2001: Provisional Liberalization

Based on the vision of establishing a socialist market economy and the perception of the impact of economic globalization, Chinese leaders in this period made great efforts to nudge China into the GATT-WTO system.[18] The 14th National Congress of the CCP, convened in 1992, made it clear that, "The state will deepen the reform in foreign trade with a view to establishing a new foreign trade system that conforms to international trade rules".[19] In the 15th National Congress of the CCP convened in 1997, the then president JIANG Zemin pointed out that, "Facing economic and technological globalization, we should walk up to the world with a more active attitude and promote all-directional, multi-tiered and wide-ranging opening-up".[20]

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[15] SHEN Muzhu, Zhongguo Duiwai Maoyi Falv [China's Foreign Trade Law], p. 9 (1989)

[16] Sally Lord Ellis, *Decentralization of China's Foreign Trade Structures*, 11 Georgia J. Int'l & Comp. L. 283, p. 284 (1981)

[17] FU Ziying, Zhongguo Duiwai Maoyi Sanshi Nian [China's Foreign Trade in 30 Years], p. 146 (2008)

[18] On 10 July 1986, China formally submitted to the GATT Secretariat its request for resumption of China's status as a GATT contracting party. In a communication dated 7 December 1995, China applied for accession to the WTO.

[19] JIANG Zemin, Accelerate Reform, Opening-up, and Socialist Modernization Drive and Win Victory for the Cause of Building Socialism with Chinese Characteristics: Report Delivered at the 14th National Congress of the CCP (2004), http://news.xinhuanet.com/zhengfu/2004-04/29/content_1447497.htm (last visited Mar. 17, 2016)

[20] JIANG Zemin, Hold High the Great Banner of DENG Xiaoping Theory for An All-round Advancement of the Cause of Building Socialism with Chinese Characteristics into the 21st Century: Report Delivered at the 15th National Congress of the CCP,

In order to obtain the trust of trading partners, to showcase its sincerity in economic cooperation, and to fulfil the transparency requirement of the GATT-WTO, China made provisional efforts to convert its legal system into consistency with GATT-WTO rules. Foreign Trade Law, which is China's fundamental law governing foreign trade, went into force as of 1 July 1994. It was provided in this law that, "The State encourages the development of foreign trade, exercises the initiative of localities and safeguards the autonomy of business operation of foreign trade dealers".[21] It also set forth the basic requirements for a foreign trade dealer[22]; in particular, it stipulated that foreign trade dealers must acquire license from the competent authorities before operation, which in fact excluded individuals and most corporations from foreign trade operation.[23] It was not until 1999 that private enterprises were allowed to apply for foreign trade operation in accordance with a rule adopted by the Ministry of Foreign Trade and Economic Cooperation.[24]

Since in this period China was continuously striving for GATT-WTO membership, the 1994 Foreign Trade Law was of transitional nature. On the one hand, it proclaimed China's commitment to maintain a fair and liberalized foreign trade order[25]; on the other hand, protective measures were still in force, though the tariff was generally reduced and export licensing and quota were eliminated in a large scale.[26] Independent operational right was extended to private enterprises, but the participation into this sector were still subject to licensing procedures.

D. 2001-Today: Full Open to Private Sector

After fifteen years of arduous and prolonged negotiations, China formally became the 143rd member of the WTO on December 11, 2001. China's accession to the WTO is a milestone in China's reform and opening-up process, bringing china into a new era of further integration into the world. Also, Foreign Trade Law was amended in April 2004, echoing the free trade ideal endorsed by the WTO rules. Highlights in this amendment include the straightforward acknowledgement to protect the legitimate rights and interests of foreign

http://news.xinhuanet.com/zhengfu/2004-04/29/content_1447509.htm (last visited Mar. 17, 2016)

[21] Foreign Trade Law of the PRC 1994, Art. 4.

[22] Foreign Trade Law of the PRC 1994, Art. 9.

[23] This also protected the interests of the former foreign trade corporations. *See, e.g.*, HE Maochun, Duiwai Maoyi Fa Bijiao Yanjiu: Zhongguo Rushi Hou Waimao Tizhi De Quanmian Gaige [A Comparative Study on Foreign Trade Law: A comprehensive reform after China's WTO Accession], p. 176 (2000)

[24] Interim Provisions concerning Granting Import and Export Rights to Private Enterprises and Research Institutes 1999, Art. 3.

[25] *Supra* note 21

[26] *See* LIU Sichen, *Evolution and Trend of Foreign Trade Policies*, 8 Zhongguo Guoqing Guoli [China's National Conditions and Strength] 48, p. 49 (2004)

trade dealers[27] and the explicit recognition of individuals as subjects of foreign trade dealers.[28] Furthermore, in line with the requirement of China's Protocol of Accession, the amendment changed the previous licensing requirement to the current registration requirement for obtaining foreign trade operational rights,[29] which in effect opened completely the door for individuals and private enterprises to engage in foreign trade business.

After its accession to the WTO, China progressively reduced its import tariff and eliminated all the non-tariff measures that are inconsistent with WTO rules. Up to the 10th anniversary year of China's WTO accession, the general tariff rate had dropped from 15.3% to 9.8%, lower than the WTO's requirement for developing countries.[30] Regulations on trade remedy measures, including antidumping, countervailing, were also set up soon after the accession,[31] with a view to providing and maintaining a fair competition environment.

More importantly, the most direct form of discipline that WTO accession brings is the increased competition that China's state-owned sector would face from foreign trade opening-up.[32] China's accession to the WTO and the subsequent amendment of its Foreign Trade Law terminated its practice of protecting inefficient state-owned enterprises and fostered the rise of private sectors.[33] By lifting the restrictions on foreign trade operation and expanding the private sector, more and more citizens and private enterprises become self-initiated dealers in foreign trade.

Conclusion: Rise of Private interests

Roscoe Pound states that interests can be classified into individual interests, public interests (state interests), and social interests,[34] which are often contradictive to each other.[35] One basic objective of administrative law is to

[27] Foreign Trade Law of the PRC 2004, Art. 1.

[28] Foreign Trade Law of the PRC 2004, Art. 8.

[29] Article 5 of the Protocol on China's Accession stipulates: "… China shall progressively liberalize the availability and scope of the right to trade, so that, within three years after accession, all enterprises in China shall have the right to trade in all goods throughout the customs territory of China". This requirement is reflected in Art. 9 of Foreign Trade Law of the PRC 2004.

[30] HU Jintao, Speech at the High Level Forum on the 10th Anniversary of China's WTO Accession (2011), http://news.xinhuanet.com/politics/2011-12/11/c_111234873.htm (last visited Mar. 17, 2016)

[31] China's Regulation on Antidumping, Regulation on Countervailing, and Regulation on Safeguard were all promulgated in November 2001, came into effect in January 2002, and were amended in March 2004.

[32] Karen Halverson, *China's WTO Accession: Economic, Legal, and Political Implications*, 27 Boston College Int'l & Comp. L. Rev. 319, p. 334 (2004)

[33] *Ibid*. p. 335

[34] Roscoe Pound, Social Control through Law, pp. 63-80 (1942)

[35] HE Qinhua, Xifang Faxue Shi [History of Western Legal Science], p. 400 (1996)

reconcile the conflicts between public interests and private interests. Insofar as China is concerned, public interests have been prioritized for a long time, especially before the Constitution was amended in 2004. Despite no frank expression that public interests preceded private interests, the underlining principle was unambiguous; that is, public interests ran first in case of conflicts between the two.[36] This can be discerned from the phrasing of Constitution 1982 that "Public property is sacred and inviolable",[37] but for citizens' legitimate property rights only "protection" was promised.[38] This can also be inferred from the provision of Foreign Trade Law 1994 that, "This law is formulated with a view to developing the foreign trade, maintaining the foreign trade order and promoting a healthy development of the socialist market economy", without reference to the interests of foreign trade dealers.[39] Prioritization of public interests was an outcome of the supervising administrative mode that had been applied predominantly since the PRC establishment, which underscored the superiority of administrative power over private interests and disregarded administrative procedure and judicial review.[40] The fundamental reason for adopting this mode is that in a planned economic system, the government becomes the major distributor and redistributor of social resources and therefore the deputy of public interests, whereas the actual participants in economic activities can only obey the distribution and redistribution of social resources and thus fail to be independent stakeholders. Hence, China's foreign trade corporations under the planned economy system were in essence instruments for the state to implement foreign trade control.

2004 is a landmark in China's legislative development in view of the affirmation and guaranty of Chinese citizens' private interests. The Amendment to Constitution 1982, adopted by the 10th National People's Congress (NPC) in March 2004, raises private interests up to a new height. Constitution 2004 provides that "The State protects the lawful rights and interests of the individual and private sectors of the economy",[41] and that "Citizens' lawful private property is inviolable".[42] Further, Foreign Trade Law 2004 proclaimed for the first time to protect the legitimate rights and interests

[36] HU Yuhong, Faxue Fangfalun Daolun [Introduction to Law Methodology], p. 280 (2002)
[37] Constitution of the PRC 1982, Art. 12.
[38] Constitution of the PRC 1982, Art. 13.
[39] Foreign Trade Law of the PRC 1994, Art. 1.
[40] For the supervising administrative theory, *see* Gan Wen, The Equilibrium Theory of Administrative Law, *in* Luo Haocai and others (eds.), Xingzheng Fa Luncong [Collected Essays on Administrative Law], pp. 23-31 (Vol. 1, 1998)
[41] Constitution of the PRC 2004, Art. 11.
[42] Constitution of the PRC 2004, Art. 13.

of foreign trade dealers,[43] signalling a significant shift of China's foreign trade paradigm.

To summarize the evolution of China's foreign trade operation since 1949, three conversions come up. First, it is a conversion from state orientation to private orientation. This is closely related to China's overall economic reform from a highly centralized planned economy to a socialist market economy. Second, it is a conversion from political governance to legal governance. Before China's WTO accession, foreign trade policy was significantly influenced by the ideology of the CCP, embodied in the CCP's documents and even the speech of its leaders; after that, foreign trade policy has been publicized in the form of legislation, which is ostensibly outcomes of citizens' democratic participation. Third, it is a conversion from control to liberation. When foreign policy was merely an instrument to attain political objectives, control from the state was indispensable; but when China has been integrated into the liberalized world trading system, more freedom should be given to citizens. In all, the evolution of China's foreign trade policy features a rise of private interests, and with this comes an advancement of Chinese citizens *vis-a-vis* a retreat of the state in foreign trade operation.

II. CHINESE CITIZENS' PARTICIPATION IN FOREIGN TRADE GOVERNANCE

It is a common practice for various countries to attain state interests by establishing or participating into international economic relations under the background of economic globalization. Compared to the governance of domestic affairs, foreign affairs are handled much covertly in all countries with elitism politics as a camouflage. This can be discerned not only from the inadequate participation by representative bodies in foreign affairs decision-making, but also the inefficient judicial review of the practice of foreign affairs departments. This issue has been observed by many western theorists. Louis Henkin asserts that individual rights receive less attention in the area of foreign affairs,[44] which results in the inherent deficiency of representative democracy, that is, the widened difference between the public will and the activities of representative bodies. Ernst-Ulrich Petersmann puts forward a bolder constitutionalisation theory for international economic law. He observes that national parliaments, national courts, and citizens are often incapable of effectively control the discretionary power exercised by foreign

[43] *Supra* note 27

[44] Louis Henkin, Constitutionalism, Democracy, and Foreign Affairs, p. 137 (DENG Zhenglai tr., 1996)

policy bureaucrats.[45] Based on the imperfect EU experience in complementary domestic and international safeguarding of representative democracy, power control, and judicial review, he calls for constitutionalizing governance powers beyond states "with due regard for citizens as legal subjects and sources of justification of international law".[46] Petersmann proposes a bottom-up reform of the Westphalian model of international economic law[47]; but the means, including broader democratic participation and stronger judicial protection, are traditionally rooted in the Enlightenment. So, essentially, what Petersmann has advocated is an extension of western liberal values to a broader global sphere.

As is illustrated in Section 1, the evolution of China's foreign trade system since 1949 has led to more commercial freedom, enhanced private property protection, and risen individual interests for Chinese citizens. China's accession to the WTO also entails a legislative amendment storm for what it described as rule-of-law blueprint.[48] In a sense, all these social changes can be traced to the diffusion of western liberalism which is also planted into the WTO principles. However, it must be noted that the evolution of China's foreign trade system is not a citizen-driven process; instead, the CCP has always played a leading role in China's social and economic development. So, it is still worthwhile to examine whether China has totally accepted those western liberal values during its integration into the world, and more importantly, whether China will follow the constitutionalisation pathway advocated by Petersmann.

A. Legislative participation

Currently, foreign trade policies remains the domain of China's central legislation, embraced in its *Falv* (laws), *Xingzheng Fagui* (administrative

[45] Petersmann, *How to Constitutionalize International Law and Foreign Policy for the Benefit of Civil Society?* 20 Michigan J. Int'l L. 1, p. 24 (1998)

[46] Petersmann, *Human Rights Require "Cosmopolitan constitutionalism" and Cosmopolitan Law for Democratic Governance of Public Goods*, 5 Contemporary Readings L. & Social Justice 90, p. 94 (2013)

[47] Petersmann, International Economic Law in the 21st Century: Constitutional Pluralism and Multilevel Governance of Interdependent Public Goods, (2012). *See also* Petersmann, *Addressing Institutional Challenges to the WTO in the New Millennium: A Longer-Term Perspective*, 8 JIEL 647, (2005); Petersmann, *The Future of the WTO: from Authoritarian "Mercantilism" to Multilevel Governance for the Benefit of Citizens?* 6 Asian J. WTO & Int'l Health L. & Pol'y 45, (2011); Petersmann, *International Economic Law in the 21st Century: Need for Stronger Democratic Ownership and Cosmopolitan Reforms*, 31 Polish Y.B. Int'l L. 9, (2011); Petersmann, *Fragmentation and Judicialization of International Law as Dialectic Strategies for Reforming International Economic Law*, 5 Trade L. & Dev. 209, (2013); Petersmann, *Need for a New Philosophy of International Economic Law and Adjudication*, 17 JIEL 639, (2014).

[48] China revamped more than 2,300 laws, regulations and department rules at the central level and more than 190,000 regulations and policies at the local level to ensure that they are consistent with WTO rules. HU Jintao, *supra* note 30

regulations), and *Guizhang* (rules) respectively adopted by the central legislature,[49] the State Council, and relevant central government departments. Theoretically, one opportunity for individuals and groups to influence the formation of foreign trade policy is to participate in the legislation. By electing deputies who represent their opinions and sending them into the legislation process, individuals and groups can indirectly manage to bring foreign trade policies in consistent with their own interests. However, this is only a vision in theory; its effectiveness to real practice remains to be checked.

Regarding the enactment and revision of laws, also the highest legal source other than the Constitution in China, a major problem is the less representation of the members of the NPC and its SCNPC. The Constitution provides that all power in the PRC belongs to the people and that the organs through which the people exercise state power are the NPC and its local counterparts.[50] So, supposedly the NPC and the SCNPC should be composed primarily of citizens outside the government and representing the will of the general public. But in fact, there is a far distance between the central legislature and the people, which can be illustrated by the 10th SCNPC, also the legislature of the amendment of the Foreign Trade Law. Among its total 175 members, 118 were from the CCP, making the CCP the predominant component.[51] If viewed from the perspective of vocation, the members were preferably chosen from former officials of the central government and heads of the local counterparts of the SCNPC.[52] In contrast, few can represent the interests of a vast number of consumers. In fact, the scope of SCNPC candidates is rather limited, those from the non-governmental sectors are quite a few in quantity, and civil social elites hardly have any access to the SCNPC.[53] The SCNPC is a highly bureaucratized body of the CCP, resulting its decisions, including the formulation of trade policy, hardly reflecting the people's will.[54]

Democracy is more badly missing in China's administrative legislation, mainly including the aforesaid administrative regulations and rules. Administrative legislation is a quasi-legislative activity that is conducted by the administrative body based on the mandate from the Constitution or laws

[49] The central legislature refers to the NPC and the SCNPC. The NPC develops and amends the basic laws on criminal matters, civil matters, and state authorities, among others. The SCNPC develops and amends laws other than those developed by the NPC. (Legislation Law of the PRC 2015, Art. 7)

[50] Constitution of the PRC 2004, Art. 2.

[51] ZHANG Tao, *An Analysis of the Constituent Structure of the 10th SCNPC: Main Characteristics and Development Tendency*, 7 Dangdai Zhongguo Zhengzhi Yanjiu Baogao [Contemporary Chinese Politics Review] 78, p. 80 (2009)

[52] *Ibid*. p. 84

[53] ZHU Haiying, *An Analysis of the Constituent Structure of the SCNPC: A Comparative Point*, 8 Renda Yanjiu [People's Congress Study] 10, p. 16 (2004)

[54] *Ibid*.

rather than on citizens' delegation,[55] thus it suffers a democratic deficit from the very beginning. In order to make sure that the people's will can find expression in administrative legislation, a mechanism for safeguarding public opinion expression is requisite.[56] Legislation Law 2015 stipulates that legislation shall represent the will of the people and ensure the people's participation in legislative activities through various channels.[57] It also provides that in drafting administrative regulations and rules, the opinions of general public shall be extensively solicited in multiple forms such as forums, discussion meetings, and hearings, and that the draft regulations and rules shall be published to request public comment.[58] However, these legal provisions are inherently deficient in that there are no formalized procedures for requiring the administrative body to solicit public opinions.[59] Hence, the administrative body is much discretionary in applying these provisions, and public participation can hardly be guaranteed.[60] In the realm of foreign trade, an overwhelming majority of legal source are in the form of administrative regulations and rules; but for most of them, there had been no drafts published in advance to solicit public comments.[61] The Regulation on Import and Export Duties stipulates that the Customs Tariff Commission is responsible for readjusting tariff rates subjected to the approval of the State Council,[62] but in this Regulation, and even in the whole tax law system of China, there is no provision specifying the mechanism for citizens to participate in tax legislation.[63] And in practice, no announcement has been publicized for soliciting comments from the general consumers regarding any adjustment of tariff rates. Thus, somewhat unfortunately, the story seems to be that only a few officials in the Chinese government can determine the pocket of more than a billion Chinese consumers who are most concerned with the collecting of customs duties.

[55] For instance, the NPC or the SCNPC may make a decision to empower the State Council to develop administrative regulations as actually needed on certain matters, unless otherwise specified by this Law. (Legislation Law of the PRC 2015, Art. 9)

[56] LIU Xin, Xingzheng Lifa Yanjiu [A Study on Administrative Legislation], p. 122 (2003)

[57] Legislation Law of the PRC 2015, Art. 5.

[58] Legislation Law of the PRC 2015, Art. 67 & 83.

[59] *See* ZENG Huaqun and others (eds.), WTO Yu Zhongguo Waimao Fa De Xin Lingyu [The WTO and New Areas of China's foreign Trade Law], p. 28 (2006)

[60] CUI Hao, *Study on the Effectiveness of Public Participation in Administrative Legislation*, 4 Faxue Luntan [Legal Forum] 145, pp. 149-50 (2015)

[61] ZENG Huaqun, *supra* note 59, p. 29

[62] Regulation on Import and Export Duties of the PRC 2013, Art. 4. This provision has constituted a violation of Art. 8(1) of Legislation Law of the PRC 2015, which requires that the determination of tax rates shall be governed by laws (rather than regulations). Supposedly, the Regulation on Import and Export Duties will be amended in the future, but now it is still effective.

[63] The NPC Adjusted Its Legislation Plan and Tax Legalism Needs to Be Detailed (2015), http://finance.qq.com/a/20150811/007269.htm (last visited Mar. 17, 2016)

Though in all countries citizens are more restricted in negotiating and concluding foreign treaties than in domestic legislation, the situation in China looks worse. Just as China's foreign trade policy is a direct outcome of the Protocol on China's WTO accession, a treaty can cause significant influence on many domestic and foreign-related affairs. Accordingly, without wide participation in the process of negotiating and signing foreign trade treaties, citizens cannot be said as an influencing party in the formulation of foreign trade policies. In the US, the President's fast track authority expired in 2007 and has not been renewed, indicating that the Congress have more power to amend or annul trade agreements negotiated by the President with other nations.[64] In the Europe Union, since the entry into force of the Lisbon Treaty, the Europe Parliament has brought a much needed element of democratization and open political debate in EU trade policy making.[65] In China, however, issues relating to trade agreements remain assumed to be a domain of high authorities. According to the *Law of the PRC on the Procedure of the Conclusion of Treaties,* the State Council is the statutory organ to examine and decide on the draft treaty in Chinese, while the SCNPC has the power to make final decision on the final ratification and abrogation of treaties.[66] There is no provision regarding solicitation of public opinions. In view of the less representation of the SCNPC, Chinese people are too far from being able to control the negotiation and conclusion of foreign trade agreements. A telling example is the proposed China-Japan-Korea Free Trade Agreement, which is believed will benefit the people of each country but, due to political disputes, will not be seen in the immediate future.[67]

B. Judicial Review

An independent and impartial judicial system is essential for safeguarding citizens' legitimate rights and interests. XI Jinping pointed out that "the judicial system is the last line of defense for maintaining a fair and just society".[68] Petersmann even asserts that courts of justice are responsible for challenging the ubiquity of "governance failures" in international relations[69]. However, China's judicial system is still far from being a competent body to

[64] Eli J Kirschner, *Fast Track Authority and Its Implication for Labor Protection in Free Trade Agreements*, 44 Cornell Int'l L. J. 385, p. 415 (2011).

