CONTENTS

Feature Articles

Student Article

Published semi-annually by Loyola University Chicago School of Law
Loyola University Chicago School of Law
Twenty-Five East Pearson Street
Chicago, IL 60611

Cite as 10 LOY. U. CHI. INT'L L. REV. __ (2012)

LOYOLA UNIVERSITY CHICAGO INTERNATIONAL LAW REVIEW

Loyola University Chicago School of Law
25 East Pearson Street
Chicago, IL 60611
E-mail: International-LawReview@luc.edu
Phone: (312) 915-7490

SUBSCRIPTIONS: **two issues per year at $10.**

Please start my subscription to Loyola University Chicago International Law Review.

Name

School

Address

City, State Zip Code

E-mail Address

If you would like to subscribe, please complete the information above, include a $10 check payable to **Loyola University Chicago International Law Review**, and send to:

LOYOLA UNIVERSITY CHICAGO INTERNATIONAL LAW REVIEW
Loyola University Chicago School of Law
25 East Pearson Street
Chicago, IL 60611

International Focus at Loyola University Chicago School of Law

Curriculum

Loyola University Chicago School of Law provides an environment where a global perspective is respected and encouraged. International and Comparative Law are not studied only in theoretical, abstract terms but primarily in the context of values-based professional practice. In addition to purely international classes, courses in other disciplines – health law, child and family law, advocacy, business and tax, antitrust, intellectual property – have strong international and comparative components.

International Centers

The United Nations has designated Loyola Chicago School of Law as the home if its Children's International Human Rights Initiative. The Children's International Human Rights Initiative promotes the physical, emotional, educational, spiritual, and legal rights of children around the world through a program of interdisciplinary research, teaching, outreach and service. It is part of Loyola's Civitas ChildLaw Center, a program committed to preparing lawyers and other leaders to be effective advocates for children, their families, and their communities.

Study Abroad

Loyola's international curriculum is expanded by its foreign programs and field study opportunities:

International Programs

– A four-week summer program at Loyola's permanent campus in Rome, Italy, the John Felice Rome Center, focusing on international and comparative law
– A three-week summer program at Loyola's campus at the Beijing Center in Beijing, China focusing on international and comparative law

International Field Study

– A ten-day, between-semester course in London on comparative advocacy, where students observe trials at Old Bailey, then meet with judges and barristers to discuss the substantive and procedural aspects of the British trial system. Students also visit the Inns of the Court and the Law Society, as well as have the opportunity to visit the offices of barristers and solicitors.
– A comparative law seminar on *Legal Systems of the Americas*, which offers students the opportunity to travel to Chile over spring break for on-site study and research. In Santiago, participants meet with faculty and students at the Law Faculty of Universidad Alberto Hurtado.
– A one-week site visit experience in San Juan, Puerto Rico, students have the opportunity to research the island-wide health program for indigents as well as focus on Puerto Rico's managed care and regulation.
– A comparative law seminar focused on African legal systems. The seminar uses a collaborative immersion approach to learning about a particular country and its legal system, with particular emphasis on legal issues affecting children and families. The most recent trip was to Tanzania.

Wing-Tat Lee Lecture Series

Mr. Wing-Tat Lee, a businessman from Hong Kong, established a lecture series with a grant to the School of Law. The lectures focus on an aspect of international or comparative law.

The Wing-Tat Lee Chair in International Law is held by Professor James Gathii. Professor Gathii received his law degree in Kenya, where he was admitted as an Advocate of the High Court, and he earned an S.J.D. at Harvard. He is a prolific author, having published over 60 articles and book chapters. He is also active in many international organizations, including organizations dealing with human rights in Africa. He teaches International Trade Law and an International Law Colloquium.

International Moot Court Competition

Students hone their international skills in two moot competitions: the Phillip Jessup Competition, which involves a moot court argument on a problem of public international law, and the Willem C. Vis International Commercial Arbitration Moot, involving a problem under the United Nations Convention on Contracts for the International Sale of Goods. There are two Vis teams that participate each spring in an oral argument involving an international moot arbitration problem. One team participates in Vienna, Austria against approximately 255 law school teams from all over the world, and the other team participates in Hong Kong SAR, China, against approximately 80 law school teams.

Acknowledgments

We would like to recognize friends and alumni of the law school who have contributed within the past year to our international law program at Loyola University Chicago by their support of the Willem C. Vis International Commercial Arbitration Moot Program:

Peter B. Carey
The CME Group Foundation
John H. Calhoun
The PepsiCo Foundation
Freddi L. Greenberg
Silvia Rota
Terry Moritz
Margaret Moses
Harold (Rod) Heard
Michael A. Barranda
Cara A. Boyle
Beata Guzik Brewster
Paul Burmeister
Ellen M. Carey
Lisa Ellison
Edward Fluet
James M. Gillespie
Chantal Kazay
Melissa A. King
Hanh Diep Meyers
John A. Meyers
Jonathan Robillotto
Michelle K. Schindler

New Zealand Antitrust: Some Reflections on the First Twenty-Five Years

Dr. Mark N. Berry[†]

I. Introduction

New Zealand's antitrust law turned twenty-five in 2011. The Commerce Act,[1] enacted in 1986, provides New Zealand's first coherent antitrust regime. Earlier legislative attempts to regulate competition, dating back to 1908, had focused on a mix of goals and considerations. The imposition of price controls and prevention of profiteering were central themes through many of the decades up until the 1970s. From that point, up to 1986, a limited range of trade practices were as-

[†] Dr. Berry is the Chairman of the New Zealand Commerce Commission. This Article is based upon a guest lecture presented by Dr. Berry at the Loyola University Chicago School of Law on April 2, 2012. The views expressed in this Article are entirely those of the author.