[65] Youri Devuyst, *European Union Law and Practice in the Negotiation and Conclusion of International Trade Agreements*, 12 J. Int'l Business & L. 259, p. 264 (2013)

[66] Law of the PRC on the Procedure of the Conclusion of Treaties 1990, Art. 3.

[67] Darren Bean, *China-Japan-Korea Free Trade Agreement*, 6 J. East Asia & Int'l L. 597 pp. 598-99 (2013)

[68] XI Jinping, Introduction on the Decision of the CCCCP to Comprehensively Advancing Rule of Law (2014), http://politics.people.com.cn/n/2014/1029/c1001-25926928-3.html (last visited Mar. 17, 2016)

[69] Petersmann, *supra* note 46

protect justice against the government's potential abuse of powers, just because of its lack of independence.

During China's thousands years of autocratic monarchy period, there is no separation between the power of the judiciary and that of governmental officials[70]; consequently, the history of the litigation system serves as a disincentive for the Chinese people to resort to litigation to solve their disputes.[71] During the first thirty years of the PRC, law was an instrument of politics and sometimes "replaced by a precarious balance between policy considerations and the capricious will of the rulers",[72] thus courts had no impact upon the people's lives.[73] Even after the rule-of-law blueprint has been set up over thirty years of economic reform, China's judicial system is still widely criticized for its lack of impartiality, independence and authority. Fundamental obstacles to an independent judicial system persist because local governments and the CCP exercise power over the courts' personnel and financial arrangements, and because the CCP's policies override laws.[74] Although in recent years a judicial reform aimed at decreasing the influence that local governments have on the court system is underway, the prospect remains unclear, especially in consideration of the persistence of the CCP's leadership.[75]

China's accession to the WTO gave rise to a higher requirement on its judicial system. The Protocol on the Accession stipulates: China shall have certain tribunals responsible for the prompt review of certain WTO-related administrative actions; such tribunals shall be impartial and independent of the agency entrusted with administrative enforcement.[76] It also requires that an opportunity for appeal to a judicial body shall be guaranteed in any cases.[77] In short, China provides a guarantee for all specific administrative cases to be reviewed by an impartial and independent judicial body. In accordance with this requirement, the Supreme Court of China promulgated in 2002 three judicial interpretations, respectively regarding the adjudication of

[70] Sam Hanson, *The Chinese Century: An American Judge's Observations of the Chinese Legal System*, 28 Wm. Mitchell L. Rev. 248, p. 250 (2001)

[71] Graig R Avino, *China's Judiciary: An Instrument of Democratic Change*, 22 Pennsylvania State Int'l L. Rev. 369, pp. 373-74 (2003)

[72] HE Weifang, *China's Legal Profession: The Nascence and Growing Pains of A Professionalized Legal Class*, 19 Columbia J. Asian L. 138, p. 145 (2005)

[73] XIN Chunying, *What Kind of Judicial Power Does China Need?* 1 Int'l J. Constitutional L. 58, p. 60 (2003)

[74] Veron Mei-Ying Hung, *China's WTO Commitment on Independent Judicial Review: Impact on Legal and Political Reform*, 52 Am. J. Comp. L. 77, p. 82 (2004)

[75] For details of the judicial reform, refer to, The Court Reform Plan Outline of the Supreme People's Court of the PRC (2015), http://www.court.gov.cn/fabu-xiangqing-13520.html (last visited Mar. 17, 2016)

[76] Protocol on the Accession of the PRC 2001, Art. 2(D)(1).

[77] *Ibid.* Art. 2(D)(2).

administrative cases in international trade, antidumping, and countervailing. A common provision contained in these interpretations is that those cases shall be handled by an intermediate court at least, as the court of the first instance,[78] which is meant to guarantee the impartiality and independence of the adjudication. Yet till this day, no WTO-related administrative case has emerged from China's judicial system, though a number of cases have been submitted to the DSB of the WTO. This implies that despite the judicial interpretations, individuals and groups do not believe that their WTO-related rights and interests can be protected by China's judicial system.

The Protocol on China's Accession to the WTO makes it clear that the administrative actions subject to judicial review include those relating to administrative rulings of general application.[79] According to China's Administrative Litigation Law, however, the Peoples Court does not accept complaints against administrative rulings with general binding force.[80] Chinese scholars generally refer to this Article as the legal source of non-actionability of abstract administrative actions.[81] This means that Chinese citizens are not entitled to protect their rights and interests against illegitimate abstract administrative actions in foreign trade area, by resorting to the judicial system.

III. FUNDAMENTAL VALUES DIFFERENT FROM THE WEST

Section 1 demonstrates that along with the evolution of China's foreign trade system, private interests in this realm have been progressively recognized. Section 2 reveals that Chinese people are not entitled to, and have scarcely participated in, the legislation and judicial review in foreign trade area. Hence, the overall picture is that despite a widely recognized private interests, Chinese citizens have less access to, and supposedly, less concern with, foreign trade governance. China's foreign trade system underlies an up-down mechanism that features a high dominance by the government and less participation by citizens. This is fairly far from the constitutionalisation blueprint depicted by Petersmann. Just as "Laws should be so appropriate to the people for whom they are made that it is very unlikely that the laws of

[78] The Supreme People's Court's Interpretation Concerning Several Questions about Adjudication of Administrative Cases Relating to International Trade 2002, Art. 5; The Supreme People's Court's Interpretation Concerning Several Questions about Adjudication of Administrative Cases Relating to Antidumping Investigation 2003, Art. 5; The Supreme People's Court's Interpretation Concerning Several Questions about Adjudication of Administrative Cases Relating to Countervailing Investigation 2003, Art. 5.

[79] Protocol on the Accession of the PRC 2001, Art. 2(D)(1).

[80] Administrative Litigation Law of the PRC 2015, Art. 13.

[81] *See, e.g.*, JIANG Mingan, Xingzheng Fa Yu Xingzheng Susong Fa [Administrative Law and Administrative Litigation Law], p. 480 (3rd ed., 2007)

one nation can suit another",[82] so is China's foreign trade governing mechanism rooted in China's indigenous social values. Following are two points that this article considers is most relevant.

A. A Centralized System

Historically, China is a centralized bureaucratic state, partly due to the domination of Confucianism. In this day, China still constitutes a peculiar model of political system under the post-World War II international order created by the US and its partners; this has much to do with its one party system. After it defeated the Kuomintang in 1949, the CCP became the core of Chinese political system, controlling the power of every aspect, from economy, society, military, to judiciary, and of every level, from various local governance to central governance. Although following the opening-up the CCP has shifted its emphasis to economic development and accordingly withdrawn its power from many areas, it still conducts a comprehensive leadership in China's social life. By purporting "a represent of the fundamental interests of the overwhelming majority of the Chinese people",[83] the CCP obtained an ostensible legacy for its ruling. Indeed, there exists in China some other important tunnels that are not popular in western countries for the CCP to solicit public opinions, like *Zhengzhi Xieshang* (Political Consultation), *Xin Fang* (Petition), and *Jijian Jubao* (Disciplinary Inspection Clues). Just as the Chinese words "*Guojia*" (country) implies that a country is also a family, so does the theory of the CCP seem to demonstrate that the CCP is the patriarch of the large Chinese family while all other social strata, groups, and individuals are its children.

Although China has made progress in advancing the rule of law over decades, China is still far from being a rule-of-law society in the western sense. Admittedly, a large number of legal codes have been promulgated in China, but most of them have not been realized in practice and the people's thoughts.[84] The constitutional provision acknowledging the people as the source of all power looks superficial in consideration of the non-actionability of the Constitution in Chinese courts and the CCP's overwhelming leadership in China. In contrast, some normative documents of the CCP provides that the CCP is responsible for selecting and appointing the leading cadres in the SCNPC, the State Council, the Supreme Court, the Supreme Procuratorate, and the counterparts at various local levels,[85] and that the CCP conducts the

[82] Charles Louis de Secondat Montesquieu, The Spirit of the Laws (Anne M. Cohler and others tr., China Social Science Pub. House 1999)

[83] Zhongguo Gongchan Dang Dangzhang [Constitution of the CCP] 2012, General Outline.

[84] Some Chinese scholars observed that nearly 80% of all Chinese laws had never been applied by Chinese courts. *See, e.g.*, Zhou Wangshen, *The Reasons for the Difficulty of Law Implementation*, 3 Fazhi Yu Shehui Fazhan [Law and Social Development] 16, p. 17 (2003)

[85] Dang Zheng Lingdao Ganbu Xuanba Renyong Gongzuo Tiaoli [Regulations on the Work of Selection and Appointment of Leading Cadres of the CCP 2014], Art. 2.1 & 4.

full and comprehensive leadership in political, economic, cultural, and social development at various local places.[86] The CCP is, in essence, the power center in the whole Chinese society that is irreplaceable by any other political force.

Generally speaking, the phrase *"Waijiao Wu Xiao Shi"*,[87] firstly spoken by the late Chinese Premier ZHOU Enlai, is still applicable to China's diplomatic work this day. Chinese diplomacy, especially the decision of major foreign affairs, is still subject to a strict political control by the CCP, with individuals and civil forces causing only a marginal effect.[88] However, with the development of modern informational and communicational techniques, the general public are more willing and convenient to express their opinions on specific foreign affairs, and accordingly China's foreign policies are more and more influenced by citizens' participant willing. For instance, during the negotiation for China's WTO accession, the negotiating personnel of the Chinese government not only conducted arduous negotiation with the WTO's Working Party on China and a number of member states, they also spent much time reconciling the requirements of domestic institutions, which restricted their discretionary power.[89]

China's distinctive political regime determines that its foreign trade policies are formed less democratically than in some western economy like the EU. Although there are also competing interest groups and increasingly influential public opinions within China, the highly centralized, authoritarian mode of governance make it much easier for Chinese leaders to move expeditiously in creating new foreign trade policies by participating in world governance. Paradoxically, the less democratic mode does not render Chinese people unhappiness with the government's overall decision during the past three decades; rather, most elderly people, even those benefited the least from the openness and reform, would not like to revert to the life thirty years ago.

B. Group Orientation

As opposed to the individual-oriented liberalism characteristic of many of the western nations, emphasis is put on collective life rather than to the individual in China.[90] Group orientation has been embedded into Chinese culture for thousands of years. Chinese society generally treasures the wellbeing of the family and, by extension, that of the nation; so Chinese

[86] Zhongguo Gongchan Dang Difang Weiyuanhui Gongzuo Tiaoli [Regulation on the Work of the Local Committee of the CCP] 2015, Art. 3.

[87] It means there is no trifle for foreign affairs.

[88] WANG Yizhou, *Civil Society and Chinese Diplomacy*, 3 Zhongguo Shehui Kexue [Social Science of China] 28, p. 36 (2000)

[89] Margaret M Pearson, The Case of China's Accession to GATT/WTO, *in* David M Lampton (ed.), The Making of Chinese Foreign and Security Policy in the Era of Reform, pp. 337-71 (2001)

[90] Lening Zhang, *Crime Prevention in a Communitarian Society: Bangjiao and Tiao-Jie in the PRC*, 13 Justice Quarterly 199, p. 202 (1996)

people have been taught to emulate their ancient role models who would be the first to bear hardships and the last to enjoy themselves.[91] This group-oriented ethical standard indicates that Chinese culture stresses individuals' subordination to groups and accordingly the harmony of collective life. Confucian ethics emphasizes that the monarch is of the highest power in the country and patriarchs in families. The basic unit under the patriarchal clan system is families rather than individuals. Under such a group-oriented culture, Chinese people tend to passively accept the political regime rather than add their own will to it. This explains why Chinese people are generally satisfied with their current life though they did not participate into the decision making of China's opening-up and WTO accession, and why China has no signs of political unrest on the whole for a long time though various interest subjects are emerging from the fast developing economy.

Chinese dialectics, which is also related to the group oriented culture, stresses heavily on the complementarity between parts. Much alike to Hegel's theory, Chinese dialectics considers that all things are composed of two poles, *Yin* (darkness) and Yang (light); but Chinese dialectics thinks that the two poles are complementary rather than competing, and that the cosmos is in essence harmonious.[92] Also, from China's diplomatic perspective, there is not an assumed enemy on the world and maintaining a friendly bilateral and multilateral relationship is given priority for most of the time.[93] This helps explain why China has always called for mutual respect and mutual learning rather than a total westernization in order to maintain peace for the world.

IV. CONCLUSION

From a historical perspective, foreign trade operation in China has evolved from complete state monopoly to progressive private expansion, with private interests being progressively recognized. From a legal perspective, however, Chinese citizens are still extremely restricted in democratically participating in the legislation of foreign trade policies and in safeguarding their liberal foreign trade rights through judicial protection, though a seemingly comprehensive legal code system have been established in China especially following its accession to the WTO. In all, foreign trade policy in China remains the domain of strict political control, with individuals and civil forces causing only a marginal effect.

Drawing on the experience of some Eastern Europe countries in acceding the GATT during the 1960s-70s, some scholars have predicted that China's

[91] This comes from a well-known Chinese verse "Xian Tianxia Zhi You Er You, Hou Tianxia Zhi Le Er Le" written by FAN Zhongyan.

[92] QIN Yaqing, *Chinese Culture and Its Impact on Foreign Policy Making*, 5 Guoji Wenti Yanjiu [International Studies] 21, p. 29 (2011)

[93] *Ibid*. p. 31

accession to the WTO might result in mass unrest or the CCP's power loss.[94] However, after more than a decade, no signs have emerged that indicates the existence of social instability and political turmoil in today China. Instead, China has showcased a more robust image to the world by actively participating into the establishment of a new world economic order. The process of China's integration into the World demonstrates that China has accepted part of the western values constantly spreading on the globe during the last century, but rejected those that are fundamentally contradictive to its indigenous values. From the view of China, the constitutionalisation pathway proposed by Petersmann can only lead to utopia.

As China rises onto the world stage, it will also attempt to extend its own values to the global sphere. This article does not mean to suggest that all the western values are trashes or all the Chinese values are gems. But, in a global society where China possesses one fifth of the mankind and plays an increasingly important role, a theory of global economic governance totally based on western background seems to be implausible. As is pointed out by Russell, there is something of the ethical qualities cherished by China that the modern world most desperately needs, like the pacific temper.[95] Likewise, theorists of international economic law should learn something from China.

[94] *See, e.g.*, Halverson, *supra* note 32, p. 319

[95] Bertrand Russell, The Problem of China, p. 176 (Central Compilation & Translation Press, 2011)

Kamal Huseynli*

DIFFERENT APPROACHES TO CONFLICTING STANDARD TERMS UNDER THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS

Abstract

'Battle of the forms' is one of the unresolved legal problems to which different countries' courts have their own approach. There are three main approaches in the literature in respect of the 'battle of the forms': (i) domestic approach; (ii) last shot rule; (iii) knock-out rule. However, mainly the last shot and the knock-out rules are in competition with each other. While some courts of the contracting states to the United Nations Convention on Contracts for the International Sale of Goods (CISG or Convention)[1] apply the last shot rule referring to article 19 of the CISG, other contracting states' courts try to solve the 'battle of the forms' problem within the general principles of the Convention by applying the knock-out rule. In this article, the main pros and cons of those three approaches are discussed in order to find the most appropriate solution for the 'battle of the forms' problem. In the conclusion, it is supposed that courts must apply the knock-out rule while adjudicating in respect of the conflicting standard terms.

Annotasiya

Formların ziddiyyəti müxtəlif dövlətlərin məhkəmələrinin öz yanaşmaları olan, həll olunmamış hüquqi problemlərdən biridir. Formaların ziddiyətinə münasibətdə ədəbiyyatda üç əsas yanaşma mövcuddur: 1) yerli yanaşma 2) "last shot" qaydası 3) "knock-out" qaydası. Amma ən çox 2ci və 3cü yanaşmalar bir-biri ilə rəqabətdədirlər. Razılığa gələn dövlətlərin bəzi məhkəmələri Konvensiyaya onun 19-cu maddəsinə istinadən last shot qaydasını tətbiq edərkən, digər razılığa gələn dövlətlər knock-out qaydasını tətbiq etməklə konvensiyanın ümumi prinsipləri çərçivəsində formaların ziddiyyəti problemini həll etməyə çalışırlar. Məqalədə formaların ziddiyyəti probleminin ən uyğun həllinin tapılması məqsədilə bu üç yanaşmanın əsas əlverişli və əlverişsiz cəhətləri müzakirə olunmuşdur. Nəticədə, güman olunur ki, məhkəmələr ziddiyyətli standart şərtlərin həllində knock-out qaydasını tətbiq etməlidirlər.

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[1] UN Convention on Contracts for the International Sale of Goods (adopted 11 April 1980), 1489 UNTS 3, http://www.uncitral.org/pdf/english/texts/sales/cisg/V1056997-CISG-e-book.pdf (last visited March 10, 2016).

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INTRODUCTION

Today using standard forms of one of the parties to contracts for the international sales of goods to enter into contract is a common way.[2] Although the standard forms of the parties have an important role in a formation of contract, the CISG does not clearly deal with this issue.[3] Therefore, there is no uniformity in incorporation of the standard forms into the contract. Furthermore, as each party's standard form reflects its own interest, there are always discrepancies between the standard terms which are parts of the standard forms of the parties. Therefore, these non-matching standard terms create the 'battle of the forms' phenomenon in case of exchange of the standard forms.[4] In respect of the 'battle of the forms' courts are required to answer two questions; (i) Is there a valid contract between the parties? (ii) If yes, which terms of the standard forms are the parts of the contract?[5] As there is no uniform answer to these questions under the CISG, courts do not apply the same approach to solve arisen disputes.[6] Therefore,

[2] See Belkis Vural, *Formation of Contract According to the CISG*, 6 Ankara B. Rev. 125, p. 141 (2013); Christine Moccia, *The United Nations Convention on Contracts for the International Sale of Goods and the "Battle of the Forms"*, 13 Fordham Int'l L.J. 649, p. 658 (1989-1990); CISG Advisory Council Opinion No. 13, *Inclusion of Standard Terms under the CISG* (2013), http://www.cisg.law.pace.edu/cisg/CISG-AC-op13.html (last visited March 10, 2016).

[3] Vural, p. 141.

[4] See Kaia Wildner, *Art. 19 CISG: The German Approach to the Battle of the Forms in International Contract Law: The Decision of the Federal Supreme Court of Germany of 9 January 2002*, 20 Pace Int'l L. Rev. 1, p. 3 (2008); Edward Allan Farnsworth, in Cesare Massimo Bianca and Michael Joachim Bonell (eds.) Commentary on the International Sales Law: the 1980 Vienna Sales Convention 175-184, p. 177 (1987); Moccia, p. 659; Andrea Fejõs, *Formation of Contracts in International Transactions: The Issue of Battle of the Forms under the CISG and the UCC*, Electronic Library on International Commercial Law and the CISG (2006), http://www.cisg.law.pace.edu/cisg/biblio/fejos.html (last visited March 10, 2016).

[5] See Vural, p. 143; Sieg Eiselen, Sebastian K. Bergenthal, *The Battle of Forms: A Comparative Analysis*, 39 Com. and Int'l L.J. S. Afr. 214, p. 216 (2006).

[6] See Larry A. DiMatteo *et al.*, *The Interpretive Turn in International Sales Law: An Analysis of Fifteen Years of CISG Jurisprudence*, 24 Nw. J. Int'l L. & Bus. 299, pp. 349-357 (2004).

there are different approaches being applied by the courts which deal with the 'battle of forms' problem.

Those different approaches to conflicting standard terms will be analyzed in this article in order to find the most appropriate approach among them in respect of a solution of the 'battle of the forms' phenomenon which must be applied by courts. The domestic approach (2.1), the last shot rule (2.2) and the knock-out rule (2.3) are examined in Part 2 of this article by indicating proponents' and opponents' views to each of those approaches, and the conclusion of the analysis of this article is reflected in Part 3.

I. DIFFERENT APPROACHES TO 'BATTLE OF THE FORMS'

It is difficult to solve the 'battle of the forms' dilemma within 'a single formula', because of 'the different situations of collision' and 'the various possible behaviors of the parties.'[7] Intention of courts inclines to find a valid contract between the parties where it is obvious that the parties have exchanged their standard forms and their will is to conclude a binding contract. In this situation, the more unpredictable issue relating to the courts' approach is the determination of the terms of the contract which is a main dispute arisen between the parties.[8] But basically, three different approaches[9] are applied on how the 'battle of the forms' should be adjudicated: (i) domestic approach; (ii) last shot rule; (iii) knock-out rule.

A. Domestic Approach

According to this approach, 'the 'battle of the forms' dispute has to be regarded as a validity issue.'[10] As under article 4(a) of the CISG envisages that the Convention is not concerned with the validity of the contract, it is considered by the proponents of this approach that the CISG does not provide an adequate solution to this problem. Therefore, the solution in respect of which standard terms should be incorporated into the contract shall be solved by the applicable domestic law.[11]

The domestic approach is not supported by the majority of scholars, 'since the issue does not really address the validity of a contract, but is rather a

[7] Peter Schlechtriem, *Kollidierende Geschäftsbedingungen im internationalen Vertragsrecht*, in Karl-Heinz Thume (ed.), Festschrift für Rolf Herber zum 70. Geburtstag 36-49 (1999), (Martin Eimer, translation, *Battle of the Forms in International Contract Law*, 2002), http://www.cisg.law.pace.edu/cisg/biblio/schlechtriem5.html (last visited March 10, 2016).

[8] *Ibid*.

[9] This article is focused on three main approaches. The remained approaches such as the 'first shot' rule, etc. are not covered by this article.

[10] Eiselen, Bergenthal, p. 219.

[11] François Vergne, *The "Battle of the Forms" Under the United Nations Convention on Contracts for the International Sale of Goods*, 33 Am. J. Comp. L. 233, pp. 256-257 (1985).

question of contract formation.'[12] Furthermore, Christine Moccia argues that as 'there are ample solutions to the battle of the forms issue within the CISG, arguments that domestic law should apply are unpersuasive. The good faith requirement of article 7(1) of the CISG provides courts with a means to resolve battle of the forms cases in a manner that is equitable to both parties.'[13] A gap-filling mechanism providing by the CISG according to article 7(2) is another argument against this approach.[14] Additionally, the domestic approach is inconsistent with the main reason for the existence of the CISG, namely the unification of the sales law.[15] Taking all those arguments into consideration, it can be stated that courts are required to look to the general principles of the CISG first, before taking recourse to the domestic law.[16] Under these reasons, the domestic approach is not widespread and 'has also not been followed in any of the reported case law.'[17]

B. Last Shot Rule

According to article 19(1) of the CISG, a reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer. The traditional common law rule namely the 'mirror image' rule, which produces the last shot rule in order to answer to the 'battle of the forms' issue, is envisaged in that article. As a practical result of the 'mirror image' rule,[18] the last shot rule follows literally and strictly of the offer-acceptance rule which is stipulated in article 19(1) of the CISG.[19] Based on the rule established in that article, the last shot rule 'treats every statement made with reference to conflicting standard terms as a rejection of the earlier (counter-) offer, combined with a counteroffer.'[20] According to this rule, 'the contract is concluded on the terms of the final form used, without being objected by the other party.'[21] The Appellate Court Cologne in *Shock-cushioning seat case*[22] held that 'the interpretation of contracts

[12] Wildner, p. 4.

[13] Moccia, p. 675.

[14] Wildner, p. 4.

[15] See Vural, p. 143; Eiselen, Bergenthal, p. 220; Wildner, p. 4.

[16] Moccia, p. 674; Wildner, p. 5.

[17] Eiselen, Bergenthal, p. 220.

[18] See Martin Davies and David V. Snyder, International Transactions in Goods: Global Sales in Comparative Context, p. 119 (2014); Fejõs, para. I7.

See Wildner, p. 5; Ulrich Magnus, *Last Shot vs. Knock Out - Still Battle over the Battle of Forms under the CISG*, in Ross Cranston *et al.* (eds.), Commercial Law Challenges in the 21st Century; Jan Hellner in memoriam 185-200, p. 191 (2007).

[20] Andre Corterier, *A Peace Plan for the Battle of the Forms*, 10 Int'l Trade & Bus. L. Rev. 195, p. 197 (2006).

[21] Peter Huber, *Standard Terms under the CISG*, 13 Vindobona Journal of International Commercial Law & Arbitration 123, p. 129 (2009).

[22] *Shock-cushioning seat case* [2006] 16 U 25/06, http://cisgw3.law.pace.edu/cases/060524g1.html (last visited March 10, 2016).

with conflicting terms leads to the application of … the so-called "last shot doctrine" … according to which the governing terms are those which were exchanged last.'[23] If a party fails to object to the last offered terms or performs, then courts interpret this action or performance as an assent to the last sent terms under article 18(1) of the CISG.[24] For example, the U.S. District Court (Illinois) in *Magellan International v. Salzgitter Handel*[25] case held that exchanges of offers and counteroffers after Magellan's purchase orders which were offers and Salzgitter's response with price changes which was a counteroffer put to an end with issuing the letter of credit by Magellan which constituted a performance. As a result of the application of the last shot rule, the last submitted standard form becomes a part of the contract and the party who sent the last form becomes a winner of the 'battle of forms'.[26]

The proponents of this approach refer to the legislative concept by stating that this approach produces uniformity and legal certainty on terms of the contract, because the terms stipulated in the last offer become a part of the contract.[27] Additionally, it is also argued that the last shot approach tries to find a solution within the CISG by referring to articles 19(1) and 18(1) of the CISG.[28]

There are some arguments against the last shot approach. Firstly, it is argued that this approach supports arbitrary solutions. Thus, it is unpredictable that which party will begin to exercise its obligations without mentioning to its own standard terms and bow to other party's standard terms.[29] In addition, it is argued that this rule results in a 'ping-pong' effect.[30] Thus, each party intends to continue correspondence by referring its standard terms until the other party gives it up and starts to perform.[31] As 'it would be a difficult task to decide when the final curtain for such objections falls,'[32] this rule would not response to business realities. Furthermore, it is unrealistic

[23] Ibid.

[24] DiMatteo *et al.*, pp. 353-354.

[25] *Magellan International v. Salzgitter Handel* [1999] 99 C 5153, http://www.cisg.law.pace.edu/cases/991207u1.html (last visited March 10, 2016).

[26] See Wildner, p. 6; Davies and Snyder, p. 120; Maria del Pilar Perales Viscasillas, *Battle of the Forms, Modification of Contract, Commercial Letters of Confirmation: Comparison of the United Nations Convention on Contracts for the International Sale of Goods (CISG) with the Principles of European Contract Law (PECL)*, 14 Pace International Law Review 153, p. 157 (2002).

[27] See Maria del Pilar Perales Viscasillas, *"Battle of the Forms" Under the 1980 United Nations Convention on Contracts for the International Sale of Goods*, 10 Pace Int'l L. Rev. 97, pp. 97-155 (1998); Burghard Piltz, *Standard Terms in UN-Contracts of Sale*, 8 Journal of International Commercial Law & Arbitration 233, pp. 233-244 (2004).

[28] Wildner, p. 6.

[29] Eiselen, Bergenthal, p. 221.

[30] Viscasillas, *supra*, n. 28, p. 97.

[31] Eiselen, Bergenthal, p. 221.

[32] Huber, p. 130.

from the aspect of the day-to-day business activities of the parties that they investigate all the correspondence under pressure of the last shot rule.[33] Additionally, the rule 'imposes an implied duty on the offeror to object to additional or conflicting terms. The failure to object combined with performance result in what is deemed an implied consent to the terms of the last submitted offer.'[34] But in many cases the parties to the contract are not even aware of the non-matching standard terms existed between their standard forms. Therefore, this approach unfairly imposes a burden on a party who performs its obligations while it releases the other from the unfavourable clauses based on 'a single fact: being the last in the battle of the forms.'[35] Sometimes even it is not clear who is the sender of the last form. Or 'sometimes one party or both parties' terms include a "defensive incorporation clause" which expressly rejects the terms of the other party and expressly excludes them from becoming part of the contract.'[36] In such cases, it is more difficult for courts to determine the terms of the contract.

Taking all arguments which are against the last shot approach into consideration, it can be stated that this approach is not adequate in case of dispute arisen from the battle of forms.[37]

C. Knock-out Rule

According to the knock-out rule, the 'battle of the forms' is considered as one of the gaps of the CISG and to find a solution to this problem by referring to the general principles of the Convention would be a rational way. As this approach takes the parties' autonomy into consideration which is stipulated in article 6 of the CISG, it requires the courts 'find the actual or deemed consensus of the parties based on their negotiations in respect of the essential elements of the transaction.'[38] It is argued that the parties' agreement on the *essentialia negotii* and the performance of their contractual obligations by them should be considered as an implied deviation from the strict application of article 19 of the CISG relating to offer-acceptance rule and also as a waiver of the inclusion of their conflicting standard terms.[39] Thus, firstly, the parties' performance is deemed as an implied exclusion of article 19 of the CISG, as under article 6 of the CISG, the parties may exclude the application of this Convention, derogate from, or vary the effect of any of its provisions. Secondly, the exclusion of article 19 of the CISG, which requires the agreement on all terms of the contract for the conclusion of the contract, supports an

[33] Eiselen, Bergenthal, p. 221.
[34] Wildner, p. 7.
[35] Fejõs, para. I7.
[36] Wildner, p. 7.
[37] Vural, p. 144.
[38] Eiselen, Bergenthal, p. 224.
[39] See Wildner, p. 7; Eiselen, Bergenthal, pp. 224-225; Viscasillas, p. 157.

assumption that there is a valid contract despite the fact that there is no consensus between them in respect of the incorporation of their standard terms into the contract.[40] Therefore, the performance is also considered as a tacit consensus not to insist on the incorporation of the standard terms, and in case of conflict between those terms, to replace them residual statutory law, namely the CISG.[41] In other words, the conflicting standard terms knock each other out and the provisions of the CISG are applied instead of them. This approach has been applied by different countries' courts. For example, the Federal Supreme Court of Germany confirmed this approach in *Powdered milk case*[42] by stating that 'the parties have indicated by the execution of the contract that they did not consider the lack of an agreement between the mutual conditions of contract as essential within the meaning of Art. 19 CISG … partially diverging general terms and conditions become an integral part of a contract (only) insofar as they do not contradict each other; the statutory provisions apply to the rest ...'[43] However, the Court held that the 'conflicting standard forms [terms] are entirely invalid and are replaced by the CISG provisions ...'[44] Furthermore, the *Cour de Cassation* in France also applied the knock-out rule in *Les Verreries de Saint Gobain, SA v. Martinswerk GmbH*[45] by determining jurisdiction instead of invalidating the contract based on difference of the material terms which would have been in consistence with article 19(3) of the CISG.[46]

Although the above-mentioned situation appears where both parties perform their contractual duties, the knock-out rule can be applicable to cases where only one of the parties starts its performance. In this situation, as it is not relevant to apply article 6 of the CISG, because of the non-existence of an implied consensus between the parties due to the lack of consent of one of the parties, it is argued that the principle of good faith envisaged in article 7(1) of the CISG precludes the non-performing party to deny the conclusion of the contract by relying on its standard terms as well as the performing party to object against the other party's standards terms by relying on its standard terms.[47]

The knock-out approach is also criticized by some reasons. Professor Burghard Piltz states the following criticism against this approach:

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[40] See Huber, p. 130; Wildner, p. 8; Eiselen, Bergenthal, p. 225.

[41] Wildner, p. 8.

[42] *Powdered milk case* [2002] VIII ZR 304/00, http://cisgw3.law.pace.edu/cases/020109g1.html (last visited March 10, 2016).

[43] Ibid., para. II 1.

[44] Schlechtriem, pp. 36-49.

[45] *Les Verreries de Saint Gobain, SA v. Martinswerk GmbH* [1998] J 96-11.984, http://cisgw3.law.pace.edu/cases/980716f1.html (last visited March 10, 2016).

[46] DiMatteo *et al.*, p. 353.

[47] Magnus, p. 196.

'The application of the knock-out-rule conflicts with the goal of Art. 7 CISG to promote a uniform application of the rules of the CISG in contracting states and therefore has no chance of success internationally. On the other hand, there is no reason to distance oneself completely from the mechanism of Art. 19 CISG … since the flexibility to find solutions that comes with this approach leads to unacceptable legal uncertainty in practice.'[48]

Furthermore, it is argued that this rule was rejected by the drafters of the Convention when the Belgian delegation proposed this rule to enter as the fourth paragraph of article 19 of the CISG in order to address the 'battle of the forms' problem.[49]

As a response to the mentioned criticism, firstly, it is argued that the rejection of the Belgian proposal was not based on the inappropriateness of the knock-out rule. The reason was the need for further investigation for that proposal. As it was impossible to investigate this proposal within the time limit of the drafting process, the delegations could not sufficiently pay attention to this proposal and rejected it. Therefore, that rejection does not mean that this approach was not considered as an appropriate approach by the drafters.[50] Additionally, this approach is covered by the principles of the CISG, particularly the principle of party autonomy. The suitability of this approach is supported by business dealings of the parties too.[51] This rule applies more practical as well as a more balanced solution by not referring to only one party's terms. Thus, the parties' consensus about the *essentialia negotii* is sufficient for the conclusion of the contract.[52] Additionally, as the application of this rule results in knocking the parties' standard terms and replacing them with the CISG provisions, it 'has the effect of a uniform application of the Convention.'[53]

Finally, the knock-out rule is also applied by other international tools for solution of the 'battle of the forms' problem. Thus, this rule is the guiding principle of the UNIDROIT Principles of International Commercial Contracts (Art. 2.1.22), the Principles of European Contract Law (Art. 2:209) and the Draft Common Frame of Reference (Art. II.4: 209).[54] Such wide use of the knock-out rule shows one more time that this rule is the most appropriate rule solving the problem of the conflicting standards terms.

[48] Piltz, pp. 233-244.
[49] Moccia, p. 661.
[50] Wildner, p. 9.
[51] Eiselen, Bergenthal, p. 226.
[52] Wildner, p. 9.
[53] *Ibid*. 10.
[54] Huber, p. 131.

CONCLUSION

As the 'battle of the forms' problem is not clearly resolved by the CISG, each of the discussed three approaches to conflicting standard terms proposes different solution to it. Although each of them has its own proponents, it is important to apply one of them to all cases in order to provide a uniformity of the application of the Convention. That's why it is necessary to find the most appropriate approach to the conflicting standard terms and apply it to all disputes arising from the conflict of standard terms.

As seen from the above-mentioned analysis, the knock-out rule is supported by the majority of scholars and cases, because of its advantages such as a conformity with the intention of business parties, balanced and fair approach, supportive approach to the contract validity issue, and providing uniform application of the Convention by referring to its provisions in case of knocked-out terms. Therefore, as (i) the application of the domestic approach is inconsistence with the main reason for the existence of the CISG, namely the unification of the sales law, and (ii) the application of the last shot rule makes the results difficult for the parties to foresee and also its application is random and unfair, although its consistency with article 19 of the CISG, also taking the advantages of the knock-out rule into consideration, it can be stated that the most appropriate approach among these three approaches in respect of a solution of the 'battle of the forms' phenomenon is the knock-out rule. That's why courts must apply the knock-out rule while adjudicating in respect of the conflicting standard terms.

Etibar Huseynov*

SUBROGATION – *RIGHT TRANSFER* MECHANISM IN *RISK TRANSFER* INDUSTRY

Summary

This article is discussing the subrogation as one of the key legal concepts of insurance business. Origin and definition of subrogation, historical background, types of subrogation, common and civil law approaches to this legal concept, legal doctrines made to ameliorate the harshness of subrogation, 'made whole doctrine' as the most widespread one, pros and cons of made whole doctrine are examined in this article. It is also indicated that in spite of its 'blind sides' the made whole doctrine, there is no any alternative. Furthermore, the necessity of modifications is also emphasized.

Annotasiya

Məqalədə sığorta fəaliyyətinin əsas hüquqi konseptlərindən biri olan subroqasiyadan bəhs olunur. Məqalədə təhlil olunan məsələlər sırasında subroqasiyanın anlayışı və mənşəyi, tarixi əsası, subroqasiyanın növləri, anqlo-sakson və roman-german hüquq institutlarının yanaşması, subroqasiyanın sərt mövqeyini yumşaldan hüquqi təlimlər, ən geniş yayılmış 'tam yerinə yetirmə' hüquqi təlimi, bu təlimin üstün və zəif cəhətlərinin təhlili yer tutur. Eyni zamanda bu təlimin zəif cəhətlərinə baxmayaraq alternativsiz olduğu qeyd olunur. Bununla yanaşı, dəyişikliklərə olan ehtiyac da vurğulanır.

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INTRODUCTION

Subrogation! Global community is seldom interested in this term. To be more precise, insurance subrogation has been paid so little critical attention by legal scholars. According to Hasson, as most writing in the law of subrogation has been aimed at practitioners, there is a feeling that "practitioners are not interested in policy debates".[1] Hasson goes further and emphasizes the importance of subrogation by saying that "many lawyers cannot envisage the law of insurance functioning without the doctrine of subrogation".[2] However, it is unreasonable to say that, the term 'subrogation' earned much more importance at the outset of new millennium.

On the other hand, as highlighted by Capwell, although 'subrogation' has recently gained in popularity, "much of the law is unsettled".[3] In other words, there needs to have much heated debate over it. On the positive side, subrogation has not been a 'boilerplate clause' and the doctrine has been changed in many important ways. For instance, in some jurisdictions insurers sought "the creation and enforcement of subrogation rights for payments on medical expenses and other types of claims".[4] In addition, the doctrines designed to pave the way for subrogation and to ameliorate the harshness of it, were also major ingredients of the development recipe.[5] It is worth noting that these doctrines did cause a 180-degree change in prevailing views regarding subrogation. With more attention paid to the doctrines of subrogation, it prospered as never before.

I. ORIGIN AND HISTORICAL BACKGROUND OF SUBROGATION

A. Subrogation in General

In today's parlance, the doctrine of subrogation is like a dime in a dozen in the insurance world. Without doubt, subrogation, as a front page of the *Wall Street Journal* gives right to say this and to emphasize its mushrooming growth.[6] More to the point, in juxtaposition to other institutions of insurance, subrogation has become the cornerstone of the development in insurance

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[1] Reuben Hasson, *Subrogation in Insurance Law – A Critical Evaluation*, 5 Oxford J. Legal Stud. 416, p. 416 (1985).

[2] Ibid.

[3] Rex Capwell & Thomas E. Greenwald, *Legal and Practical Problems Arising from Subrogation Clauses in Health and Accident Policies*, 54 Marq. L. Rev. 255, p. 257 (1971)

[4] Roger M. Baron, *Subrogation: A Pandora's Box Awaiting Closure*. 41 S.D. L. Rev. 237, p. 239 (1996).

[5] Ibid.

[6] Vanessa Fuhrmans, *Accident Victims Face Grab for Legal Winnings*, http://www.wsj.com/articles/SB119551952474798582 (last visited April 14, 2016).

industry. Without exaggeration, subrogation has been of vital importance for both parties – insurers and insureds to some extent. In order to provide an accurate picture of subrogation, it is worth to make an excursus into its origin.

1. What is subrogation?

According to Sheldon, subrogation is "the substitution of another person in the place of a creditor, so that the person in whose favour it is exercised succeeds to the rights of the creditor in relation to the debt".[7] This general principle of subrogation can easily be found in the law of insurance. As indicated by King, from the insurance perspective, insurance subrogation is "the substitution by which the insurer who has paid a loss under a policy succeeds to any rights the insured may have against any other person who may be primarily responsible for the loss".[8] In other words, according to legal writers of fame, "the insurer steps into the shoes of the insured and acquires all of the rights the insured may have against a third party".[9] It might be thought, at first blush, that subrogation gives all of the rights to the insurers. However, Parker made it clear that insurer can inherit the rights only possessed by insured against tortfeasor.[10] Nobody finds it odd that, authors have been on the right track when they explain subrogation as the transfer of rights. However, according to several authors, in order to get in-depth analysis of subrogation it is not enough. To be more precise, Maher and Pathak reveals that as one of the widespread legal concepts, understanding of subrogation requires "a new organizational framework that is cognizant of subrogation's analytic foundations, its players and its policy aims".[11] Thus, germane to insurance subrogation, it is important not to focus purely on it as a right transfer mechanism, but to thoroughly analyse it as a complex legal concept.

2. 'Pandora's box' or 'Cash box'?

As mentioned above, insurers insisted upon expansion of subrogation into personal injury claims. No doubt, there were resistance against the expansion of subrogation and it was also emphasized that such expansion would be equivalent to "lifting the lid on a Pandora's Box (term used to describe a source of many troubles) crammed with both practical and legal problems".[12] Baron goes even further by indicating that when subrogation will be

[7] Henry N. Sheldon, The Law of Subrogation, p. 1 (Boston, Soule and Bugbee, 1882).