[1] Commerce Act 1986 (N.Z.).

sessed against a mix of social, economic, competition and reasonableness factors.[2] Such rules had no particular antitrust pedigree.

The Commerce Act was essentially based upon the Australian Trade Practices Act of 1974 (renamed the Competition and Consumer Act in 2010),[3] which was influenced to a significant degree by the United States' Sherman and Clayton Acts. Therefore, there was some knowledge and experience of what we were about to adopt back in 1986, but the appropriateness of adopting such an antitrust law model for a small and remote economy such as New Zealand's was still largely unknown.

The Commerce Act contains a reasonably high level of prescription, running into some 118 sections. However, there are only a handful of key provisions under the Act governing restrictive practices and mergers. Most of these provisions, like the central provisions of the Sherman and Clayton Acts, contain briefly stated prohibitions of broad application.

The history of antitrust law in New Zealand reflects that, in application, there have been four key provisions under the Commerce Act over the first twenty-five years of its existence. These are section 27 (contracts, arrangements or understandings which substantially lessen competition), section 30 (price fixing), section 36 (monopolization), and section 47 (mergers).

This article begins with a brief overview of the policy challenges which have faced New Zealand in the framing of an antitrust regime. An understanding of New Zealand antitrust requires an appreciation of the small nature of its economy, and its remoteness from its major trading partners.[4]

The next part of the article discusses the application of the catch-all prohibition against contracts, arrangements or understandings which may substantially lessen competition under section 27. Regrettably, at least for the purposes of this review, the traffic of section 27 cases in the first twenty-five years has not been significant. Nonetheless, two case studies on exclusive dealing and long-term contracts in the energy sector serve to demonstrate the workings of section 27.[5]

A consideration of section 27 also involves the related issue of cartel conduct. Cartel conduct is deemed by section 30 to be unlawful per se under section 27. The application of this per se rule has resulted in the application of predictable case-law principles. However, there is currently some debate around the extent to which conduct by cartels outside New Zealand may escape liability—even though they affect markets in New Zealand—and this is the primary topic for discussion in Part III, D.[6]

The final key restrictive trade practices matter discussed is monopolization. There has been significant monopoly litigation over the first twenty-five years

---

[2] *See* Hunter M. Donaldson, *The Development of New Zealand Competition Law,* in COMPETITION LAW AND POLICY IN NEW ZEALAND 11 (Rex J. Ahdar, ed., 1991) (discussing the historical development of New Zealand competition law).

[3] *Competition and Consumer Act 2010* (Austl.).

[4] *See infra* Part II.A.

[5] *See infra* Part II.

[6] *See infra* Part III.D.

under the Commerce Act. This article outlines the case-law developments to date, and highlights the serious problems now facing the application of the monopoly provision, section 36.[7]

Not surprisingly, a significant jurisprudence has emerged on the question of mergers. New Zealand has permitted levels of concentration which may be surprisingly high to some outside observers. For the most part, merger analysis under the Commerce Act has been conventional by international standards. However, there is one important qualification to this, and this relates to forward-looking counterfactual analysis. New Zealand stands apart in the adoption of multiple counterfactual analysis. This approach is potentially flawed. Given the novelty of this issue, Part V of the article pays particular attention to this subject.[8]

Part VI describes the workings of New Zealand's authorisation test, or efficiencies defense. A case study traces the methodology followed in a recent merger case. Regrettably, the redaction of confidential material makes it difficult to do justice to this case study. Nonetheless, this section is hopefully informative of the New Zealand approach to such cases.[9]

The final section provides some concluding observations.

II. Overview of the Commerce Act

A. Background

New Zealand is a case study of a small economy, which is remote from its major trading partners. New Zealand has a population of a little over four million. This means that many markets are highly concentrated and this, in significant part, sets the scene for the state of competition which may be expected in domestic markets. Coupled with this are the impacts which necessarily flow from New Zealand's remoteness. While low government trade barriers promote competition from imports, New Zealand's remoteness creates natural barriers to trade by increasing transportation costs. It also deters reliance upon imports where there may be concerns about the timeliness and reliability of supplies.[10]

This is not to suggest that import competition does not have a significant influence upon New Zealand markets. In many cases, the prices for goods in concentrated markets are constrained by actual or potential import competition. However, in some cases, domestic firms can look to earn rents by charging up to import-parity prices. Of course, this concern dissipates where import-parity pricing is not the key competitive constraint.

---

[7] *See infra* Part IV; *see also* Commerce Act 1986 §§ 29-37 (N.Z.) (prohibiting the resale of price maintenance and exclusionary provisions). Neither of these provisions has attracted sufficient attention to warrant further discussion in this Article.

[8] *See infra* Part V.

[9] *See infra* Part VI.

[10] *See Pact Group Pty. Ltd. & Viscount Plastics (N.Z.) Ltd.* [2012] 11 NZCC at paras 191, 254, *available at* http://www.comcom.govt.nz/assets/Uploads/Pact-Group-and-Viscount-Plastic-NZ-Ltd-2012-NZCC-11-Determination-public-Version-30-may-2012.pdf.