[8] Cecil King, *Subrogation under Contracts Insuring Property*, 30 Tex. L. Rev. 62, p. 62 (1951).

[9] Johnny Parker, *Made Whole Doctrine: Unraveling the Enigma Wrapped in the Mystery of Insurance Subrogation,* 70 Mo. L. Rev. 723, p. 724 (2005).

[10] Ibid.

[11] Brendan S. Maher & Radha A. Pathak, *Understanding and Problematizing Contractual Tort Subrogation*. 40 Loy. U. Chi. L.J. 49, p. 53 (2008-2009).

[12] Baron, p. 237.

eliminated from the insurance industry, the society will be better off and insurers will be deprived of their 'windfall'.[13] In contrast to Baron, to the best of Bray's knowledge, the insurance subrogation cannot be compared with Pandora's Box and vice versa, it should continue to be enforced.[14]

Central to my argument, as a widespread legal concept, insurance subrogation is not crammed with both practical and legal problems or to be more precise it is not evil to society. Moreover, it is not a novel concept; insurance subrogation derives its roots from Roman law. Nowadays, it would be wrong to say that this legal concept does not need any further analysis. Vice versa, insurance subrogation has to be explored deeply and should be modified according to the new conditions of insurance industry. Thus, it becomes natural to think that the metaphor of Pandora's Box cannot be considered as a description of insurance subrogation, which is "an excellent strategy for recouping insurance losses".[15] It is probably not unreasonable to say that, for insurers, subrogation is a 'cash box' or that is to say 'cash cow', which can easily compensate the amount given to insured by getting it from third parties.

B. An Existence Form of Insurer's Right of Subrogation

As an equitable remedy, insurance subrogation imposes ultimate responsibility on the tortfeasor for a wrong or loss.[16] As mentioned above, the insurer (subrogee) steps into the shoes of the insured (subrogor) in order to enforce the subrogation right. However, the question can arise out of this enforcement. How can this right be enforced? In order to have a clear idea, it is crucial to draw attention to the types of subrogation.

1. Conventional (arising from contract) subrogation

Conventional subrogation is that which arises by virtue of an express contract between 'the insurer' and 'the insured', that the insurer shall be subrogated to the rights of insured.[17] As should be clear by the name, this type of subrogation can only result from the agreement of parties. It is also worth to note that the term 'agreement' does not mean only contracts signed by the parties. The agreement can take many forms, such as a subrogation provision in policy or a release agreement, assignment or trust agreement.[18] In addition, King indicates that subrogation provision in policy is not mandatory, the

[13] Baron, p. 243.

[14] F. Joseph Du Bray, *A Response to the Anti-Subrogation Argument: What Really Emerged from Pandora's Box*, 41 S.D. L. Rev. 264, p. 276 (1996).

[15] Gary L. Wickert & Stan F. Nelson, *Many Insurers Overlook Advantages of Subrogation*, 96 Best's Review 84, p. 84 (1995).

[16] Veal, G. R., *Subrogation: The Duties and Obligations of the Insured and Rights of the Insurer Revisited*, 28 Tort & Insurance Law Journal 69, p. 69 (1992).

[17] Kintanar, A. Y. (1918). Subrogation. *Philippine Law Journal, 4*(8), 243-257, p247.

[18] Parker, p. 726.

conventional right of subrogation may arise through "the taking of a subrogation receipt from the insured at the time he is paid by the insurer".[19]

Conventional subrogation has some specific components of Roman law. For instance, in Roman law, "a person who pays a creditor could be subrogated to the rights of the creditor, provided that the subrogation is done simultaneously with the payment – *quum convenisset, ut mandaretur actiones*".[20] This point of view accepted by most of the Civil Law countries.

In contrast to Roman law, there were some limitations on subrogation rights by Common law. As a result, in order to recoup the losses, insurers turned to conventional subrogation. With the help of contracts, insurers started to include specific provisions in contracts which paved the way for insurers so as to realise 'strict subrogation rights or a subrogation reimbursement right'.[21]

2. Legal (equitable or judicial) subrogation

Apart from conventional subrogation, the law of insurance distinguishes another type of subrogation – legal subrogation. The word 'legal' in this broad sense resembles something according to law, but with regard to its use in legal subrogation, it means that kind of subrogation which arises *ministerio legis* and it also take place upon the concurrence of the required conditions.[22] This type of subrogation also had its origin in Roman law. For example, the subrogation in favour of a subsequent creditor had its origin in *jus offerendi*.[23]

Like most of the Roman law legal principles, it found admirers in not only Continental Europe, but also in Commonwealth countries. Especially, United States of America has made significant steps regarding legal subrogation in contrast to other Common law jurisdictions. Broadly speaking, in the vast majority of instances, "a person who performs the obligation of another does not need to obtain a conventional subrogation by the obligee or the obligor because the law by its direct operation subrogates that person to the right and action of obligee".[24] It has also been assumed that, in doing so, "the law introduces a sort of implied or constructive conventional subrogation".[25]

It should also be noted that the list of types of insurance subrogation is not limited to conventional and legal subrogation. For instance, there is also another type of subrogation which is called statutory subrogation. Although, there are several striking differences between these types, at the same time, these types share specific values which come from 'same root'.

[19] King, p. 69.
[20] Kintanar, p. 249.
[21] Maher & Pathak, p. 72.
[22] Kintanar, p. 256.
[23] Kintanar, p. 255.
[24] Saul Litvinoff, *Subrogation*, 50 La. L. Rev. 1143, p. 1163 (1990).
[25] Ibid.

C. Historical Perspective of Insurance Subrogation

1. From Roman law perspective

In light of the history of insurance subrogation, this legal concept has its roots in both Roman law and Common law. According to Maher and Pathak, being an extremely old doctrine, subrogation's precise origins are unclear, but it is true enough that this legal concept is a 'direct progeny' of Roman, Talmudic and French Law.[26]But, in juxtaposition to Common law, Roman law became the mainstay of subrogation and it can be traced back to two Roman law institutions: *cession or assignment of actions* and *successio in locum creditoris*.[27] The cession or assignment of actions gave all the advantages the creditor had to the third person, while the successio in locum creditoris allowed the third person only the benefit of a particular mortgage rank.[28] These two Roman law institutions were mixed by French *ancient droit* and in 1609; an edict of Henry IV sanctioned the binding force of conventional subrogation.[29]

At the other extreme, most French scholars admits that the French concept was similar to the Roman doctrine of *cessio actionum*.[30] Renusson noted the similarity between French concept and Roman doctrine:

> "The term *cession* is a common and equivocal term that includes many different things. This term is given to the transfer of a debt, to the delegation, the subrogation, and the voluntary transference of a debtor's goods to his creditors, and to the cession of wealth that a debtor does in Law to obtain his freedom of his person. All these things are different: nonetheless they are often called *cession*".[31]

2. From Common law perspective

As mentioned above, the legal principles of Roman law was also admired by Common law jurisdictions. However, in spite of nurturing from same root, without doubt, the Common law approach was different and had its own characteristics. For instance, in contrast to European jurisdictions, at Common law, subrogation is not a matter of strict law, "but a purely equitable doctrine, so that granting a remedy based thereon lies within the discretion of the court".[32]

By the middle of the nineteenth century, equitable remedy was widespread and used by both English equity and Common law courts. However, English

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[26] Maher & Pathak, p60.

[27] Litvinoff, p1150.

[28] *Ibid*.

[29] *Ibid*.

[30] M. L. Marasinghe, *Historical Introduction to the Doctrine of Subrogation: The Early History of the Doctrine II, An*, 10 Val. U. L. Rev. 275, p. 284 (1975-1976).

[31] *Ibid*.

[32] Litvinoff, p. 1150.

courts had troubles regarding the label of the concept. Thus, as highlighted by Marasinghe, the English looked to other jurisdictions which had a similar kind of equitable doctrine to name the English concept.[33] Then, the French model was very suitable for its label and the similarities between them were clear and numerous. On the other hand, it is worth noting that English courts did not use the term of 'subrogation' till 1850. Precisely, in 1851, the Privy Council had *Quebec Fire Insurance Company v. Augustin St. Louis and John Molson* which was the first case using the French concept of 'subrogation' and this was very similar to the Roman doctrine of *cessio actionum*.[34]

Bringing us through to modern times, it can be clearly seen that both doctrines - common law doctrine of subrogation and civil law doctrine of *cessio actionum* has some distinctions and similarities. First of all, it is not unreasonable to say that both concepts are the transfer of rights. In other words, both legal systems accept subrogation as a transfer of insured's rights against tortfeasor to insurer. With regard to the distinctions, it is important to emphasize the fundamental difference. At common law, there is no any requirement of any express agreement to transfer rights for applying subrogation, while civil law is in a different position; in *cessio actionum* an express agreement to transfer rights must always precede the payment.[35]

II. MADE WHOLE DOCTRINE: A *DOUBLE EDGE SWORD* OF MODERN INSURANCE INDUSTRY

A. Made Whole Doctrine as a Panacea for the Harshness of Subrogation

All the authors who have hitherto discussed the subrogation as a legal concept, none of them appears to have considered it fair unilaterally and there has not been formed accepted orthodoxy. At one extreme, some scholars sought to discredit subrogation harsh and to support its elimination,[36] at the other extreme, several legal writers of fame oppose this argument.[37] Consequently, these academic discussions and courts' decisions led to the creation of new doctrines which were aimed to ameliorate the harshness of subrogation. These doctrines have been created primarily by courts and include different approaches to the alleviation of harshness of subrogation: outright denial of subrogation, the made whole doctrine, pro rata loss sharing by insured and insurer and the common fund theory.[38] Although, each of these doctrines is

[33] Marasinghe, p. 284.
[34] *Ibid*.
[35] Marasinghe, p. 299.
[36] Baron, p. 243.
[37] *Id* at p. 264.
[38] *Id* at p. 247.

directed to ameliorate the harshness of subrogation, they possess striking differences and particular efficacy ratios.

Central to Parker's argument, in spite of the complexity and confusion surrounding the application of subrogation, nowadays as a cornerstone of the insurance industry, the made whole doctrine has become 'a double edged sword'.[39] In other words, in contrast to other doctrines, made whole doctrine has attracted much more attention and settled on the top agenda of scholars. As highlighted by Greenblatt, this doctrine is an unalterable element of subrogation and can be labelled as 'talismanic doctrine'.[40] In order to get brief idea concerning this doctrine, it is necessary to shed additional light on it.

According to this doctrine, insurer can realize its subrogation right only when the insured party is wholly compensated. Broadly speaking, it is an equitable principle "which limits the ability of an insurer to exercise its right of subrogation until the insured has been fully compensated or *made whole*.[41] In spite of its hegemony over other doctrines, the made whole doctrine did not answer all the questions related subrogation and along with its advantages, this doctrine also has several disadvantages.

B. Holes of Made Whole Doctrine?

As mentioned above, being a staple doctrine of subrogation drew legal scholars' and courts' attention. Although the doctrine was discussed a lot and accepted as the more modern concept, in the opinions of some writers, there is no need to make this doctrine 'sacrosanct'. Because, this doctrine also does have to be reviewed and its drawbacks are modified. For instance, Baron indicates that most courts make decisions about "real or net compensation", but other costs (hiring an attorney, incur court costs, etc.) should also be considered when deciding on compensation.[42] Central to his other argument, "although the made whole doctrine appears to reach an equitable result, one drawback is that it requires policing on a case-by-case basis".[43] In my point of view, these pros and cons pave the way for quintessential examination of made whole doctrine. Upon closer inspection, it is more appropriate to say that, the advantages of this doctrine 'gets the whip hand' of its own setbacks and other doctrines. It is, in a word, fundamental doctrine of subrogation in the face of insured that seeks to get double recovery.

CONCLUSION

The examination of the 'subrogation' as one of the most attractive legal concept of insurance industry has provided an accurate picture of it. In light of

[39] Parker, p. 737.

[40] Jeffrey A. Greenblatt, *Insurance and Subrogation: When the Pie Isn't Big Enough, Who Eats Last?* 64 U. Chi. L. Rev. 1337, p. 1338 (1997).

[41] Parker, p. 737.

[42] Baron, p. 251.

[43] *Ibid.*

the current high volume of large subrogation claims, it can be easily observed that courts more often refer to this legal concept. However, with regard to its theoretical framework and historical background there is *paucity* in research area.

In spite of its Roman law roots, subrogation is a mixture of civil law and common law doctrines. This hybrid nature of subrogation brings several similarities and distinctions of two legal systems to the fore. It should also borne in mind that although subrogation was first used by common law courts in 1850, in contrast to civil law jurisdictions, there have been made staple steps in order to modify this legal concept in common law jurisdictions. In support of this opinion, the doctrines designed to ameliorate the harshness of subrogation could be best examples.

As mentioned earlier, made whole doctrine maintains its dominance over other doctrines and settled on the agenda of insurance industry approximately all around the world. In today's conditions, as Parker indicates, the made whole doctrine is a double-edged sword to the detriment of both parties: insurer and insured.[44] It is also axiomatic that there can be no any doctrine, which will remain impeccable. Thus, there is need to realize modifications of doctrines or to create new ones and only in this way subrogation can keep its actuality.

[44] Parker, p. 737.

Samir Mahmudov*

FEDERAL RESERVE SYSTEM AND ITS ROLE IN THE EMERGENCE OF THE GLOBAL FINANCIAL CRISIS

Abstract

This paper is devoted to the discussion of the principles of the US Federal Reserve System, the central bank of the largest economy in the world, and its contribution to the emergence of the financial crisis of 2008. At first, in Part II, the paper focuses on the general overview of the Federal Reserve System and its activities. The discussion, then, shifts to the structure of the Federal Reserve System and focuses on its key structural components that maintain the proper functioning of the U.S. central bank. The Part III will examine the history of past events preceding to the financial crisis, and analyze factors, including the Federal Reserve System's failures, which determined the growth of subprime mortgage bubble and its painful collapse. The Part IV (Conclusion) will summarize the regulatory failures of the Federal Reserve System, clarify the chronology of mistakes, and propose possible alternative approach.

Annotasiya

Bu məqalə dünyanın ən iri iqtisadiyyatının mərkəzi bankı olan ABŞ Federal Rezerv Sisteminin (FED) strukturu və fəaliyyət prinsiplərinin, habelə FED-in 2008-ci ilin qlobal maliyyə böhranının yaranmasındakı rolunun müzakirəsinə həsr edilmişdir. Məqalənin birinci hissəsində FED-in fəaliyyəti haqqında ümumi məlumat verildikdən sonra, həmin qurumun əsas funksiyalarını təmin edən struktur elementləri və onların iş prinsipi təhlil edilir. Üçüncü hissədə maliyyə böhranından əvvəlki tarixə nəzər salınmaqla, böhranın əsas yaranma səbəblərindən biri olmuş "subprime" ipoteka köpüyünün yaranmasını və partlamasını şərtləndirmiş faktorlar, o cümlədən FED-in maliyyə siyasətindəki səhvlər diqqətdən keçirilir. Məqalənin nəticə hissəsində FED-in maliyyə siyasətindəki nöqsanlar ümumiləşdirilməklə, alternativ anti-böhran tənzimləmə yanaşması təklif olunur.

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INTRODUCTION

In the early 20th century, the United States of America could set up the most efficient and powerful financial regulator ever existed. As the following events would prove, the creation of this regulatory institution, the so-called Federal Reserve System (hereinafter, the "Federal Reserve", the "System", or the "Fed") was a historic blessing for the United States. Since its establishment, the Fed played a key role in the phenomenal rise of the American might. Through its super-efficient domestic and international financial policies, the Fed reshaped the face of the global economy forever, and triggered the process of the US worldwide economic expansion. It also made the invaluable contribution to the success of political and military expansions of the US, by backing the country's imperialistic ambitions with strong monetary support.

The System was initially invented and later headed by the most talented and powerful economists, financiers, bankers and notorious businessmen of the US at the time.[1] Acting together these people could identify the essential needs of the country's economy and the ways to effectively address those needs. In a nutshell, the Federal Reserve directed all its efforts to the creation of the sustainable financial system, which would maximize employment in the country, keep the prices stable, and generate tremendous wealth and abundance. The Fed's approach and methods for the achievement of these goals were so successful that, eventually, they ended up with making America the wealthiest country in the world.

Today, another product of the System, the Federal Reserve note (or the US dollar), is the most well-known and recognized national currency in the world. Due to its stability and reliability, the US dollar became an irreplaceable instrument of the international trade. Most of the countries in the world, including very large economies, such as China, Russia, India, etc., hold considerable parts of their foreign exchange reserves in US dollars. As it is seen, the influence of the Fed to the world economy cannot be overestimated. That being said, the Fed is simply a financial institution directed by group people. These people, no matter how smart and sophisticated they are, sometimes make mistakes. In this paper, we will try to focus on particular regulatory failures of the Fed, which subsequently led or, if to be more correct, contributed to the emergence of the global financial crisis. Alongside, the paper will provide a substantial insight into the

[1] *The Federal Reserve was created 100 years ago. This is how it happened,* The Washington Post, https://www.washingtonpost.com/news/wonk/wp/2013/12/21/the-federal-reserve-was-created-100-years-ago-this-is-how-it-happened/ (last visited Nov. 25, 2015).

structure and functions of the Fed, its activities and key structural institutions that maintain the proper functioning of the U.S. central bank.

I. PRINCIPLES OF THE FEDERAL RESERVE SYSTEM

A. Overview of the Federal Reserve System

"The Federal Reserve System – is the central bank of the United States."[2] Congress founded it in late 1913, through enacting the Federal Reserve Act, which was subsequently approved by President Woodrow Wilson, the U.S. President at the time.[3] The Fed commenced its activities in 1914, and so far it is the most successful and efficient financial regulatory institution ever established in the United States. [4] Creation of the Fed was stipulated by the necessity of centralized regulation of financial system, which became obvious after the Banking panic of 1907.[5] The Federal Reserve Act defines the purposes of the Fed as follows: "to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."[6]

The current banking legislation of the U.S. vested the Fed with following duties:

1) Performing national monetary policy focused on such economic goals as "maximum employment, stable prices, and moderate long-term interest rates;"[7]
2) Overseeing banking institutions and regulating financial system of the country;[8]
3) Securing stability of the financial system;[9]

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[2] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions p. 1 (2005), http://www.federalreserve.gov/pf/pdf/pf_complete.pdf (last visited Nov. 25, 2015).

[3] *Id.* at 1-2.

[4] *Id.* at 11.

[5] Myron T. Herrick, *The Panic of 1907 and Some of Its Lessons*, 31(2) Annals of the Am. Acad. of Pol. and Soc. Sci., 8, pp. 8–25 (1908).

[6] *See* An Act to Provide for the Establishment of Federal Reserve Banks, to Furnish an Elastic Currency, to Afford Means of Rediscounting Commercial Paper, to Establish a More Effective Supervision of Banking in the United States, and for Other Purposes, Public Law 63-43, 63d Congress, H.R. 7837 (1913), https://fraser.stlouisfed.org/scribd/?title_id=966&filepath=/docs/historical/fr_act/nara-dc_rg011_e005b_pl63-43.pdf#scribd-open (last visited Nov. 25, 2015).

[7] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra note 2*.