In her leading work on the subject of competition law in small market economies, Professor Michal Gal suggests that there are three main economic characteristics of small economies: high market-concentration levels, high entry barriers, and inefficient levels of production.[11] All of these characteristics are observable in New Zealand. New Zealand manufacturing markets are more concentrated than those of most other countries.[12] Smallness of an economy can also affect the height of barriers to new entry—although there are dangers that this concern may be overstated. Then, there is the issue of scale economies. In small economies a significant fraction of output may be manufactured in sub-optimal volumes by sub-optimal plants.[13] A recent study concluded that New Zealand industry, relative to four other countries in the relevant sample, had the lowest revenue to capital employed ratio and significant diseconomies of scale.[14] These market circumstances are not as a rule conducive to new entry. It has also been suggested that other entry barriers facing small economies include various factors of production, such as the availability of skilled labour and access to a diversified range of inputs for production.[15] It is, however, not altogether clear these should properly be regarded as entry barriers because they are factors of production experienced by all parties.[16] It should also be appreciated that, notwithstanding the smallness of markets in New Zealand, there are many instances of new entry (whether actual or potential).

These background economic circumstances set the scene and challenges for competition policy in New Zealand. Small, concentrated markets with significant barriers to entry are unlikely to exhibit the competitive dynamics of markets not reflecting these characteristics. The policy response to these circumstances is not, however, straightforward. There exists a basic tension between productive efficiency and competitive conditions. In many markets in New Zealand, demand means that only a few firms can operate at productively-efficient levels of manufacture. New entry may often create diseconomies of scale, unless domestic firms are also able to export their output.

---

[11] *See* MICHAL S. GAL, COMPETITION POLICY FOR SMALL MARKET ECONOMIES 14 (Harvard University Press) (2003) (discussing high market concentration levels, high entry barriers and inefficient levels of production).

[12] Michal S. Gal, *The Effects of Smallness and Remoteness on Competition Law – The Case of New Zealand*, 14 COMPETITION & CONSUMER L.J. 292, 295 (2007).

[13] *Id.* at 295-96.

[14] *See* Terence Arnold, David Boles de Boer & Lewis T. Evans, *The Structure of New Zealand Industry: Its Implications for Competition Law, in* COMPETITION LAW AT THE TURN OF THE CENTURY: A NEW ZEALAND PERSPECTIVE 24, 30-40 (Mark N. Berry & Lewis T. Evans eds., 2003) (the other countries in the sample being the U.K., the U.S., Sweden and Australia).

[15] Gal, *supra* note 12, at 295.

[16] New Zealand courts have endorsed a Stiglerian approach to the definition of entry barriers. *See Commerce Commission v Southern Cross Medical Care Society* [2001] 10 TCLR 269 (CA) 75 (the Court of Appeal defined barriers to entry and expansion as "a significant cost or limitation which a person has to face to enter a market or expand in the market and maintain that entry or expansion in the long run, being a cost or limitation that an established incumbent does not face."). Nonetheless, subsequent cases reflect that rather than determining whether an entry barrier exists according to some economic definition, a factual assessment is required whether new entry is likely, sufficient in extent and timely. *See New Zealand Bus. Ltd. v Commerce Comm'n* (2008) 12 TCLR 69, 252 (CA).

While recognisable benefits arise from having industry operating at productively efficient levels of output, having a small number of firms in a market can result in the creation and realisation of market power. This can also dampen dynamic efficiency, particularly where the threat of import competition is not real.

New Zealand's legislators faced these problems at the time the Commerce Act was enacted in 1986. There was no real debate about whether we should adopt an antitrust regime which conformed to international best practice—that was a given. The problem was assessing how competition laws should be fashioned for New Zealand's small market economy. There was a desire to develop an economy characterised by productively-efficient firms. But the pursuit of this goal also brought with it the prospect of markets characterised by a few large firms (by New Zealand standards), to which market power risks may attach. There were, therefore, competing challenges which needed to be addressed at the same time under the one law.

B. Goals

The first, and perhaps most problematic, issue in the context of this policy design was the question of the goals of competition laws. While it is generally acknowledged that competition laws strive to promote competition, questions remain about why the competitive process is valued. The history of competition laws, particularly in the U.S., reflects fluctuating views as to appropriate goals for antitrust.[17] The modern-day debate is whether the goal of economic efficiency should prevail, or whether greater weight should attach to concerns about wealth transfers resulting from the exercise of market power.

This debate is of particular relevance to small market economies. Indeed, the choice of goal in such markets is likely to impact market structure and performance. Policy tradeoffs need to be made. Granting economic efficiency primacy over other goals focuses upon ensuring that the mix of goods and services most preferred by consumers is produced at minimum cost. The pursuit of such a goal, if all goes well, should result in competition for the long-term benefit of consumers as firms strive to become more productively and dynamically efficient. Where the issue of scale economies is overcome, the pursuit of efficiency will also enhance the international competitiveness of domestic firms. This was an important part of the background fabric to the Commerce Act. It was feared that alternative goals in a small market economy which focused on short-term distributional goals or involved preserving inefficient firms would come at a cost.

When first enacted, the Commerce Act did not make the goal of the Act abundantly clear. The long title to the Act was: "An Act to promote competition in markets within New Zealand." Nonetheless, early judicial consideration of this long title tended towards adopting an efficiencies goal for the Act. In *Tru Tone Ltd. v. Festival Records Retail Marketing Ltd.*, the Court of Appeal stated that the Act was "based on the premise that society's resources are best allocated in a

[17] For a survey of the U.S. scene, *see* Mark N. Berry, *Efficiencies and Horizontal Mergers: In Search of a Defense*, 33 SAN DIEGO L. REV. 515, 528-32 (1996).

competitive market where rivalry between firms ensures maximum efficiency in the use of resources."[18] More recently, there has been legislative clarification of the issue through the introduction of the current purpose statement under the 2001 amendments to the Commerce Act.[19] Section 1A of the Act now provides that: "[T]he purpose of this Act is to promote competition in markets for the long-term benefit of consumers within New Zealand."