[8] *Id.*

[9] *Id.*

4) Furnishing financial services to a number of specific recipients, including the U.S. government, internal and external (foreign) financial institutions, and etc.[10]

The Fed is a very powerful financial regulator, which is entitled to adopt independent decisions within the scopes of its competences, stipulated by national objectives of economic and financial policy.[11] None of the representatives of the executive branch, including the U.S. Secretary of the Treasury, or even a President of the United States, is authorized to influence on or disapprove the decisions of the Fed.[12] However, the latter is accountable to the Congress, and has to maintain transparency in the governing of the financial system.[13]

B. Structure of the Federal Reserve System

Pursuing the economic prosperity of the nation, the U.S. Congress structured the Fed as a system of the following agencies:

a) the Board of Governors ("the Board" or "the Governors");[14]
b) twelve regional Federal Reserve Banks ("the Reserve Banks");[15]
c) the Federal Open Market Committee;[16]
d) In addition to the foregoing major bodies, there are also two auxiliary elements of the System:
e) the Depository Institutions (Member Banks);[17] and
f) the Federal Advisory Committees (Councils).[18]

The central agency of the System is, of course, the Board, which together with the Federal Reserve Banks controls and regulates the proper operation of financial system.[19]

The Federal Open Market Committee ("the FOMC") is another crucial element of the System. It supervises financial activities in the open market.[20] This function is the main instrument used by the Fed to regulate monetary policy.[21] The FOMC consists of twelve Members, who are appointed out of the

[10] *Id.* at 3.
[11] William J. McDonough, *An Independent Central Bank in a Democratic Country: The Federal Reserve Experience*, 19 FRBNY Q. Rev. 1, pp. 2-4 (Spring, 1994).
[12] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at pp. 2-3.
[13] *Id.*
[14] Federal Reserve Act, 12 U.S.C. § 241-252 (2006).
[15] 12 U.S.C. § 225.
[16] 12 U.S.C. § 263.
[17] 12 U.S.C. § 342.
[18] 12 U.S.C. § 261-262.
[19] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 3.
[20] 12 U.S.C. § 263.
[21] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at pp. 3-4.

members of the Board and the Reserve Banks, as follows: a) seven Members of the Board; b) the president of the Federal Reserve Bank of New York, and c) four rotating members - the presidents of other Federal Reserve Banks.[22]

The Fed governs monetary policy through regulating the federal funds rate —the rate at which banks make loans to each other from their balances held at the Federal Reserve.[23] The Federal Reserve performs this function through application of following regulatory tools:

1) Open market operations — trading with government bonds and securities in the open market "to influence the level of balances that depository institutions hold at the Federal Reserve Banks"[24]. As can be seen from the very name of this tool, the Fed buys and sells government bonds only in the open market, since the law prohibits the latter from trading directly with the U.S. Department of the Treasury that actually issues the government bonds[25] (also called Treasury bonds)[26]. The Federal Reserve Bank of New York is authorized by the FOMC to conduct open market transactions on behalf of the Federal Reserve.[27] In order to ensure the permanent ability to buy and sell securities, the Federal Reserve Bank of New York trades mainly with its major financial counterparts[28] from the approved list of primary dealers.[29] The primary dealers hold their respective accounts at the Federal Reserve Bank of New York, and are required to comply with the "capital standards of their primary regulators and satisfy other criteria consistent with being a meaningful and creditworthy counterparty."[30] As to the very trading process, the Federal Reserve Bank of New York purchases and sells the government bonds through the QE auctions.[31] The initial prices for the securities are

[22] *Id.*

[23] *Federal-Funds Rate*, Black's Law Dictionary (10th ed. 2014).

[24] See Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 3.

[25] 12 U.S.C. § 355(1).

[26] *Treasury Bond*, Black's Law Dictionary (10th ed. 2014); *Treasury Bond – T-Bond*, INVESTOPEDIA, http://www.investopedia.com/terms/t/treasurybond.asp?layout=orig (last visited Nov. 25, 2015).

[27] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 37.

[28] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at pp. 37-38.

[29] For the current primary dealers list *see Primary Dealers List*, FED. RES. BANK of N. Y., https://www.newyorkfed.org/markets/pridealers_current.html (last visited Nov. 25, 2015).

[30] *Id.*

[31] Zhaogang Song and Haoxiang Zhu, Divisions of Research & Statistics and Monetary Affairs, Bd. of Governors of the Fed. Reserve Sys., QE Auctions of Treasury Bonds 1, (2014). "QE auctions—a series of multi-object, multi-unit, and discriminatory-price auctions, conducted with primary dealers recognized by the Fed," http://www.federalreserve.gov/pubs/feds/2014/201448/201448pap.pdf (last visited Nov. 25, 2015).

stipulated by demand in the open market and supply conditions.[32] If the Fed decides to increase the money supply (for regulatory purposes), then it purchases Treasury bonds from the securities dealers, "who sell the bonds with cash" and, accordingly, "increases the overall money supply in the economy".[33] As a result of this additional money injection into the economy, the interest rate (or the cost of borrowing) in the banking system declines, since the overall availability and accessibility of money in the market increases substantially.[34] When the decline in the interest rate goes beyond the target range established by the FOMC, then the Fed may decide to decrease the money supply.[35] For this purpose, the Fed will sell government securities from its account, "thus taking in cash and removing money from the economic system."[36] As opposed to the consequences of buying the bonds, here as an effect of sale, the money supply will decrease causing an upsurge of interest rates.[37]

2) Reserve requirements — the specified amount of funds (usually in the form of cash), which depository institutions are required to hold in their vault against potential claims of customers.[38] The Fed is authorized by law to change the required reserve ratios and, thus, to adjust the latter to its regulatory needs and purposes.[39] When the Fed wants to decrease money supply, it increases the required reserve ratios so that banks are compelled to hold more deposits in their vaults and consequently have less money lend to their customers.[40] As a result the borrowing costs (or the interest rates) begin to increase.[41] Conversely, when the Fed decreases the required reserve ratios, banks are allowed to release some additional money from their vaults and use them for lending or other interest bearing financial purposes.[42] Accordingly, while the overall money supply in the economy is increased, the interest rates start gradually declining.[43]

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[32] *Why doesn't the Federal Reserve just buy Treasury securities directly from the U.S. Treasury?*, Bd. of Governors of the Fed. Reserve Sys., http://www.federalreserve.gov/faqs/money_12851.htm (last visited Nov. 25, 2015).

[33] Chris Gallant, *How do central banks inject money into the economy?*, INVESTOPEDIA, http://www.investopedia.com/ask/answers/07/central-banks.asp (last visited Nov. 25, 2015).

[34] *Id.*

[35] *Id.*

[36] *Id.*

[37] Reem Heakal, *How The U.S. Government Formulates Monetary Policy?*, INVESTOPEDIA, http://www.investopedia.com/articles/04/050504.asp (last visited Nov. 25, 2015).

[38] See Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 3.

[39] 12 U.S.C. § 461.

[40] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra note 2*, at pp. 41-42.

[41] *Id.*

[42] *Id.*

[43] *Id. at 43.*

3) Contractual clearing balance requirement — financial reserve that depository institutions are recommended to hold in their Federal Reserve accounts in addition to the required reserve balance.[44] The purpose behind this requirement is to increase safety and soundness of the financial system and to facilitate possible clearing[45] needs of member banks.[46]

4) Discount window lending—is another tool of regulating monitory policy, which allows depository institutions to borrow money from the Federal Reserve at a discount rate for the purpose of addressing their liquidity issues.[47] Every Federal Reserve Bank is entitled to change the discount rate for its discount window ("subject to review and determination of the Board of Governors")[48]; thus, making borrowing from federal funds more or less expensive or, in other words, more or less accessible.[49] So, for instance, when the Federal Reserve Bank increases the discount rate, member banks try to abstain from borrowing money from discount window.[50] Therefore, member banks have less money to lend and the overall money supply in the economy decreases, entailing an increase in the federal funds rate.[51] In contrast, by decreasing the discount rate, the Fed makes the cost of borrowing from the discount window less expensive and, accordingly, more attractive for the banks.[52] This, in turn, causes the reduction in the federal funds rate, which stimulates transfers and circulation of large volumes of money among financial institutions.[53] Through these larger money circulation and affordable borrowings, banks obtain more money to lend their clients and, consequently, inject more money in the economy.[54]

Two other elements of the System also play a very important role in its operation and, along with other duties, are responsible for transmitting the

[44] *Id.* at p. 3.

[45] *Clearing*. Black's Law Dictionary (10th ed. 2014). The exchanging of checks and balancing of accounts [through debiting the account of check issuer and crediting the account of beneficiary].

[46] *See* Reserve Requirements for Depository Institutions, 74 Fed. Reg. 25,620, 25,622 – 25,629 (May 29, 2009) (to be codified at 12 C.F.R. pt. 204).

[47] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra note 2*, at pp. 2-3.

[48] 12 U.S.C. § 357.

[49] *Discount Window Lending*, Bd. of Governors of the Fed. Reserve Sys., http://www.federalreserve.gov/newsevents/reform_discount_window.htm (last visited Nov. 25, 2015).

[50] *Id.*

[51] *Id.*

[52] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra note 2*, at p. 33.

[53] *Id.*

[54] *Id.*

monitory policy to the financial markets (depository institutions),[55] as well as advising the System's major bodies different concerning specific aspects and demands of the financial system (Federal Advisory Committees).[56]

1. Board of Governors

Being established in accordance with the Congressional Statute (Federal Reserve Act, 1913), the Board of Governors is "an independent entity within a federal government."[57] The "independence" of the Fed is restricted by the nation's primary macroeconomic objectives, such as, maximum employment and price stability, set by the Congress.[58] In this regard, it is often said that the Federal Reserve has only limited *goal independence*, and rather broad *instrument independence*.[59] For instance, the Fed, cannot sacrifice the price stability in order to decrease unemployment level (or to pursue any other economic objective).[60] At the same time, the vagueness of the objectives (e.g. maximum employment) leaves to the System a large room for interpretation and, thus, increases its goal independence.[61] The Federal Reserve enjoys full instrument independence and, in this sense, is free to choose the economic methods and tools by which it intends to accomplish its goals.[62] The general idea behind the independence of the Federal Reserve is that the decisions of the nation's central financial regulator should not be politically motivated, rather have to be based on rational judgement determined by the "laws of economics."[63] Throughout the wild economic upheavals of the 20th century,

[55] Ann-Marie Meulendyke, Fed. Reserve Bank of N.Y, U.S. Monetary Policy and Financial Markets 57 (1998).

[56] *See* Wendy R. Ginsberg, *Federal Advisory Committees: An Overview*, Congressional Research Service 1-2, (2009), https://fas.org/sgp/crs/misc/R40520.pdf (last visited Nov. 25, 2015).

[57] *What does it mean that the Federal Reserve is "independent within the government?"*, Bd. of Governors of the Fed. Reserve Sys., (Jan. 9, 2015), http://www.federalreserve.gov/faqs/about_12799.htm.

[58] Fed. Reserve Bank of St. Louis, In Plain English: Making Sense of The Federal Reserve 16 (2013), https://www.stlouisfed.org/~/media/Images/Education/In%20Plain%20English/PDFs/In_Plain_English.pdf (last visited Nov. 25, 2015).

[59] Guy Debelle & Stanley Fischer, *How Independent Should a Central Bank Be?*, *in* Goals, Guidelines, and Constraints Facing Monetary Policymakers 197, (Jeffrey C. Fuhrer ed., 1994).

[60] *Id.*

[61] Carl E. Walsh, *Central Bank Independence*, *in* 1 The New Palgrave Dictionary of Economics 729 (Steven N. Durlauf & Lawrence E. Blume eds., 2d ed. 2008), http://people.ucsc.edu/~walshc/MyPapers/cbi_newpalgrave.pdf (last visited Nov. 25, 2015).

[62] *See* Debelle & Fischer, *supra* note 59.

[63] Lorenzo Bini Smaghi, *Central bank independence*, Speech at the "Good Governance and Effective Partnership" conference in Budapest, Hungarian National Assembly (Apr. 19, 2007), https://www.ecb.europa.eu/press/key/date/2007/html/sp070419.en.html (last visited Nov. 25, 2015).

the concept of the "independent central bank" has proved to be efficient, and currently is successfully applied by the world's strongest economies.[64]

The Board is comprised of the seven members, of whom "at least 1 member with demonstrated primary experience [in banking area]", appointed by the U.S. President and subject for the Senate's approval.[65] With the consent of the Senate, every four year the President also designates one Chairman and two Vice-Chairmen of the Board, selecting them out of active Governors.[66] The Board members serve for the period of 14 years and cannot be reappointed for the second term.[67] Their mandates are staggered, so that the term of one Governor expires every two years.[68] Such organization helps to limit the influence of the U.S. President to the Board's decisions, "making it unlikely that any President would be able to dominate the Board with a majority of his own appointees until near the end of his own second four-year term in office."[69] Moreover, once having appointed, the President cannot dismiss the Governors from their positions; therefore, the latter enjoy broad functional independence and may ignore or even oppose the President's view regarding the monetary policy issues.[70] The Federal Reserve also benefits from the privilege of being self-financing agency, generating its income from several payments of member banks and, thus, is financially independent from the Congress.[71] However, compared to the U.S. President, the Congress possesses larger competence to check and influence on the Board's decisions.[72] The Congress not only participates in the process of granting the Governor's mandates, but also hears the annual reports of the Board's Chairman on the Federal Reserve operations.[73] The Congress may discuss, criticize and express its recommendations concerning System's activities.[74] Although, the Fed is not obliged to follow Congressional opinion, it must act carefully in this regard, since the Congress retains the power to impeach the Governors, to alter the

[64] *Central bank*, New World Encyclopedia (last modified Apr. 28, 2013), http://www.newworldencyclopedia.org/entry/Central_bank (last visited Nov. 25, 2015).
[65] 12 U.S.C. § 241.
[66] 12 U.S.C. § 242.
[67] *Id.*
[68] *Id.*
[69] Paul M. Johnson, *Federal Reserve System*, A Glossary of Political Economy Terms, https://www.auburn.edu/~johnspm/gloss/federal_reserve_system (last visited Oct. 17, 2015).
[70] *Id.*
[71] *Where does the Federal Reserve get the money to fund its operations?*, Fed. Reserve Bank of S.F. (2006), http://www.frbsf.org/education/publications/doctor-econ/2006/may/federal-reserve-funding (last visited Nov. 25, 2015).
[72] Johnson, *supra* note 69.
[73] 12 U.S.C. § 247.
[74] Johnson, *supra* note 69.

Fed's statutory responsibilities, or even to entirely eliminate the Federal Reserve System through simple majority vote in both chambers.[75]

The Federal Reserve Act vests the Board with a very wide range of, so called, "enumerated powers,"[76] which determine the following primary responsibilities of the Board: a) to control and supervise financial institutions operating within the system; b) to coordinate activities of supervised financial institutions; c) to examine accounts and affairs of financial institutions; and etc.[77] In order to properly fulfil its duties and deliver prudent decisions, the Board of Governors conducts comprehensive analysis of modern trends and achievements in such areas as economics and finance.[78] Moreover, the Board "oversees and regulates the operations of the Federal Reserve Banks, and exercises broad responsibility in ensuring proper operation of the nation's payments system."[79] It supervises the in-country activities of nearly "900 state-chartered member banks and 5,000 bank holding companies"[80], as well as their out of the U.S. operations.[81] It worth noting that the Board is also authorized to inspect the nonbank subsidiaries of the bank holding companies, such as mortgage companies[82] (to ascertain the effects and repercussions of financial transactions between nonbank and bank subsidiaries of the bank holding companies).[83] Alongside, foreign financial institutions operating in the U.S. are also subjected to the Board's supervision.[84] In order to correct existing regulatory deficiencies, Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("the Dodd-Frank Act")[85], further extended powers of the Board, transferring to the latter "the supervisory functions of the Office of Thrift Supervision (OTS)

[75] *Id.*

[76] 12 U.S.C. § 248.

[77] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 4.

[78] *Id.*

[79] *Id.*

[80] *Bank Holding Company*, Black's Law Dictionary (10th ed. 2014). A company that owns or controls one or more banks. Ownership or control of 25 percent is usually enough for this purpose.

[81] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 4.

[82] Div. of Banking Supervision and Regulation, Bd. of Governors of the Fed. Reserve Sys., Supplement 46 to the Bank Holding Company Supervision Manual 1 (July, 2014), http://www.federalreserve.gov/boarddocs/supmanual/bhc/bhc.pdf (last visited Nov. 25, 2015).

[83] *Bank Holding Company Supervision Manual*, Bd. of Governors of the Fed. Reserve Sys., http://www.federalreserve.gov/boarddocs/supmanual/supervision_bhc.htm (last visited Nov. 26, 2015).

[84] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 4.

[85] 12 U.S. Code § 5412.

related to [Savings and Loan Holding Companies] SLHCs and their non-depository subsidiaries beginning on July 21, 2011."[86]

Some of the Board's regulations are binding for the whole banking system, while its other acts touch only member banks (state banks that have opted to join the System) and national banks (required to be the Fed's members in accordance with law).[87] Governors are in permanent contact with other key governmental officials.[88] Quite often, congressional committees listen to the Governor's reports and testimonies concerning various financial issues and the potential economic impact of the drafted bills.[89] According to the Federal Reserve Act, the Vice Chairman semi-annually testifies before the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services concerning "the efforts, activities, objectives, and plans of the Board with respect to the conduct of monetary policy", as well as regulation of financial institutions and future projections in this regard.[90] In order to ensure the public accountability and transparency in the operation of the System, the Law requires the Board of Governors "to order an annual independent audit" of its own financial statements and those of Reserve Banks.[91] The audit is conducted by one of the major public accounting firms, and the final audit report together with other relevant materials is included in the Annual Report of the Board of Governors, which is subsequently submitted to the consideration of the Congress.[92]

2. Federal Reserve Banks

The Board of Governors controls and regulates the banking system of the United States through the network of twelve Federal Reserve Banks[93] and their twenty-four Branches.[94] Reserve Banks perform a wide range of Fed's functions, as to "operating a nationwide payments system, distributing the nation's currency and coin, supervising and regulating member banks and

[86] *Supervision of Savings and Loan Holding Companies (SLHCs)*, Supervision and Regulation Letters, Bd. of Governors of the Fed. Reserve Sys., http://www.federalreserve.gov/bankinforeg/srletters/sr1111.htm#Footnote1 (last visited Nov. 26, 2015).

[87] *See* Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 4.

[88] *Id.*

[89] *Id.*

[90] 12 U.S.C. § 247b.

[91] 12 U.S.C. § 248b.

[92] 12 U.S.C. § 247; Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 6.

[93] *Id.*

[94] Bd. of Governors of the Fed. Reserve Sys., Annual Report: Budget Review p. 1 (2013), http://www.federalreserve.gov/publications/budget-review/files/2013-budget-review.pdf (last visited Nov. 26, 2015).

bank holding companies, and serving as banker for the U.S. Treasury."[95] Furthermore, each Reserve Bank accepts, holds and manages the deposits of the member banks that operate in its District.[96]

The Reserve Banks carry out the foregoing functions within the boundaries of their specific geographic area, the so called the Federal Reserve Districts.[97] Each District labeled with its specific number and the appropriate letter of the alphabet (e.g. 1 A – is a District of the Federal Reserve Bank of Boston, 2 B – New York, 12 L – San-Francisco, and etc.).[98] One may find these "requisites" reflected on the national currency (usually, below the serial number of the bill).[99] This reflection indicates on the respective Reserve Bank, which issued that particular banknote and accounts for it. For instance, the banknote with the requisite of "3 C" on it was issued by the Federal Reserve Bank of Philadelphia and appears on the balance sheet of the latter.[100]

The Board oversees the proper performance of major functions of the Federal Reserve Banks and their Branches, as well as examines compliance their activities to the standards established by laws and regulations.[101] This supervision and the examinations mainly concern the services rendered by the Federal Reserve Banks' to respective financial institutions.[102] However, more frequently activities of separate banking institutions are also becoming a subject of the Board's direct oversight.[103] Another form of the Board's supervision over the Federal Reserve Banks is the requirement for the latter to submit annual budgets for getting the Board's approval.[104]

The Congress also oversees the proper functioning of the Federal Reserve Banks as part of their supervision of the Federal Reserve System.[105] Among other things, the Congress usually pays special attention to the particular goals behind actions of the Federal Reserve Banks, since the latter were exclusively chartered by the Congress for a public purpose, so that they

[95] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 6.

[96] *Id.*

[97] Bd. of Governors of the Fed. Reserve Sys., Annual Report: Budget Review, *supra* note 94, at 47.

[98] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at pp. 7-9.

[99] Fed. Reserve Bank of St. Louis, In Plain English: Making Sense of The Federal Reserve *supra* note 58, at p. 8.

[100] *Id.*

[101] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at pp. 10-11.

[102] *Id.*

[103] *Id.*

[104] *Id.*

[105] *Id.*

cannot pursue any private interests.[106] This becomes especially important, as the Federal Reserve Banks "combine both public and private elements in their makeup and organization."[107]

The Law provides that "[e]very Federal Reserve Bank shall be conducted under the supervision and control of a board of directors."[108] In total, the board shall consist of nine directors selected outside the particular Reserve Bank.[109] The Law divides the board of directors into three Classes (A, B, and C), [110] intended to establish cross-sectional representation of such areas as "banking, agriculture, commerce, industry, services, labor, and consumers."[111] Three directors of Class A shall be selected by and out of representatives of commercial (stockholding) banks that are members of the Fed.[112] Therefore, Class A designated to represent both banking sector and private interest in regulation of banking system.[113] Class B and Class C directors designated to represent all other sectors specified by law and pursue public interests.[114] Member banks of the Fed choose Class A and Class B directors,[115] while the Board of Governors appoints Class C directors.[116] The Board of Governors, further, shall designate one of Class C directors as the chairman of the board of directors and as the "Federal reserve agent"[117] The latter regularly reports to the Board of Governors on current issues and activities of the particular Federal Reserve Bank and the respective board of directors.[118] In this capacity, the chairman shall act as an "official representative" of the Board.[119]

Another crucial position in the structure of the Federal Reserve Banks is a position of the president, who acts as a chief executive of the Reserve Bank.[120] The Dodd-Frank Act changed the appointment procedure for the presidents

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[106] *Id.*

[107] *Id.*

[108] 12 U.S.C. § 301.