While comments around this new purpose statement in the course of legislative deliberations were ambiguous, the reference to long-term benefits was seen to have a strong connection with efficiency goals. The Commerce Committee noted that: "An efficiency analysis considers the net present value impacts of any arrangement on productive, allocative and dynamic efficiency. This would be consistent with long-term consumer welfare."[20]

Combined with this purpose statement is an efficiencies defense under the Commerce Act which applies to both restrictive trade practices and merger authorisations in cases where there are market power findings leading to the identification of detriments.[21] In such cases, these practices and mergers can be authorised on the grounds that there are public benefits which outweigh such detriments. On this question, the legislation directs under section 3A that:

> Where the Commission is required under this Act to determine whether or not, or the extent to which, conduct will result or will be likely to result, in a benefit to the public, the Commission shall have regard to any efficiencies that the Commission considers will result or will be likely to result from that conduct.[22]

Accordingly, a goal of economic efficiency prevails, and this has impacted on case law principles and their application, as will be apparent from the following discussion on how the Commerce Act has been applied in its first twenty-five years.

III. Contracts, Arrangements or Understandings Which Substantially Lessen Competition

A. Central Provisions and Basic Concepts

Because the documents being created by Working Group III are not treaties, but are The central provision of the restrictive trade practices part of the Act is section 27.[23] This section provides that no person may enter into or give effect to a provision of a contract, arrangement or understanding that has the purpose,

---

[18] *Tru Tone Ltd. v Festival Records Retail Mktg. Ltd.* [1988] 2 NZLR 352 (CA) 358.

[19] Section 1A of the Commerce Act 1986, as substituted by Section 4 of the Commerce Amendment Act 2001 (N.Z.).

[20] Commerce Committee (Report (296-2), 7 (2001).

[21] *See infra* Part VI (for further discussion of this defense).

[22] Commerce Act 1986 §3A (N.Z.).

[23] *Id.* pt. 2, § 27 (this, and other key sections in Part 2 of the Act, are reproduced in the Appendix to this Article).

effect or likely effect of substantially lessening competition in a market. This section of the article begins with an outline of general principles under section 27, followed by two case studies relating to exclusive dealing and long-term contracts.

The concepts of "market" and "competition" are defined in the Act. Section 3(1A) provides that the term "market is a reference to a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common-sense, are substitutable for them."[24] Standard market definition principles have applied from the outset. A leading decision of the Australian Trade Practices Tribunal which predates the Commerce Act, *Queensland Co-operative Milling Assn. Ltd.*,[25] served as a case providing first principles. It discussed the concept of market in the following terms:

> A market is the area of close competition between firms or, putting it a little differently, the field of rivalry between them. (If there is no close competition there is, of course, a monopolistic market). Within the bounds of a market there is substitution – substitution between one product and another, and between one source of supply and another, in response to changing prices. So a market is the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive.[26]

Notwithstanding the adoption of these standard principles, the legislative requirement that markets be in New Zealand means that in some cases geographic market boundaries will be artificially narrow from a proper economic perspective.[27] However, to the extent that this is a problem, it is normally overcome under entry barrier analysis.

The concept of "competition" is defined under section 3(1) to mean "workable or effective competition."[28] This legislative formulation of the concept of competition can be traced to U.S. antitrust law origins. Again, the first principles were enunciated here in the pre-Commerce Act case, *Queensland Co-operative Milling Assn. Ltd.*, which stated:

---

[24] *Id.* §3A.

[25] *See generally Queensland Coop. Milling Ass'n Ltd.* (1976) 25 FLR 169 (Austl.) (discussing market definition principles).

[26] *Id.* at 190. This statement of principle has been routinely endorsed in New Zealand. *See, e.g.*, T.M. Gault & Barry Craig Allen, Gault On Commercial Law (2010); *see also* N.Z. Commerce Comm'n, Mergers and Acquisitions Guidelines § 3 at 14-20 (2003), *available at* http://www.comcom.govt.nz/mergers-and-acquisitions-guidelines/ (explaining how the Commission defines relevant markets in terms of five dimensions: product, geographical, functional, temporal, and customer).

[27] Some complexity has arisen in cases involving markets which have components both within and outside of New Zealand. *See Commerce Comm'n v Air New Zealand Ltd*. (unreported) High Court, Auckland, CIV 2008-404-008352, 24 August 2011, at paras 35-37, 241. This case involved price fixing in relation to inbound and outbound air cargo services to New Zealand. *Id.* It was argued that there was a clear geographic cut off between the relevant markets at the place of origin (where collusion had occurred) and New Zealand points of destination. *Id.* The Court concluded that a market does not have to be wholly in New Zealand for the Act to apply. *Id.* at 241; *see also infra* Part III.D (for further discussion).

[28] Commerce Act 1986 §3(1) (N.Z.).

> As was said by the US Attorney-General's National Committee to Study the Antitrust Laws in its Report of 1955 (at p 320):
>
> > 'The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert has the power to choose its level of profits by giving less and charging more. Where there is workable competition, rival sectors, whether existing competitors or new potential entrants into the field, would keep this power In check by offering or threatening to offer effective inducements. . .'
>
> Or again, as is often said in US antitrust cases, the antitrust of competition is undue market power, in the sense of the power to raise price and exclude entry.[29]

Various principles of general application have emerged in relation to ascertaining whether competition has been substantially lessened under section 27. Three principles, in particular, are noteworthy.

First, the inquiry is centred upon counterfactual analysis. As Justice Smithers said in *Dandy Power Equipment Pty. Ltd. v. Mercury Marine Pty. Ltd.*, "[I]t is necessary to assess the nature and extent of the market, the probable nature and extent of competition which would exist therein but for the conduct in question, the way the market operates and the nature and extent of the contemplated lessening," and there is a need to "ask oneself how and to what extent there would have been competition therein but for the conduct."[30] In other words, a comparative assessment is required into the state of competition both with and without the practice in question.

Second, section 27 is concerned with a net effect on competition, with both pro-competitive and anti-competitive effects being taken into account.[31] Accordingly, it is open to the Court to give regard to any efficiencies which are pro-competitive.[32]

Third, it is clear from the New Zealand jurisprudence that section 27 is concerned with the level of rivalrous conduct, rather than the fate of individual competitors.[33]

---

[29] *Queensland* at 187-88 (Austl.). This statement of principle has also been routinely endorsed in New Zealand. *See, e.g.*, *Fisher & Paykel Ltd. v Commerce Comm'n* [1990] 2 NZLR 731 (CA) 759 (where the court found the height of barriers to entry is the most important element of market structure); *see also Tru Tone Ltd* at 363 (CA) (which reiterated the most important element of market structure is the assessment of competition).

[30] *Dandy Power Equip. Ltd. v Mercury Marine Ltd.* (1982) 64 FLR 238, 259-60 (Austl.); *see also ANZCO Foods Waitara Ltd. v AFFCO N.Z. Ltd.* [2006] 3 NZLR 351 (CA) 404 (affirming that New Zealand has widely accepted the analytical approach taken in *Dandy Power*).

[31] *See Fisher & Paykel* [1990] 2 NZLR at 740 (the court stating it needed to consider both the pro and anti-competitive effects to determine the net-effect on a market); *see also ANZCO* [2006] 3 NZLR at 405 (discussing the net effect on competition).

[32] *Shell (Petroleum Mining) Co. Ltd. v Kapuni Gas Contracts Ltd.* (1997) 7 TCLR 463, 528-31.

[33] *Transpower N.Z. Ltd. v Todd Energy Ltd.* [2007] NZCA 302 at para 114.

B. Exclusive Dealing

Exclusive dealing is a practice which lends itself well to a case study under the substantial lessening of competition test. There has been one test case on this subject, *Fisher & Paykel*[34]—one of the first cases to be determined under the Commerce Act of 1986.

Fisher & Paykel had for many years been the leading manufacturer and wholesaler of whiteware (namely refrigerators, washing machines and the like). It was Fisher & Paykel's practice to enter into exclusive dealing arrangements with its retailers.[35] Such exclusive distribution arrangements were terminable by either party on ninety days' notice.[36]

Prior to 1987, Fisher & Paykel had enjoyed a position protected by import licensing and tariffs. However, beginning in 1987, these barriers to import competition were progressively removed through the repeal of import restrictions. Notwithstanding the emergence of import competition at the time of hearing in 1989, Fisher & Paykel still remained by far the largest player in the market. It held approximately an 80% market share and held exclusive dealership arrangements with around 450 of the total 800 to 850 outlets retailing whiteware in New Zealand.[37]

This case involved an appeal from a decision of the Commerce Commission (by a majority) that these exclusive dealing arrangements should not be authorised. The High Court reversed this finding and found that the Fisher & Paykel exclusive dealing arrangements did not contravene section 27. Regrettably, the High Court's analytical framework is not altogether clear, given that its analysis is confined solely to a range of concluding propositions.[38]

The Court first found that Fisher & Paykel had a significant degree of market power by virtue of factors, including its historic monopoly supply position and high market share.[39] However, this conclusion was internally inconsistent because the Court then observed, in its next breath, that Fisher & Paykel was nevertheless constrained by its competitors by the removal of artificial barriers to entry, particularly for Australian imports.[40]

Most significantly, the Court concluded that in the absence of artificial barriers to entry, exclusive dealing arrangements can have positive pro-competitive effects provided that a significant component—in this case access to retail space—had not been foreclosed.[41] On the facts presented, no significant foreclosure of retail space was found to exist as a result of the Fisher & Paykel exclusive dealing arrangements.

---

[34] *Fisher & Paykel* [1990] 2 NZLR at 731.

[35] *Id.* at 734.

[36] *Id.*

[37] *Id.* at 737.

[38] *Id.* at 767.

[39] *Id.* at 734.

[40] *Id.*

[41] *Id.*

Apart from this emphasis on foreclosure, the Court also attached some weight to the fact that the exclusive dealing arrangements could be terminated upon ninety days' notice.[42] It is not clear whether this point served to indicate that only short-term exclusive dealing arrangements should be regarded to be permissible. There was no elaboration on this point. A preferable view in analysing the significance of this point is that it was simply a further factor to be taken into account in justifying the conclusion that section 27 was not contravened in this case. Presumably, the ability of retailers to switch at relatively short notice supported the conclusion that the Fisher & Paykel exclusive dealing arrangements did not foreclose access to retail space for new entrant competitors who proposed to compete against Fisher & Paykel in this market. Clearly, it is arguable that the case did not turn on this point alone. So long as a new entrant was not foreclosed from access to adequate retail space, it appears that the view of the Court in *Fisher and Paykel* was that section 27 was not contravened.