[109] 12 U.S.C. § 302.

[110] *Id.*

[111] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 10.

[112] 12 U.S.C. § 302.

[113] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 10.

[114] 12 U.S.C. § 302.

[115] 12 U.S.C. § 304.

[116] 12 U.S.C. § 305.

[117] *Id.*

[118] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at 10.

[119] 12 U.S.C. § 305.

[120] *Federal Reserve Bank Presidents*, Bd. of Governors of the Fed. Reserve Sys., http://www.federalreserve.gov/aboutthefed/bios/banks/default.htm (last visited Nov. 26, 2015).

of the Federal Reserve Banks.[121] If earlier the entire board of directors selected the Federal Reserve president, and this selection had to be approved by the Board of Governors,[122] now the Reserve Bank presidents are appointed by a vote of only the Class B and Class C directors with a subsequent approval of the Board of Governors.[123] The main purpose behind the exclusion of the Class A directors from the appointment of the Reserve Bank presidents, was the desire of Congress to reduce the overall influence of bankers to the selection process, as well as to prevent "potential conflicts of interest that could arise from bankers participating in the selection of the leadership of their federal bank supervisor."[124] The Branches of Reserve Banks have their own board of directors comprised of three to seven members.[125] The Branch's Reserve Bank appoints the majority of those directors, and the Board appoints remained members.[126]

The Federal Reserve Banks through their boards of directors collect important "information on economic conditions from every corner of the country" and subsequently convey it to the Fed.[127] This information reflects the reports of the Reserve Bank directors and Branch directors, interviews with major business persons, economists, financial experts and other reliable sources.[128] The Board of Governors and the FOMC analyze this information and use it in making crucial decisions on monetary policy.[129] The Federal Reserve System also shares this information with the public through the so-called *Beige Book*, which is published eight times a year.[130] The Beige Book includes the reports of all the Federal Reserve Banks on current economic conditions in their respective district.[131] The board of directors of each Federal Reserve Bank is authorized to propose the interest rate for its Reserve Bank's

[121] Peter Conti-Brown and Simon Johnson, Peterson Institute for International Economics, Governing the Federal Reserve System after the Dodd-Frank Act, (Pol'y Brief, Oct. 2013), https://www.piie.com/publications/pb/pb13-25.pdf (last visited Nov. 26, 2015).

[122] *Id.*

[123] 12 U.S.C.A. § 341.

[124] Bd. of Governors of the Fed. Reserve Sys., DIRECTORS – Appointment of Reserve Bank Presidents and First Vice Presidents, http://www.federalreserve.gov/aboutthefed/directors/PDF/appointment-of-reserve-bank-presidents-first-vice-presidents.pdf (last visited Nov. 25, 2015).

[125] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 10.

[126] *Id.*

[127] *Id.*

[128] *Beige Book,* Bd. of Governors of the Fed. Reserve Sys., http://www.federalreserve.gov/monetarypolicy/beigebook/ (last visited Nov. 26, 2015).

[129] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at pp. 10-11.

[130] *Beige Book,* Bd. of Governors of the Fed. Reserve Sys., *supra* note 128.

[131] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at pp. 10-11.

discount window.[132] However, the discount rates subsequently shall be reviewed and approved by the Board of Governors.[133]

3. Federal Open Market Committee

As it was mentioned above, the principal function of the FOMC refers to oversight of open market operations, which is the Fed's main instrument in regulation of the U.S. monetary policy.[134] In general, the open market operations determine how much money financial institutions can get from the Federal Reserve balances, and in this regard affect "overall monetary policy and credit conditions."[135] Another major task of the FOMC is conducting financial operations initiated by the Fed in foreign exchange markets.[136]

The FOMC is comprised of twelve members, of whom seven are the members of the Board of Governors and five are the Federal Reserve Bank presidents.[137] The president of the Federal Reserve Bank of New York serves as the FOMC member on a permanent basis, while each of other four presidents serve one-year rotating term.[138] Though all the FOMC members actively participate in the committee's discussions of major financial issues, economic trends and policy variations, only five members who are the Federal Reserve Banks' presidents are allowed to vote on policy decisions.[139] The members of the FOMC through internal voting elect their chairman and vice-chairman, however, according to the established tradition, the Chairman of the Board of Governors and the president of the Federal Reserve Bank of New York are elected to the mentioned positions respectively.[140]

4. Member Banks

All the U.S. commercial banks can be broken into three groups according to their relations with the Federal Reserve System.[141] The first group consist of the national banks chartered by the federal government. [142] These banks automatically get membership in the Federal Reserve System as prescribed by law.[143] The second group includes state chartered banks, which subsequently

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[132] Brian F. Madigan and William R. Nelson, *Proposed Revision to the Federal Reserve's Discount Window Lending Programs,* 88 Fed. Res. Bull. 313, p. 316 (July, 2002).

[133] *Id.*

[134] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at pp. 11-12.

[135] *Id.*

[136] *Id.*

[137] 12 U.S.C. § 263(a).

[138] *Federal Open Market Committee*, Bd. of Governors of the Fed. Reserve Sys., http://www.federalreserve.gov/monetarypolicy/fomc.htm (last visited Nov. 25, 2015).

[139] 12 U.S.C. § 263(a).

[140] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at pp. 11-12.

[141] *Id.* at p. 12.

[142] *Id.*

[143] *Id.*

opted to become a member of the Fed (state member banks).[144] The third group is comprised of other state banks, which decided not to join the Fed or simply cannot meet the requirements of the Fed (state non-member banks).[145] As can be seen, the law does not require state banks to obtain the Fed's membership, rather they are free to elect this prerogative, if they can comply with the Fed's standards.[146] Member banks shall "subscribe to the stock of the Federal Reserve bank [in the amount of 6 percent of their capital and surplus] organized within the district in which the applying bank is located."[147] This subscription (or purchase) is basically a legal condition of having membership in the Fed.[148] Member banks cannot sell subscribed stocks or use them as collateral for business transactions.[149] Similarly, the Federal Reserve Banks are also prohibited to sell their stocks to "individuals or entities other than member banks."[150] Regarding member banks, the law additionally provides that they shall receive the annual dividends in the amount of 6 percent on those subscribed stocks,[151] and also shall have a right to vote for Class A and Class B directors of their respective Federal Reserve Banks.[152]

5. Advisory Committees

Advisory Committees play a very important role in ensuring the proper functioning of the Federal Reserve System by advising the latter on various significant issues.[153] Out of nearly 1,000 active committees[154] only three are entitled to advise the Board of Governors directly[155]:

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[144] *Id.*

[145] *Id.*

[146] The membership requirements for the state banks are envisaged in the 12 U.S.C. § 321 – 339(a).

[147] 12 U.S.C. § 282, 321.

[148] Bob Eisenbeis, *Dividends on Federal Reserve Stock and Highway Funding*, Cumberland Advisors, http://www.cumber.com/dividends-on-federal-reserve-stock-and-highway-funding/ (last visited Oct. 8, 2015).

[149] Pam Martens, *Kill This Entitlement Program: The 6% Risk-Free Dividend the Fed Has Been Paying Wall Street Banks For Almost a Century*, Wall Street On Parade (Nov. 4, 2012), http://wallstreetonparade.com/2012/12/kill-this-entitlement-program-the-6-risk-free-dividend-the-fed-has-been-paying-wall-street-banks-for-almost-a-century/.

[150] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at pp. 11-12.

[151] Martens, *supra* note 149.

[152] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at pp. 11-12.

[153] *Id.* at p. 13.

[154] Wendy R. Ginsberg, *The Federal Advisory Committee Act: Analysis of Operations and Costs*, Congressional Research Service 7 (Oct. 27, 2015), https://www.fas.org/sgp/crs/secrecy/R44248.pdf (last visited Nov. 25, 2015).

[155] *Advisory Councils*, Bd. of Governors of the Fed. Reserve Sys., http://www.federalreserve.gov/aboutthefed/advisorydefault.htm (last visited Nov. 25, 2015).

• ***Federal Advisory Council*** **-** consists of representatives of all twelve Federal Reserve Districts, selected by the respective Federal Reserve Bank.[156] The representatives to the Federal Advisory Council are chosen annually, but as a tradition serve three one-year terms.[157] This council advises the Board on all range of responsibilities carried out by the latter and, in particular, regarding the current conditions in the banking industry and money supply issues.[158] The law requires the Federal Advisory Council to gather as minimum four times a year in Washington, D.C.[159]

• ***Community Depository Institutions Advisory Council ("the CDIAC")*** – is also composed of twelve representatives (one per Federal Reserve District), selected by the respective Federal Reserve Bank from local advisory councils.[160] The main task of the CDIAC is to provide oral and written representations to the Board on matters of "economy, lending conditions, and other issues of interest to community depository institutions."[161] Meetings of the CDIAC with the Board of Governors are held twice a year in Washington D.C.[162]

• **Community Advisory Council ("the CAC")** – is one of the youngest advisory committees established by the Board on January 16, 2015.[163] Unlike the Federal Advisory Council and the CDIAC, which represent depository institutions, the CAC is intended to represent consumers with a special emphasis on low-income and moderate-income population.[164] 15 members of the CAC are selected by the Board among the applicants who submitted their Statements of Interest in response to "the Board's public request for candidates."[165] The main qualification for the members of the CAC is a good knowledge and expertise in such areas as "affordable housing, community and economic development, small business, and asset and wealth building"

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[156] *Federal advisory council*, 2 West's Fed. Admin. Prac. § 1808 (2015).

[157] Bd. of Governors of the Fed. Reserve Sys., The Federal Reserve System: Purposes and Functions, *supra* note 2, at p. 13.

[158] *Id.*

[159] *Id.*

[160] Gavin Miller, *Community Banks, Fed Connect Through the Community Depository Institutions Advisory Council*, Cmty. Banking Connections, Fed. Reserve Sys., https://www.communitybankingconnections.org/articles/2012/q3/community-banks-connect-with-cdiac (last visited Nov. 28, 2015).

[161] *Community Depository Institutions Advisory Council*, Bd. of Governors of the Fed. Reserve Sys., http://www.federalreserve.gov/aboutthefed/cdiac.htm (last visited Nov. 28, 2015).

[162] *Id.*

[163] Solicitation of Statements of Interest for Membership on the Community Advisory Council, 80 Fed. Reg. 19,662 (Apr. 13, 2015), http://www.gpo.gov/fdsys/pkg/FR-2015-04-13/pdf/2015-08354.pdf (last visited Nov. 25, 2015).

[164] *Community Advisory Council*, Bd. of Governors of the Fed. Reserve Sys., http://www.federalreserve.gov/aboutthefed/cac.htm (last visited Nov. 28, 2015).

[165] Solicitation of Statements of Interest for Membership on the Community Advisory Council, 80 Fed. Reg. at 19,662.

and etc.[166] The Board of Governors plans to meet with the CAC twice a year in Washington.[167]

II. FEDERAL RESERVE POLICIES CONTRIBUTED TO THE FINANCIAL CRISIS

Many academic and non-academic papers were written explaining a large number of reasons behind the Financial Crisis of 2008. Indeed, there are multiple factors which have triggered this financial disaster,[168] but the "guilt" of the Federal Reserve System in this regard seems much higher than that of any other contributor, since the prediction and prevention of such disasters is the direct duty of the country's central bank. The Fed began contributing to the Financial Crisis of 2008 much before the actual occurrence of the crisis, and even before the preceding *Dot-Com Crisis* of 2000. But let us first go to Japan.

In the late 1980s, the economy of Japan after decades of swift development started acquiring the symptoms of bubble economy.[169] One of the major reasons behind the formation of the so-called *Japanese asset price bubble* was a delayed response of the Bank of Japan ("the BoJ") and its erroneous monetary policy.[170] Too much liquidity in the economy and the low interest rates maintained by the central bank stimulated excessive economic activity that resulted in the ultimate overheating of the economy,[171] entailing artificial overinflation of real estate and stock market prices.[172] Trying to address the upcoming crisis the BoJ in a few steps tightened the monetary policy, raising the official discount rate from 2.5% in 1989 to 6% in 1990. Together with some additional measures applied by the BoJ,[173] this tightening policy increased the

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[166] *Id.*

[167] *Id.*

[168] *The origins of the financial crisis,* The Economist (Sep. 7, 2013), http://www.economist.com/news/schoolsbrief/21584534-effects-financial-crisis-are-still-being-felt-five-years-article (last visited Nov. 25, 2015).

[169] Thayer Watkins, *The Bubble Economy of Japan*, San Jose State University, http://www.sjsu.edu/faculty/watkins/bubble.htm (last visited Nov. 25, 2015).

[170] Barry Nielsen, *The Lost Decade: Lessons from Japan's Real Estate Crisis*, INVESTOPEDIA, http://www.investopedia.com/articles/economics/08/japan-1990s-credit-crunch-liquidity-trap.asp (last visited Nov. 29, 2015).

[171] Takatoshi Ito and Frederic S. Mishkin, *Two Decades of Japanese Monetary Policy and the Deflation Problem*, Monetary Policy under Very Low Inflation in the Pacific Rim, 15 NBER-EASE 131, 137 (2006), http://www.nber.org/books/ito_06-1 (last visited Nov. 25, 2015).

[172] Thayer Watkins, *supra* note 169.

[173] Takatoshi Ito and Frederic S. Mishkin, supra note at p. 171. ("In tandem with the interest rate hike, regulatory tightening was applied to stop increases in land prices including: limiting the increase in bank lending to real estate related projects and companies in the spring of 1990, and raising taxes on realized capital gains from land investment. Stock prices finally turned down from the first trading day of 1990. The stock price index declined by one-

cost of borrowing by more than 150%, thereby substantially decreasing the ability of consumers to repay their loans, and severely affecting financing of real estate related business projects.[174] As subsequent events revealed, these too late and too harsh measures failed have intended healing effect, rather they accelerated the actual collapse of the bubble causing one of the deepest and longest recessions in the history.[175]

The similar situation occurred in the United States in 1997, as a result of the unprecedented development of information technologies and internet boom of 1990s, where the IT (or Dot-Com) stock market was speculatively overvalued.[176] Not willing to repeat the Japanese scenario, the Fed through the "four monetary strikes" increased the federal fund's rate from 5.25% in 1999 to 6.5% in 2000 and the Dot-Com bubble collapsed.[177] The Fed acted much more careful than BoJ at the time and boosted interest rates just to an extent necessary to lash-out the bubble.[178] However, since the Fed failed to react timely, the bubble could still become sufficiently big to entail painful financial consequences, though less significant than in case of Japan.[179] The Dot-Com crisis was further aggravated by 9/11 events, and the Fed, in order to avoid a deeper recession, decided to undertake prompt measures to revive the economy.[180] For that purpose, the Fed dramatically decreased the target interest rate, at first to 1.75%, then to 1.25, and finally reaching the 1% rate in 2001, 2002 and 2003 respectively.[181] Thus, the economy indeed started

third from the end of 1989, the peak, to the end of 1990. Stock prices continued to decline and the index lost 60 percent of the peak level by the summer of 1992. Land prices started to decline in 1991. The bubble had burst.").

[174] *Id.*

[175] Peter Alford, *Japan headed for longest, deepest post-war recession*, THE AUSTRALIAN, http://www.theaustralian.com.au/business/latest/japan-headed-for-depression/story-e6frg90f-1111118867488 (last visited Nov. 25, 2015).

[176] Ben Beachy, *A Financial Crisis Manual: Causes, Consequences, and Lessons of the Financial Crisis*, GDAE Working Paper No. 12-06, Tufts University 8 (2012), http://www.ase.tufts.edu/gdae/Pubs/wp/12-06BeachyFinancialCrisis.pdf (last visited Nov. 25, 2015).

[177] Farrokh Langdana, *Federal Reserve Policy From the Dot-Com Bubble to the "Subprime Mess": A Story Of Two Ups and Two Downs*, 6 Rutgers Bus. L.J. 56, pp. 56-57 (2009). After several unsuccessful attempts to "'talk down' the market in 1996 with his 'irrational exuberance' comment, then [the Chairman of the Federal Reserve Alan Greenspan] was determined not to follow the path taken by Japan in the late 1980s", and did eventually undertake effective but still not seasonable preventive measures.

[178] *Id.*

[179] *Id.* After several unsuccessful attempts to "'talk down' the market in 1996 with his 'irrational exuberance' comment, then [the Chairman of the Federal Reserve Alan Greenspan] was determined not to follow the path taken by Japan in the late 1980s", and did eventually undertake effective but still not seasonable preventive measures.

[180] Langdana, *supra* note 177.

[181] *Historical Changes of the Target Federal Funds and Discount Rates,* FED. RES. BANK of N. Y., https://www.newyorkfed.org/markets/statistics/dlyrates/fedrate.html (last visited

growing again.[182] As an effect of low interest rates, loans became more affordable for the subprime borrowers, low-income customers or persons with below-than-average credit histories.[183] However, since this category of borrowers usually has no collaterals (assets) which could be used to secure the payment of a debt, banks were offering subprime loans mostly for a purpose of purchasing real estate (mortgage), thereby securing the loans by the very purpose of those loans.[184] However, the subprime mortgages also have another specific feature, which is an adjustable interest rate "that is low at inception, to help a financially weak borrower qualify, then rises over the life of the loan."[185]

After the "technology shock" of the preceding crisis, investors were seeking to purchase less risky assets and invest in more stable projects.[186] The collateralized debt obligations backed by mortgages seemed as perfect investment targets at that time, and investors were actively purchasing them. These bonds emerged as a result of "mortgage securitization"[187], the process where the mortgages of different risk categories (from high to low risk) are getting put and combined in one common "pool", and then being '''sliced and diced'- that is, some of the excellent mortgages (or parts of them) are combined with parts of the other categories of mortgages, [so that a resulting 'mortgage-backed security' composed of bits and pieces of many individual mortgages.]"[188] The major purpose behind securitization is that through this process financial institutions can substantially increase the liquidity of their illiquid assets, and a mortgage due to its financial nature is among the least

Nov. 29, 2015).

[182] *Post-Recession: Predicting the Next Growth Cycle*, SBC magazine, http://www.sbcmag.info/news/2014/jul/post-recession-predicting-next-growth-cycle (last visited Nov. 29, 2015).

[183] *Subprime Loan,* Black's Law Dictionary (10th ed. 2014).

[184] *Mortgage*, Black's Law Dictionary (10th ed. 2014).

[185] *Id.*

[186] William Poole, *Causes and Consequences of the Financial Crisis of 2007-2009*, 33 Harv. J.L. & Pub. Pol'y 421, p. 424 (2010).

[187] *Id.* at 425. "The federal government encouraged growth of the subprime mortgage market in an attempt to increase the percentage of families owning their own homes. Congress and the Bush Administration pushed the giant mortgage intermediaries, Fannie Mae and Freddie Mac, to accumulate subprime mortgages. Previously, Fannie and Freddie had dealt only in prime mortgages with a maximum loan-to-value ratio of eighty percent. The main business of these government-sponsored enterprises (GSEs) was to securitize prime mortgages into mortgage-backed securities, some of which they sold into the market and some of which they held in their own portfolios."

[188] Bruce D. Fisher, *A Simple Explanation of Some Legal and Economic Aspects of the Financial Meltdowns of Banks*, 89 Mich. B.J. 38, p. 39 (Mar. 2010).

liquid assets.[189] Usually, the creditor has to wait from 25 to 30 years to fully assume the benefits of a mortgage lending, whereas through securitization of mortgages the creditor may put the resulting securities on the market and get the mortgage benefits within days or even hours.[190]

When the consequences of the Dot-Com bubble started disappearing and the overall economic activity in the country reached the pre-crisis level and even went beyond, the Fed decided to increase the target federal funds rate, in order to cool down the economy.[191] Already, in June 2005, the rate increased to 3.25% and in June 2006 to 5.25%, and remained so until September 2007.[192] At this point, banks started readjusting subprime mortgages to a new higher interest rate. As a result, millions of subprime borrowers became incapable to duly perform their mortgage payments.[193] Some borrowers were substantially delaying the payments, while others were simply leaving the collateralized properties.[194] In response, banks began selling collaterals, most of which were private houses, and at some point, the offer in the private housing market exceeded the demand to such an extent that prices simply plummeted.[195] Price decline was so steep that creditors were unable to recover even their actual loans, thereby incurring huge losses.[196] Another major problem was the panic spread among the mortgage-backed securities holders, including foreign entities.[197] The panic began when the holders discovered that the mortgages combination behind each particular security or package of securities was too uncertain to effectuate full (if any) payments in case of mortgage default.[198] What property will be seized to disburse the debt that the mortgage secures? Is it a bathroom of the house that was sliced and diced during securitization or just a door into the bathroom?[199] What will happen, if only one of the portioned and blended mortgages defaulted, and the other mortgages from the same bundle were not? Investors were asking the same questions and were not given clear answers.[200] Mortgage defaults and foreclosures in

[189] *Securitization*, INVESTOPEDIA, http://www.investopedia.com/terms/s/securitization.asp?layout=orig (last visited Nov. 25, 2015).