Interestingly, the Court concluded by noting that it had derived substantial assistance from U.S. legal thinking in reaching its conclusions, and it commented in passing that if its views earned it "the appellation of 'Chicago School', then so be it."[43]

C. Long-term Contracting: A Case Study

The energy sector is one sector in which there has been some Commerce Act litigation in the first twenty-five years of the operation of the Act. The most significant of these cases is *Shell (Petroleum Mining) Co. Ltd. v. Kapuni Gas Contractors Ltd.*[44] This case related to the long term Kapuni gas contract which was entered into in 1967, some nineteen years prior to the commencement of the Commerce Act. Nonetheless, the legality of the contract under section 27 was open to assessment in the 1990s because section 2(3) of the Act provides that any provision of a contract may be rendered unenforceable if in contravention of section 27—even though at an earlier time the relevant anticompetitive effect may not have been present.[45] Further complicating the landscape was the impact of another provision of the Commerce Act, section 3(5), which provides that an assessment of section 27 liability takes into account not only the contract asserted to be unlawful, but also any other contractual arrangements in combination with the contract under dispute. A problem for the defendants was that their 1967 gas entitlements to Kapuni field gas were supplemented in 1973 by entitlements to gas from the Maui field.

New Zealand has few natural gas fields and, at the time of trial, Kapuni and Maui were the only two significant gas fields in production. Kapuni was owned by Shell and Todd, although they were required to sell all Kapuni gas to the Crown. The Crown's rights to Kapuni gas had been assigned to Kapuni Gas

[42] *Id.* at 767.

[43] *Id.*

[44] *Shell (Petroleum Mining) Co. Ltd. v Kapuni Gas Contracts Ltd.* (1997) 7 TCLR 463.

[45] Commerce Act 1986 §2(3) (N.Z.).

Contracts Ltd. ("K.G.C.L."), being a wholly owned subsidiary of Fletcher Challenge Ltd. (which in turn was a 33% shareholder of Natural Gas Corporation ("N.G.C.").[46] K.G.C.L. on-sold this gas to petrochemical companies and to N.G.C. Gas from the Maui field was committed to N.G.C., Methanex (a petrochemical company) and Contact (an electricity generator).

Shell and Todd, the owners of the Kapuni field, argued that section 27 rendered the long-term contract under which they had agreed to sell all Kapuni gas to the Crown unenforeceable.[47] Shell and Todd asserted that the combined effect of the Kapuni and Maui contracts was to commit all gas other than gas used for electricity generation and petrochemical production to N.G.C.[48] Plainly, as a result of these contractual arrangements, N.G.C. held substantial market power over the supply of gas to the wholesale and reticulated gas markets. One of the plaintiffs, Todd, provided evidence of potential customers it could supply in competition with N.G.C. if it was allowed access to Kapuni gas. These buyers included companies in other significant New Zealand sectors, such as the dairy sector.[49]

Market definition assumed some significance in this case, as the defendant argued that there was a single market in New Zealand for all gas. The Court concluded that the relevant markets in this case were those for the wholesale and retail sale of natural gas.[50] In so doing, the Court regarded the argument that other forms of gas (such as land-fill gas, coal-gas, porta-gas and liquefied natural gas) and other energy sources (such as light fuel oil, coal and electricity) were not sufficiently close substitutes because such alternative forms of energy were, in the medium-to-long run, either priced substantially above the price for natural gas or available only in small volumes.[51] This inevitably resulted in a finding of liability because it identified N.G.C. as being dominant in the wholesale market and as having a substantial degree of market power in the retail market.

The Court's analysis of the long-term contract here makes interesting reading because it involves a consideration of competing concerns regarding on the one hand foreclosure of competition under a contract which had run for twenty-nine years already, and could run for another twenty years (depending on the life of the Kapuni field) and, on the other hand, the efficiency and pro-competition effects that long-term contracts may have in incentivising high-risk and high-cost exploration and production of natural gas.[52]

On this issue, the Court first noted a tension which exists here under a statute which both prohibits provisions of contracts, arrangements or understandings

---

[46] *Shell*, 7 TCLR at 531.

[47] *Id.*

[48] *Id.*

[49] *Id.* at 516-17.

[50] *Id.* at 527.

[51] *Id.* at 531.

[52] *Id.* at 528; *see also* A.I. Tonking, *Long-term Contracts: When are they Anti-competitive?* 6 COMPETITION & CONSUMER L.J. 13, 23-27 (1998) (discussing how a court may consider whether or not a long-term contract has social utility).

which substantially lessen competition and only permits such matters under an authorisation regime based upon efficiencies defense considerations. One view is that the efficiencies defense is available only to parties who have the foresight to seek prior authorisation and that the scheme of the Act otherwise prohibits defendants from raising such issues in defense of breaches of section 27 where no prior authorisation has been obtained. However, the Court stated here that efficiencies were also relevant to the assessment of section 27, absent authorisation. As the Court noted, "there is now a recognisable trend for efficiencies to be considered in terms of their pro-competition effect."[53]