[190] Fisher, *supra* note 188.

[191] Langdana, *supra* note 177, at p. 59.

[192] *Historical Changes of the Target Federal Funds and Discount Rates*, *supra* note 181.

[193] Randall S. Kroszner, *The Challenges Facing Subprime Mortgage Borrowers*, Speech at the Consumer Bankers Association 2007 Fair Lending Conference, Washington, D.C. (Nov. 5, 2007), http://www.federalreserve.gov/newsevents/speech/kroszner20071105a.htm.

[194] *Id.*

[195] Poole, *supra* note 186, at p. 426.

[196] *Id.*

[197] *Id.* at pp. 425-426.

[198] *Id.*

[199] Fisher, *supra* note 188, at p. 39.

[200] *Id.*

tandem with founded panic among investors caused a dramatic decline in the value of the mortgage securities, "costing portfolio managers millions or billions of dollars in losses."[201] Since these "toxic securities" were purchased and repurchased not only by national, but also many international actors, the consequences of the U.S. subprime mortgages default affected almost all major economies of the world, entailing the global financial crisis.[202]

CONCLUSION

Summarizing the Federal Reserve System's contributions to the financial crisis of 2008, the following major mistakes can be highlighted:

- *Failure to learn from Japanese asset price bubble experience.* The foregoing history of events shows that one minor regulatory mistake assumed in tackling the problem entails the whole chain of new problems which may +require more sophisticated approach. The Fed failed to make necessary conclusions from Japanese experience, and could not develop key risk indicators and proper risk assessment system to be able to address the emerging threats timely and effectively. Inability to seasonably handle the growing Dot-Com bubble eventually resulted in its collapse, putting the economy in recession. This fact compelled the Fed to substantially decrease the target federal funds rate to revive economy. The outcome seems clear: had not the Fed make a delay while tackling the Dot-Com bubble, there would be no need in such steep decline of federal funds rate in 2001.
- *Failure to set up the proper underwriting standards for subprime mortgages and to establish certain requirements for banks dealing with mortgage securitization.* The Fed had to be more attentive to the increasing market of subprime mortgages and their securitization. It should definitely ascertain whether this one of the fastest growing shares of the economy develops in a proper way, and should seasonably prevent the cases of gross negligence existing in the field of mortgage securities underwriting and securitization.
- *Failure to predict and prevent the re-pricing of subprime mortgages to higher interest rates effectuated by an increase in the target federal funds rate.* Once again, the Fed did not apply any necessary risk assessment measures and, accordingly, could not foresee the obvious consequences of its incorrect monetary policy. It would be most reasonable to undertake appropriate regulatory measures which would restrain the banks from

[201] Eamonn K. Moran, Wall Street Meets Main Street: Understanding the Financial Crisis, 13 N.C. Banking Inst. 5, p. 55 (2009).

[202] G20 summit: Barroso blames Eurozone crisis on US banks, The Guardian (June 18, 2012), http://www.theguardian.com/world/2012/jun/18/g20-summit-barroso-eurozone-crisis (last visited Nov. 25, 2015).

readjusting the subprime mortgage prices. As a result, the Fed would, if not prevent the crisis, then at least mitigate its consequences.

It is easy to look back after all these events and judge about the mistakes of the Fed, however, no one can guarantee that the Fed would be able to prevent the crisis, had it acted differently and implemented all the recommendations of its critics.

Elnur Kərimov*

TELEFONLA APARILAN DANIŞIQLARIN ƏLƏ KEÇİRİLMƏSİ: AZƏRBAYCAN VƏ ABŞ QANUNVERİCİLİYİ VƏ MƏHKƏMƏ PRAKTİKASININ MÜQAYİSƏLİ TƏHLİLİ

Annotasiya

Məqalədə telefon və digər qurğularla aparılan danışıqların, rabitə və digər texniki vasitələrlə ötürülən məlumatların və başqa məlumatların ələ keçirilməsinin maddi və prosessual aspektləri, belə məlumatlara müdaxilənin cinayət məsuliyyəti yaratdığı və ya qanuni hesab edildiyi hallar yer almışdır. Açıq və məhdudlaşdırılan informasiyalar, onların əldə edilməsi və yayılmasının legitim hesab edildiyi şərtlər Azərbaycan Respublikasının və Amerika Birləşmiş Ştatlarının bu sahədə milli qanunvericiliyində və məhkəmə praktikasında öyrənilmiş və əlavə tövsiyələr verilmişdir.

Abstract

The article is discussing substantive and procedural aspects of capturing conversations made through telephone and further devices, information transmitted by the means of communication and other technical resources, and in which condition the capture may cause criminal liability or be considered legal. Open and prohibited types of information, the cases in which the capture of such information and its disclosure is legitimate are analyzed in the example of national legislations and practice of domestic courts of Azerbaijan Republic and the United States, and further recommendations are given.

MÜNDƏRİCAT

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GİRİŞ

1972-1974-cü illərdə Amerika Birləşmiş Ştatlarında həmin dövr üçün səs-küylü nəticələr doğuran Uotorgeyt skandalı insanların şəxsi və işgüzar həyatının nə dərəcədə əhəmiyyətli olduğunu bir daha ortaya qoymuşdu. Demokratların seçki qabağı ideya və söhbətlərinin dinləmə cihazı ilə qanunsuz dinləməyə çalışan beş nəfər şübhəli şəxs tutulduqları zaman onların o zamankı prezident Riçard Niksonla əlaqəsinin olduğu aşkarlanmışdı. Bu hadisə R. Niksonun prezidentlikdən istefası ilə nəticələnmişdi. Yazışma, telefon danışıqları, poçt və digər rabitə məlumatlarına qəsd, xüsusilə onlar sirr məzmunlu olduğu halda insanın şəxsi və işgüzar həyatını mənfi təsir edə biləcək nəticələrə səbəb ola bilər, ona görə də bir çox hallarda belə məlumatlara qəsd cəmiyyətin və dövlətin sütunlarına güclü zərbə vura bilir. Kontekst və siyasi vəziyyətdən əlavə, belə məlumatlara hər hansı qanunsuz və əsassız qəsdlə bağlı hüququn mövqeyi birmənalıdır; hər bir halda, bu məlumatlar hüququn müdafiəsi altındadır.

Telefon və digər qurğularla aparılan danışıqlar, rabitə və digər texniki vasitələrlə ötürülən məlumatlar və ya başqa məlumatların əldə edilməsi bir çox ölkələrin, o cümlədən Azərbaycan Respublikasının və Amerika Birləşmiş Ştatlarının qanunvericiliyində təsbit olunduğu kimi, həm cinayət-hüquqi, həm də cinayət-prosessual mənada araşdırılmalı məsələdir. İnsanların şəxsi və işgüzar həyatı ilə bilavasitə bağlı olan bu məlumatların hüquqi rejimi həm maddi, həm də prosessual normalarla tənzimlənir. Burada maddi normalar həmin məlumatların sahibindən başqa şəxslərin qanunsuz hərəkətlərini kriminallaşdırır, prosessual normalar isə bu məlumatların cinayət prosesində istintaq hərəkətlərinin bir növü kimi müvafiq səlahiyyətli orqanlar tərəfindən əldə olunmasının qaydalarını müəyyən edir. Azərbaycan Respublikasının Cinayət Məcəlləsinin 155-ci maddəsinin dispozisiyasında yazışma, telefon danışıqları, poçt, teleqraf və digər məlumatların sirrini pozma əməli kriminallaşdırılır. Prosessual norma müəyyən edən Azərbaycan Respublikasının Cinayət-Prosessual Məcəlləsinin 259-cu maddəsi bu məlumatların ələ keçirilməsinin qanuni formalarını – cinayətin qarşısının alınması və ya cinayət işinin istintaqı zamanı həqiqəti üzə çıxarmaq naminə istintaq hərəkəti qismində məlumatların ələ keçirilməsini müəyyən edir. Göründüyü kimi, hər iki halda şəxsi və ya işgüzar həyatın sirrinə bu və ya digər formada müdaxilə olsa da, müdaxiləni həyata keçirən subyektlərin dairəsi müxtəlifdir.

Məqalədə telefon və digər qurğularla aparılan danışıqların, rabitə və digər texniki vasitələrlə ötürülən məlumatların və ya başqa məlumatların bugünkü hüquqi rejimindən, hansı məlumatların hüququn müdafiəsi altında olmasından və Azərbaycan Respublikasının və ABŞ qanunvericiliklərinin məlumatların əldə edilməsinin qanuniliyinə maddi və prosessual yanaşmalarından söhbət açılacaq, Azərbaycan Respublikasının cinayət

qanunvericiliyində tənzimlənməyən məsələlər araşdırılacaq və ABŞ-ın həmin məsələlər üzrə qanunvericilik təcrübəsi öyrənilib tövsiyə olunacaq.

I. AZƏRBAYCAN RESPUBLİKASINDA TELEFON DANIŞIQLARININ ƏLƏ KEÇİRİLMƏSİ ÜZRƏ MİLLİ QANUNVERİCİLİK VƏ PRAKTİKA

A. Azərbaycan Respublikasının qanunvericiliyində telefon və digər qurğularla aparılan danışıqların və rabitə kanallarından məlumatların ələ keçirilməsi istintaq hərəkəti kimi

Cinayət təqibinin faktiki cəhətdən daha effektiv nəticələrə nail olmasının müasir dövrdə ən səmərəli yolu müvafiq səlahiyyətli orqanlar tərəfindən həyata keçirilən cinayət-prosessual istintaq hərəkətləridir. İstintaq hərəkətlərinin aparılması zamanı təhqiqatçı, müstəntiq və ya ibtidai araşdırmanın hər hansı növünü həyata keçirən vəzifəli şəxs cinayət-prosessual hüquqla təmin olunan vasitələrdən maksimum şəkildə istifadə etməlidir. Azərbaycan Respublikasının cinayət prosesi praktikasında bu üsulların kifayət qədər istifadəsini müşahidə etmək mümkündür. Telefonların dinlənilməsi hər bir dövlətin mövcud hüququndan daha çox məsələyə yanaşması, öz təhlükəsizliyini təmin etməsi və texnoloji inkişafla bağlıdır. Belə ki, hüquq hər bir ölkənin rabitə kanallarından lazımi məlumatların hansı halda əldə edilib-edilmədiyini, onların istifadə olunmasının prosessual formalarını normativləşdirir. Cinayətlərin açılması, təqsirləndirilən şəxslərin məsuliyyətə cəlb edilməsi üçün hüquq-mühafizə orqanları müxtəlif vasitələrdən istifadə edərək sübutları əldə edir və toplayır. Bu tədbirlərdən biri də telefon və digər qurğularla aparılan danışıqların, rabitə və digər texniki vasitələrlə ötürülən məlumatların və ya başqa məlumatların ələ keçirilməsidir.

Lakin bəzən elə hallar olur ki, təhqiqatçı və ya müstəntiq üçün yalnız şübhəli şəxsin, şahidin ifadələri ilə induktiv məntiqi nəticəyə gəlmək, cinayət mühakimə icraatının yekun məqsədinə nail olmaq kifayət etmir. Təqsirləndirilən şəxsi müəyyən etmək mümkün olsa belə, sübutların kifayətliliyi qaydası cinayət təqibinin sonrakı mərhələlərində - ədalət mühakiməsi forumunda bu və ya digər formada realizə olunmur və məhkəmə əlavə sübutları lazım bilir. Deməli, sübutların əldə olunmasının istintaq hərəkətləri formasında olan əksər üsullarından fərqli olaraq, cinayət təqibini həyata keçirən orqan insan və vətəndaş hüquq və azadlıqlarına, konkret olaraq insanların şəxsi və ya işgüzar həyatına toxunaraq müəyyən sübut və dəlilləri aşkar etməyə çalışır. Bu cəhd isə, əlbəttə ki, cinayət mühakimə icraatının təyinatına uyğun olmalı və cinayət təqibinin məqsədlərinə xidmət etməlidir.

Azərbaycan Respublikasının Konstitusiyasında hər kəsin yazışma, telefon danışıqları, poçt, teleqraf və digər rabitə vasitələri ilə ötürülən məlumatın sirrini saxlamaq hüququ şəxsi toxunulmazlıq hüququnun əsaslarından biri kimi təsbit olunub.[1] Dövlət bu hüquqa konstitusion səviyyədə təminat verir. İlk növbədə, nəzərdən qaçırmaq olmaz ki, belə məlumatlar kifayət qədər şəxsidir, onların cinayət təqibini həyata keçirən səlahiyyətli subyekt tərəfindən ələ keçirilməsindən əvvəl dinlənilməsi, başqa şəxsə çatdırılması hüquq sahiblərinin şəxsi həyatlarına müdaxilənin bariz formasıdır. Belə bir müdaxilə hüquq sahibində, əlbəttə ki, psixoloji təsirlə müşayiət olunacaq. Şəxsi həyatın toxunulmazlığı hüququ yalnız ictimai maraq və mənafe üçün təhlükə yarandığı təqdirdə məhdudlaşdırıla bilər. Telefon və digər qurğularla aparılan danışıqların ələ keçirilməsi və texniki vasitələrlə ötürülən məlumatların ələ keçirilməsi istintaq hərəkətlərinin məcburi aparılması üçün, bir qayda olaraq, məhkəmə qərarının alınmasını tələb edir. Bundan əlavə, mülki hüquq belə məlumatları də şəxsi mülkiyyətə aid edir, deməli onların qanunsuz və əsassız ələ keçirilməsi mülkiyyətə qəsd kimi tövsif olunmalıdır.

Telefon və digər qurğularla aparılan danışıqların, rabitə və digər texniki vasitələrlə ötürülən məlumatların və ya başqa məlumatların ələ keçirilməsi hər zaman qanunsuz və əsassız olmur. Azərbaycan Respublikasının Konstitusiyasında qeyd olunur ki, bu hüquq qanunla nəzərdə tutulmuş qaydada cinayətin qarşısını almaq və ya cinayət işinin istintaqı zamanı həqiqəti üzə çıxarmaqdan ötrü məhdudlaşdırıla bilər.[2] Belə məhdudlaşdırılma isə öz növbəsində problem yaratmır, ona görə ki, o həmin dövlətin adından qərar çıxara bilən subyektin – məhkəmənin qərarı nəticəsində mümkün olur. Hesab edirik ki, Azərbaycan Respublikasının cinayət-prosessual qanunvericiliyinin belə məlumatların üzərinə həbs qoyulması üçün təxirəsalınmaz hallar istisna olmaqla, məhkəmə qərarını vacib hesab etməsi uğurlu addımdır. Ona görə ki, vətəndaşlara daha yaxın olan, obyektiv və qərəzsiz məhkəmənin insanların şəxsi həyat sirrinə daxil olan telefon danışıqlarının ələ keçirilməsi, dinlənilməsi, təqib edilməsi ilə bağlı qərarının icrası da daha asan olur, vətəndaşın məhkəmə qərarı olduğu halda müqavimət göstərməsi halları azalır və burada eyni zamanda hüquqi müdafiə vasitələrinə qənaət edilir.

Qanunla müəyyən edilmiş hallardan bəhs etsək, əvvəlcə əməliyyat-axtarış fəaliyyətinə nəzər salınmalıdır. "Əməliyyat-axtarış fəaliyyəti haqqında" Azərbaycan Respublikasının Qanunu telefon danışıqlarına qulaq asma, poçt, teleqraf və digər göndərişlərin yoxlanılması, texniki rabitə kanallarından və digər texniki vasitələrdən informasiyanın çıxarılmasını əməliyyat-axtarış tədbiri hesab edir. Bu hərəkətlər məhkəmə qərarı ilə həyata keçirilsə də, sözü gedən qanun müvafiq hərəkətləri ağır və xüsusilə ağır, dövlət əleyhinə olan

[1] Azərbaycan Respublikasının Konstitusiyası. Maddə 32.1 (Bakı, Qanun nəşriyyatı, 2009)
[2] *Yenə orada*: Maddə 32.4

cinayətlərin qarşısının alınması üçün təxirəsalınmaz hallarda məhkəmənin qanuni qüvvəyə minmiş qərarı olmadan da həyata keçirməyə icazə verir.[3] Əlbəttə ki, sonradan məhkəmə nəzarəti qaydasında məhkəmə əməliyyat-axtarış orqanının həyata keçirdiyi hüquq pozuntuları ilə müşayiət olunan yuxarıdakı hərəkətləri müraciət əsasında rəsmiləşdirir.

Azərbaycan Respublikasının Cinayət-Prosessual Məcəlləsi də tədqiqat obyektimizə oxşar münasibəti nümayiş etdirir. Şübhəli və ya təqsirləndirilən şəxsin digər şəxslərə ötürdüyü məlumatlarda (və ya şübhəli və təqsirləndirilən şəxsə ötürülən məlumatlarda) cinayət təqibi üzrə sübut əhəmiyyətinə malik olan məlumatların olmasını güman etməyə kifayət qədər əsaslar olduqda, müstəntiqin yazılı vəsatəti və ibtidai araşdırmaya prosessual nəzarəti həyata keçirən prokurorun müvafiq təqdimatı üzrə məhkəmə telefon və digər qurğularla aparılan danışıqların, rabitə və digər texniki vasitələrlə ötürülən məlumatların və ya başqa məlumatların ələ keçirilməsi haqqında qərar qəbul edir.[4] Dispozisiyanın mətnindən açıq-aşkar aydın olur ki, bu məlumatların əldə olunması üçün onların əsaslandırılması zəruridir, başqa sözlə sübutların səmərəliliyi sübut olunmalıdır. Vəsatətin mətnində, fikrimizcə, sadəcə müvafiq xahiş deyil, həm də Eyni zamanda Azərbaycan Respublikasının Cinayət-Prosessual Məcəlləsi maliyyə əməliyyatları, bank hesablarının vəziyyəti və vergilərin ödənilməsi də daxil olmaqla digər məlumatların da yalnız məhkəmə qərarı ilə ələ keçirilməsinin prosedurasını müəyyən edir. Ələ keçirilmiş danışıqlar və ya məlumatlar kağız, yaxud maqnit daşıyıcılarda əks etdirilir, onları ələ keçirmiş şəxsin imzası ilə təsdiq olunaraq müstəntiqə verilir. Nəzərə alınmalıdır ki, ötürülən məlumatların hər biri deyil, işə aidiyyəti olan, prosesdə sübuti əhəmiyyətə malik ola biləcək potensial məlumatlar ayrılır və protokollaşdırılır. İşə aid olmayan və əldə edilmiş məlumatlar isə dərhal cinayət işindən kənarlaşdırılır.

Hüquq ədəbiyyatlarında telefon və digər qurğularla aparılan danışıqların, rabitə və digər texniki vasitələrlə ötürülən məlumatların və ya başqa məlumatların ələ keçirilməsinin aşağıdakı formalarını fərqləndirilir:

1) Onların məhkəmə qərarı əsasında oxunulması;
2) Onların məhkəmə qərarı əsasında dinlənilməsi;
3) Onların məhkəmə qərarı əsasında qeyd edilməsi.[5]

Qeyd edək ki, bu hərəkətlərdən hər hansı birinin edilməsi telefon və digər rabitə qurğularından, məlumat kanallarından məlumatların çıxarılmasının qanuni formaları hesab olunur və cinayət mühakimə icraatının məqsədlərinə

[3] "Əməliyyat-axtarış fəaliyyəti haqqında" Azərbaycan Respublikasının Qanunu. Maddə 10 (Bakı, Qanun nəşriyyatı, 2001).

[4] Azərbaycan Respublikasının Cinayət-Prosessual Məcəlləsi. Maddə 259.1 (Bakı, Qanun nəşriyyatı, 2015).

[5] Firuzə Abbasova, Cinayət Prosesi, Xüsusi Hissə, Dərslik, s. 103 (Bakı, "Zərdabi LTD" MMC, 2014).

xidmət etdiyi bütün hallarda şəxsi həyata qanunsuz müdaxilə hesab edilməməlidir.