The Court's ultimate analysis of this efficiency and section 27 liability question is something of a hybrid assessment. Authorisation-type analysis influences the way that the Court analyses the section 27 issue. The Court noted that had there been an authorisation application here, it would have been likely that this would have been granted for a fixed period long enough to allow recovery of the capital investment, a return on that investment and to maintain an acceptable level of exploration. On this basis, the Court suggested that the Kapuni gas contract may have been permitted to run until either 1991 or 1996. However, this litigation fell outside of this time dimension and the Court progressed to the inevitable conclusion that exploration and efficiency considerations were not sufficient to overcome the foreclosure of competition which arose from N.G.C.'s control over output from the two fields.[54]

In granting relief in this case, the Court endeavoured to find a solution which would be inducive of competition. It decided that the remaining reserves of the Kapuni gas field should be divided equally between the plaintiffs and defendants. The Court was able to impose this remedy because section 89(2)(a) of the Commerce Act entitles the Court to vary contracts, so long as such variation is consistent with the Act. The Court was persuaded that this outcome would provide a competitive outcome while still maintaining a reasonable balance between the parties' economic interests.[55]

D. Cartels

The prohibition against cartel conduct is, in essence, a subset of section 27. Section 30 provides that price fixing between competitors is a deemed contravention of section 27, with no requirement of proof of competitive harm.[56] Price fixing does not currently constitute a criminal offense under New Zealand law, however it appears likely that this position will soon change.[57]

---

[53] *Shell*, 7 TCLR at 531. This view was in part based upon a review of U.S. case-law trends. *Id.* at 528-29.

[54] *Id.* at 532.

[55] *Id.* at 536.

[56] Commerce Act 1986 §30 (N.Z.). There are provisions which exempt the application of this per se rule. These exemptions include joint venture pricing (Section 31), price recommendations to not less than 50 persons (Section 32) and joint buying and promotion arrangements (Section 33). *Id.* §§31-33.

[57] *See* MINISTRY OF ECON. DEV., CARTEL CRIMINALISATION: DISCUSSION DOCUMENT (2010), *available at* www.med.govt.nz/business/competition-policy/cartel-criminalisation (exploring the issue of criminalizing cartels and who would be covered by such a law).

Section 30 of the Commerce Act has had significant application over the first twenty-five years of New Zealand antitrust. There have been some seventeen sets of completed judgments over a wide range of markets. The offense was somewhat trivialised in the earliest case, *Commerce Commission v. Otago and Southland Vegetable and Produce Growers Assn.*,[58] where only a $5 penalty was imposed. Nonetheless, penalty trends have been upwards in recent times. The current high-water mark case for penalties against an individual defendant is *Commerce Commission v. Qantas Airways Ltd.*,[59] where a penalty of $6.5 million was imposed.

The reason for the significant number of cartel cases in New Zealand is no doubt the per se nature of the offense. The plain wording of section 30 has led the New Zealand courts to conclude that the mere establishment of the elements of section 30 leads to an irrefutable presumption that the practice is deemed to have the purpose, effect or likely effect of substantially lessening competition.[60] As is always the case, such an approach to rulemaking is arbitrary, but as the Supreme Court observed in *U.S. v. Container Corp. of America*, such rules "are justified on the assumption that the gains from imposition of the rule will far outweigh the losses and that significant administrative advantages will result." [61]

The key elements of section 30, namely, whether there is a contract, arrangement or understanding which may substantially lower competition through the "fixing, controlling or maintaining" of prices has been largely and predictably subject to dictionary definition meanings. [62] Accordingly, most cases proceed on the basis of black letter law assessments as to whether there exists a requisite contractual, or other understanding or arrangement[63] which may have the purpose,[64] effect or likely effect of substantially lessening competition, through the fixing, controlling or maintaining of prices for goods or services.

To the extent that there is currently an issue regarding the interpretation of section 30, it pertains to the meaning of the requirement that the conspirators be "in competition with each other." This issue came to a head in the recent decision

---

[58] (1990) 4 TCLR 14.

[59] *Commerce Comm'n v Qantas Airways Ltd.* (unreported) High Court, Auckland, CIV 2008-404-8366, 2011, Allan J, at para 64 (N.Z.).

[60] *See, e.g.*, *Commerce Commission v Taylor Preston Ltd.* [1998] 3 NZLR 498, 509.

[61] 393 U.S. 333, 341 (1969).

[62] *See, e.g.*, *Radio 2UE Sydney Pty. Ltd. v Stereo FM Pty. Ltd.* [1982] ATPR 40-318, 43, 921 (Austl.); *Commerce Comm'n v Caltex N.Z. Ltd.* [1999] 9 TCLR 305, 311 (HC).

[63] To establish a contract, arrangement or understanding, the question is whether an exchange between the parties involved in the putative arrangement or understanding has engendered an expectation that at least one person would act in the manner that the consensus envisaged. *See Giltrap City Ltd. v Commerce Comm'n* [2004] 1 NZLR 608, 14, 15-6.

[64] The issue of whether the purpose test is objective has been a matter of some debate. The leading authority, by a majority, is to the effect that the purpose test is to be objectively applied, but subjective assessments may be legitimate in borderline cases where there is evidence of subjective anti-competitive effect, coupled with evidence as to equivocal anti-competitive effect. *See ANZCO Foods Waitara Ltd. v AFFCO N.Z. Ltd.* [2006] 3 NZLR 351 (CA) 404, paras 250–65.

of *Commerce Commission v. Air New Zealand Ltd*.[65] This case also involved an interrelated issue pertaining to the extra-territorial application of the Commerce Act under which section 4 states that the Act "extends to the engaging in conduct outside New Zealand by any person resident in or carrying on business in New Zealand to the extent that such conduct affects a market in New Zealand." This case is part of the litigation taken by a number of antitrust agencies concerning alleged cartel activities between airlines supplying air cargo services in relation to fuel and security surcharges. The conduct in question involved, in material part, arrangements entered into by the defendants outside of New Zealand.