B. Azərbaycan Respublikasının qanunvericiliyində telefon və digər qurğularla aparılan danışıqların və rabitə kanallarından məlumatların ələ keçirilməsi ictimai təhlükəli əməl kimi

Azərbaycan Respublikasının cinayət qanunvericiliyi telefon və digər qurğularla aparılan danışıqların və rabitə kanallarından məlumatlara müdaxilənin icazə verildiyi halları müəyyən etməklə yanaşı, digər bütün müdaxilələri ictimai təhlükəli əməl hesab edir. İnsan və vətəndaşın konstitusiya hüquq və azadlıqları əleyhinə törədilən cinayətlər sırasına Cinayət Məcəlləsinin 155-ci maddəsi – yazışma, telefon danışıqları, poçt, teleqraf və digər məlumatların sirrini pozma əməli daxil edilmişdir. Burada belə məlumatların sirrini pozma əməli özündə telefon danışıqlarına qulaq asma, elektrik rabitə məlumatları ilə tanış olma, poçt göndərişləri və bağlamaları açma, onlar haqqında məlumatları əldə etmə və yayma, habelə hər hansı başqa şəkildə bu sirri pozmanı birləşdirir.[6]

Hesab edirik ki, qanunverici bu normada məlumat sahibinin razılığı məsələsini ifadə etməməklə ictimai təhlükəli əməlin obyektiv cəhətinin dairəsini kifayət qədər məhdudlaşdırmışdır. Dünya ölkələrinin təcrübəsində, o cümlədən ABŞ-da əməlin cinayət hesab edilməsi üçün tərəflərin razılığının olmadığı sübut edilməlidir. Burada razılıq anlayışı özündə xüsusi təsdiqedici hərəkətləri (şifahi danışıq, jestlər, mimikalar və s) və yazılı razılığı birləşdirir ki, bunlardan hər hansı birinin telefon və digər danışıq məlumatları dinlənilən şəxsdən alınması bu məlumatların dinlənilməsini tamamilə hüquqi çərçivəyə salır. Texnologiyanın bugünkü inkişafı, xüsusilə, bizi insanların telefon danışıqlarının və yazışma sirrinin qorunması üçün daha təkmil mexanizmlər hazırlamağa vadar edir. Yazışma və telefon danışıqları, adətən, ən azı iki nəfər subyekt arasında həyata keçirilir və bu halda onlardan birinin razı, digərinin narazı olarsa, danışıqların qeydə alınmasının Azərbaycan Respublikasının Cinayət Məcəlləsinin 155-ci maddəsinin cinayət tərkibini yaradıb-yaratmadığı sual olaraq qalır. Normanın dispozisiyasında belə qənaətə gəlmək olar ki, qanunverici burada sirr anlayışına şəxsi və ya işgüzar həyatın bir hissəsini təşkil edən elə məlumatları daxil edir ki, bu məlumatların üçüncü şəxslərə məlum olması sirr sahibinə maddi və ya mənəvi ziyan vura bilər. Lakin bəzi hallarda, məsələn işgüzar görüşlərdə yazışma məlumatları və onların sirri yazışan hər iki tərəfə aid olur. Tərəflərdən biri bu məlumatların yayılmasından zərər görə, digəri isə buna nəinki razı olar, hətta bu yazışmanın qeydə alınmasından, yayılmasından

[6] Azərbaycan Respublikası Cinayət Məcəlləsinin Kommentariyası, s. 414 (Firudin Səməndərovun redaktəsi ilə, Bakı, 2013).

yüksək gəlir götürə bilər. Cinayət Məcəlləsinin 155-ci maddəsi isə birtərəfli, yoxsa bütün tərəflərin razılığının tələb olunmasını özündə ehtiva etmir.

C. Açıq və məhdudlaşdırılan məlumatların əldə edilməsinin xüsusiyyətləri

Telefon danışıqlarının dinlənilməsi, poçt və rabitə kanallarından məlumatların əldə edilməsi zamanı açıq və ya məhdudlaşdırılan informasiyaları da diqqətdə saxlamaq lazımdır. Ona görə ki, açıq informasiyalar şəxsi və ya işgüzar həyatın sirrini təşkil etmir və bu informasiyaların əldə edilməsi, toplanması və ya yayılması yuxarıda haqqında bəhs etdiyimiz cinayət məsuliyyətini yaratmayacaq. Bəs hansı informasiyalar açıq, hansıların alınması məhdudlaşdırılan informasiyalardır?

"İnformasiya, informasiyalaşdırma və informasiyanın mühafizəsi haqqında" Azərbaycan Respublikasının Qanununun 2-ci maddəsinə əsasən, əldə olunması məhdudlaşdırılmayan informasiyalar açıq informasiyalar hesab olunur. Əldə edilməsi qanunla məhdudlaşdırılan informasiyalar isə hüquqi rejiminə görə məxfi və gizli (konfidensial) olur. Dövlət sirri məxfi informasiyalar qrupuna aid edilir. Gizli (konfidensial) məlumatlar isə aşağıdakı kimi sadalanır:

1) vətəndaşların, mülkiyyət növündən asılı olmayaraq yaradılmış idarə, müəssisə, təşkilatların və digər hüquqi şəxslərin qanuni maraqlarının qorunması məqsədilə əldə olunmasına məhdudiyyət qoyulan peşə (məsələn, həkim, vəkil, notariat və s) sirləri;
2) kommersiya sirləri;
3) istintaq sirri;
4) məhkəmə sirləri.[7]

Yuxarıda sadalanan məlumatları qanunla müəyyən edilmiş hallar istisna olmaqla, yalnız məhkəmələr tərəfindən qəbul edilmiş qərar əsasında cinayət təqibini həyata keçirən orqan və ya onun vəzifəli şəxsi tərəfindən istintaq hərəkəti kimi ələ keçirilə bilər. Qanun konfidensial məlumatların sırasına fərdi məlumatları (şəxsi və ailə həyatını təşkil edən, habelə siyasi baxış, etiqad kimi məlumatlar) aid etmir.[8] Azərbaycan Respublikasının Cinayət-Prosessual Məcəlləsi bu hərəkətlərin həyata keçirilməsi üçün maksimum müddət kimi 6 ay müəyyən etmişdir ki, fikrimizcə, bu qayda vətəndaşların hüquqlarının qanuni əsaslarla da olsa, pozulmasını minimum həddə endirməyə xidmət edir. Hesab edirik ki, burada diqqət edilməli məqam məlumatların ələ keçirilməsi prosesini gecikdirməmək, gecikmə olduğu hallarda vətəndaşın

[7] "İnformasiya, informasiyalaşdırma və informasiyanın mühafizəsi haqqında" Azərbaycan Respublikasının 3 aprel 1998-ci il tarixli Qanunu, Maddə 2 (Bakı, Qanun, 2007).

[8] "İnformasiya, informasiyalaşdırma və informasiyanın mühafizəsi haqqında" Azərbaycan Respublikasının Qanununa dəyişiklik edilməsi haqqında Azərbaycan Respublikasının 41-IVQVD nömrəli Qanunu, 30 dekabr 2010-cu il.

telefon danışıqlarının, yazışmalarının daha uzun müddətə dinlənilməsinin, əldə edilməsinin ağlabatan səbəbləri ilə müntəzəm məlumatlandırmaqdır.

II. AMERİKA BİRLƏŞMİŞ ŞTATLARININ TELEFON DANIŞIQLARINDAN, POÇT GÖNDƏRİŞLƏRİNDƏN VƏ RABİTƏ KANALLARINDAN MƏLUMATLARIN ƏLDƏ EDİLMƏSİ VƏ YAYILMASI TƏCRÜBƏSİ

Xarici ölkələrdə telefon danışıqlarının, rabitə, poçt və teleqraf göndərişlərinin ələ keçirilməsi təcrübəsinə nəzər salsaq, cinayət-prosessual hüququn institutu kimi istintaq hərəkətlərinin bu növündən istifadə ABŞ-ın müxtəlif ştatlarının qanunvericiliyində ətraflı əks olunmuşdur.

Federal səviyyədə qanunvericiliyə əsasən, telefonla, şifahi və yazılı danışıqların qeyd alınması üçün tərəflərdən birinin razılığı kifayət edir. Ümumiyyətlə, federal qanunvericilik şəxslərin xəbəri olmadan qanunsuz dinləmələri qadağan etsə də, bu normalar həm də elektron vasitələrdən istifadə etməklə telefon danışıqları və müsahibələr də daxil olmaqla hər hansı söhbətə tətbiq edilir. ABŞ-ın 38 ştatı və Kolumbiya regionunda qanunvericilik icazə verir ki, şəxslər özlərinin tərəf kimi çıxış etdiyi söhbətləri qarşı tərəfdən icazə almadan elektron cihazla qeydə alsın. Lakin məlumatların ələ keçirilməsi zərurəti Konstitusiyanın və həm ştatların, həm də federal səviyyədə qanunların pozulması, hüquq pozuntusu və ya ictimai təhlükəli əməllə bağlıdırsa, razılıq olmadığı halda da məlumatların səlahiyyətli orqanlar tərəfindən ələ keçirilməsi qanunidir. Federal qanunvericilik ştatlar üçün məcburi hesab edildiyindən, deməli, bu normalar o cümlədən, Amerikanın 50 ştatında qüvvədədir.

Kaliforniya ştatında telefon danışıqları istisna olmaqla, danışıqların qeydə alınması o halda qanunidir ki, səsyazma cihazına qarşı tərəfin eşidəcəyi dərəcədə siqnal quraşdırılsın. Kaliforniya ştatının Cəza Məcəlləsi telefon danışıqlarının ələ keçirilməsini bütün tərəflərin razılığı olduğu halda mümkün hesab edir, digər hallarda isə bu məlumatların ələ keçirilməsi qadağan olunur.[9] Məcəllə eyni zamanda bəzi halları bu normanın tətbiq dairəsindən istisna edir:

1) dövlət orqanlarında və ictimai yerlərdə edilən söhbətlər zamanı;
2) məhkəmə və ya inzibati icraatlarda edilən söhbətlər zamanı;
3) tərəflərdən biri və ya hər ikisinin onların danışıqlarının eşidilə və ya qeydə alına biləcəyini bildiyi və bilməli olduğu hallar.[10]

Kaliforniya məhkəmə praktikası danışıqlardan məluatlarının ələ keçirilməsində tələb olunan ikitərəfli razılığı istisna edən bir halı müəyyən edir. Əgər danışıqları qeydə alınan iki nəfərdən söhbət gedirsə, onlardan biri

[9] California Penal Code. § 632.
[10] Yenə orada: § 632 (c).

telefon danışığının qeydə alınmasına razı deyilsə, digəri isə danışığın qeydə alınması barədə xəbərdar edilməsinə baxmayaraq, danışığı davam etdirirsə, belə halda məlumatların ələ keçirilməsinə icazə verilir. Deməli, birtərəfli razılıq yalnız bu halda mümkündür.

Arizona ştatının cinayət-prosessual hüquq praktikası bu məsələ ilə bağlı qadağanedici metodların tətbiqindən uzaq görünür. Telefon danışıqlarının qeydə alınması üçün tərəflərdən birinin razılığı kifayət edir.[11] Arizona Ştatının Cinayət Məcəlləsi telefonun əsas qanuni sahibinə üçüncü şəxs olduğu hallarda belə icazə verir ki, telefon danışıqlarını heç bir icazə olmadan qeydə alsın.[12] Hər halda, istintaq hərəkəti kimi bu danışıqların ələ keçirilməsi qanuni olsa da, bəzi ölkələr haqqında bəhs etdiyimiz Amerika Birləşmiş Ştatlarının Arizona ştatının qanunvericiliyindən fərqli olaraq, belə məlumatların ilk növbədə mobil operatorlar tərəfindən toplanmasını qadağan edir. Şübhəsiz, onların sonradan dövlət orqanına təhvil verilməsi də qanunsuz olacaq. Cinayət təqibini həyata keçirən orqan bu məzmunda rabitə vasitələri kanallarından mühüm hesab etdiyi, sübuti əhəmiyyətli məlumatları ələ keçirmək istəyirsə, bunun üçün başqa qanuni üsullardan istifadə etməlidir.

Nevada ştatında telefon və şəxsi danışıqların qeydə alması ilə bağlı qanunvericilik və məhkəmə təcrübəsində fərqli qaydalar nəzərə çarpır. Belə ki, qanuna əsasən, telefon danışıqlarının tərəflərdən ən azı birinin razılığı olmadan gizli qeydə alınması və yayılması qanunsuz hesab edilir. Məhkəmə qərarlarında isə bütün tərəflərin razılığını tələb edən hallara rast gəlinir. Nevada Ali Məhkəməsinin *"Lane Allstate Ins. Co.* şirkətinə qarşı" işində belə bir presedent formalaşdırmışdır ki, hər hansı bir fərd, özü söhbətin tərəfi olduğu hallar da daxil olmaqla, yalnız bütün tərəflərin razılığı olanda bu danışığı qeydə ala bilər.[13]

İllinois ştatında müxtəlif rabitə kanalları və telefon danışıqları üçün ayrı-ayrı qaydalar nəzərdə tutulur. İlk növbədə, telefon danışıqlarının müşahidə və qeyd olunması üçün tərəflərin əvvəlcədən razılığı tələb olunur. İşgüzar zənglər və şəxsi telefon danışıqları qanunvericilik səviyyəsində fərqləndirilməsə də, ştatın bəzi məhkəmələri bizneslə bağlı zənglərin qanunsuz dinləmə cihazları ilə qeydə alınmasını da qadağan edir. Belə qanunsuz hərəkətlər isə qanunla kriminallaşdırılmışdır. Telefon və digər qurğularla aparılan danışıqların, rabitə və digər texniki vasitələrlə ötürülən məlumatların və ya başqa məlumatların qanunsuz və əsassız olaraq ələ keçirilməsi görə İlinois ştatının cinayət qanunvericiliyi 3 il azadlıqdan

[11] Arizona Criminal Code. C.30, 13-3005.

[12] Yenə orada: C.30, 13-3012.

[13] Laws on Recording Conversations in All 50 States (2016). https://www.mwl-law.com/wp-content/uploads/2013/03/LAWS-ON-RECORDING-CONVERSATIONS-CHART.pdf/ (son baxış 11 aprel, 2016).

məhrumetmə və ya 10.000 (on min) manat cərimə müəyyən etmişdir. Bu cəza həmçinin vurulmuş ziyanın əvəzinin ödənilməsi ilə müşayiət olunur.

Miçiqan ştatının qanunvericilik və məhkəmə təcrübəsi telefon danışıqlarının və rabitə qurğularından digər məlumatların əldə edilməsində maraqlı qaydalar müəyyən edir. Qanunvericilik bir çox digər ştatlarda olduğu kimi, danışıqların qeydə alınması üçün tərəflərdən birinin razılığını tələb etsə də, məhkəmə praktikasında xüsusi hallara da rast gəlinir. Miçiqan apellyasiya məhkəməsi "Sullivan Greyə qarşı" işində maraqlı bir şərh edərək qeyd edir ki, danışıqların qeydə alınması ilə bağlı məhdudiyyətlər yalnız üçüncü şəxslərin danışığı qeydə almasına şamil olunmalıdır.[14] Lakin bu müddəa qanunun mövqeyindən kənar şərh deyil. Məhkəmə burada qanunun normasının genişləndirici təfsirinə yol vermiş və bu məhkəmə presedenti normanı söhbətdə iştirak edən üçüncü şəxslərə də aid edir.

Pensilvaniya ştatının təcrübəsi telefon danışıqlarının qeydə alınmasını bəzi situasiyalarda nəinki qadağan etmir, hətta bunu labüd bilir. Bu ştatın qanunvericiliyinə əsasən danışıqların qeydə alınması üçün tərəflərin razılığı vacibdir. Aşağıdakı hallarda isə qarşı tərəfin razılığı olmadan da, telefon danışığının dinlənilməsi və yazılması yol verilən hesab olunur:

1) Razı olmayan tərəf razı olan tərəfin özünün və ailə üzvlərinin həyatına bu və ya digər formada fiziki və psixi hədələr göstərərsə;
2) Razı olmayan tərəf müəyyən bir cinayət törətdikdə, xüsusilə o, bu cinayət əməlinin törətməyə cəhd etdikdə yaxud cinayət hazırlıq mərhələsində olduqda;[15]

Pensilvaniya ştatının sözü gedən qanununa nümunə kimi qeyd edə bilərik ki, əgər məlumatların dinlənilməsinə razı olmayan tərəf razı tərəfə narkotik maddələrin bir növü olan marixuana almağı təklif edirsə, hələ heç bir cinayət əməli törətməsə belə, qarşı tərəf telefon danışığını qeydə ala bilər. Eyni zamanda ştatın "Əməliyyat-axtarış haqqında" Qanununa əsasən, xüsusi texnikanın köməyi ilə əldə olunmuş məlumat açıqlandığı zaman həmin şəxs bu məlumatın qanunsuz əldə edilməsinə və ya əməliyyat-axtarış tədbirlərində xüsusi texnikanın istifadə edilməsi üçün icazə alınmamasına əsaslanaraq cinayət təqibinin gedişində ifadə verməkdən imtina edə və məhkəməyə müraciət edə bilər.

Beləliklə, Azərbaycan Respublikasında və ABŞ-da həm federal, həm də ştatlar səviyyəsində telefon və digər qurğularla aparılan danışıqların, rabitə və digər texniki vasitələrlə ötürülən məlumatların və ya başqa məlumatların ələ keçirilməsi təcrübəsini aşağıdakı sxemdə müqayisə edə bilərik[16]:

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[14] *Sullivan v. Gray*. Michigan Comparative Laws Ann. § 750.539(c); 117 Mich. App. 476, 324 N.W.2d 58 (1982).

[15] 18 Pa. Cons. Stat. Ann. Sec. 5704(4)

[16] Reporter's Recording Guide (August 1, 2012) http://www.rcfp.org/reporters-recording-guide/tape-recording-laws-glance (son baxış 12 aprel, 2016)

	Birtərəfli yoxsa ikitərəfli razılıq tələb olunur?	Qanunsuz qeydə almağa görə cərimə tətbiq olunurmu?	Gizli kameralar haqqında ayrıca qanun varmı?	Məlumatı yaymağa və nəşr etməyə görə əlavə cərimə nəzərdə tutulurmu?
Azərbaycan Respublikası		✓		✓
ABŞ (federal)	✓	✓		✓
Arizona ştatı	✓	✓	✓	✓
İllinois ştatı	✓✓	✓	✓	✓
Kaliforniya ştatı	✓✓	✓	✓	✓
Konnektikut ştatı	✓✓	✓	✓	✓
Nevada ştatı	✓✓	✓	✓	✓
Miçiqan ştatı	✓✓	✓	✓	✓

✓✓ - ikitərəfli razılıq, ✓ - birtərəfli razılıq deməkdir.

NƏTİCƏ

Telefon və digər qurğularla aparılan danışıqların, rabitə və digər texniki vasitələrlə ötürülən məlumatların və ya başqa məlumatların ələ keçirilməsi institutu üzrə Azərbaycan Respublikasında və Amerika Birləşmiş Ştatlarında istər cinayət hüququnun, istərsə də cinayət-prosessual hüququn daxilində bənzər hüquqi tənzimlənməyə rast gəlmək mümkündür. Hər iki hüquq sistemində belə məlumatların əldə edilməsinə yalnız istintaq hərəkətləri qismində cinayətlərin qarşısının alınması və ya törədilmiş cinayətlərin açılması üçün, bir qayda olaraq, məhkəmə qərarı ilə icazə verilir. Məlumatların üçüncü şəxslər tərəfindən əldə edilməsi isə cinayət məsuliyyəti yaradır.

Bununla belə, Azərbaycan Respublikasının cinayət qanunvericiliyində məlumatların qeyri-qanuni əldə edilməsi zamanı razılığın həddi müəyyənləşdirilməmişdir. Hesab edirik ki, Azərbaycan Respublikasının Cinayət Məcəlləsinin 155-ci maddəsində telefon danışıqlarının və yazışmaların tərəflərdən birinin və ya üçüncü şəxsin qeydə alması zamanı "razılıq" məsələsinin tənzimlənməməsi qanunvericilikdə boşluq kimi dəyərləndirilməli və ABŞ mövcud təcrübəsindən istifadə olunmalıdır.

Yuxarıda qeyd olunanları nəzərə alaraq, məqaləni aşağıdakı tövsiyələrimizlə yekunlaşdırırıq:

1. Azərbaycan Respublikasının Cinayət Məcəlləsinin 155-ci maddəsində "tərəflərdən heç birinin razılığı olmadığı halda" ifadəsi dispozisiya əlavə olunmalıdır və məlumatların qanuni yayılması, ümumi qaydada, ikitərəfli razılığı özündə ehtiva etməlidir.
2. Sözü gedən normanın dispozisiyasının qeyd hissəsində "telefon danışıqlarının, yazışmaların, poçt göndərişlərinin və digər rabitə qurğularından ötürülən məlumatların tərəflərinin birinin razılığı olduqda və həmin şəxs qarşı tərəfi bu barədə məlumatlandırdıqda belə məlumatın sirrinin pozulması bu cinayət tərkibini yaratmır" qeydi əlavə olunmalı və birtərəfli razılığa icazə verən müstəsna hal da burada ifadə olunmalıdır.