Three main questions arose in determining the application of section 27—via section 30, in this case. First, was market definition a necessary requirement for the establishment of whether the airlines were "in competition with each other" for the purposes of section 30? Second, was it necessary to establish that such competition was in a market in New Zealand? Third, was it necessary under section 4 to establish that the conduct in question was prohibited under the Commerce Act?

Addressing the first question, the High Court endorsed the position that it is required to establish a "market" because section 30 is an extension of section 27, which plainly requires the establishment of an anti-competitive outcome in "a market."[66]

As to the second question, the High Court ruled that the requirement that there be a market actually located in New Zealand survives the effect of the section 30 deeming provision. An element of judicial pragmatism entered the analysis at this point. It would not be necessary, for example, for a plaintiff to plead and prove a market in every claim under section 27 via section 30 where there is no suggestion that the market is outside New Zealand. However, there would need to be an answer to any such claim where the market in question was wholly outside New Zealand.[67]

To some extent, there may appear to be some inconsistency as to the strictness of the market definition exercise in the context of the above discussion of the first and second questions. Ultimately, this matter is likely to be of no particular moment. If it is apparent on the facts that there is actual competition between the alleged conspirators in New Zealand, then an exhaustive inquiry into the precise boundaries of the market is not be necessary. Provided that there is an identification of some plausible market definition assessment that should suffice.

Turning to the final issue of extra-territorial application, the matter is somewhat more complicated. On its plain wording, section 4 states that the Commerce Act extends to conduct outside New Zealand where such conduct affects a mar-

[65] *See Commerce Comm'n v Air New Zealand Ltd.* (unreported) High Court, Auckland, CIV 2008-404-008352, 24 August 2011; *Re Queensland Co-operative Milling Ass'n v Defiance Holdings Ltd.*, 25 FLR 169 (1976).

[66] *Id.* at 92, 95-6.

[67] *Id.* at para 76.

ket in New Zealand.[68] Curiously, the High Court in *Air New Zealand* read this provision to hold that section 4 is only established where the conduct is both "prohibited by a substantive provision of the Act if it occurred in New Zealand, and 'affects a market in New Zealand' by affecting competition in the market in New Zealand in respect of which that substantive provision is alleged to have been breached."[69] This conclusion appears to misread section 4. On a plain reading of section 4, it is not apparent that its operation depends on the establishment of an offense. Rather, this provision serves simply to stipulate what evidence may be taken into account in assessing liability under the Act.

IV. The Monopoly Problem

A. Background

Apart from section 27, the other pivotal restrictive trade practices provision is section 36(2). This is the monopolization provision which prohibits firms with a substantial degree of market power from taking advantage of that power to pursue various prohibited purposes. These purposes include restricting new entry, preventing or deterring competitive conduct, and eliminating persons from any market. Section 36 applies to the achievement—or potential achievement—of these proscribed purposes in both the market in which power is held and any other market where the leverage effect of monopolization may be, or may become, apparent. This is a provision of real importance in the New Zealand setting, as will be apparent from the introductory remarks to this Article. There is a particular need for robust monopolization provisions in small market economies, where high levels of concentration exist.[70]

There is nothing unusual about the current legislative prohibition against monopolization. The simplicity of the provision mirrors in some respects section 2 of the Sherman Act. The judicial interpretation of the section can, however, only be described as problematic.

Section 36 is essentially based on the monopolization provision of the Australian antitrust law, namely section 46 of the Competition and Consumer Act 2010. This provision was substantially amended in 2007 and 2008,[71] but there is a

[68] The extra-territorial reach of the Commerce Act under section 4 is also subject to the requirement that the conduct in question is engaged in by a person resident or carrying on business in New Zealand. *See Poynter v Commerce Comm'n* [2010] 12 TCLR 399.

[69] *See Commerce Comm'n v Air New Zealand Ltd.* (unreported) High Court, Auckland, CIV 2008-404-008352, 24 August 2011, at para 261; *Re Queensland Co-operative Milling Ass'n v Defiance Holdings Ltd.*, 25 FLR 169 (1976).

[70] *See* Gal, *supra* note 12, at 311-12.

[71] For example, in 2008 section 46 (6A) was introduced to legislate tests for whether a corporation took advantage of market power. This provision directs that Courts may, without limitation, have regard to whether (a) the conduct was materially facilitated by the corporation's substantial degree of market power, and (b) whether the corporation acted in reliance on its substantial degree of market power, and (c) whether it is likely that the corporation would have engaged in the conduct if it did not have a substantial degree of market power. Another of the 2008 amendments provided that predatory pricing may contravene section 46, even if the corporation cannot, and might not even be able to, recoup losses incurred in supplying the goods. *See* Competition and Consumer Act 2010 (Cth) (formerly Trade Practices Act 1974 (Cth) 46 (1AAA) (Austl.)).

significant body of Australian case-law prior to such amendments, and reliance has been placed upon this by the New Zealand judiciary.

This part of the Article will first provide an overview of the Australian case-law under section 46 which remains of direct relevance to the New Zealand setting, followed by a review of the approach taken by the New Zealand courts to section 36. The focus of the discussion will be upon the problematic "taking advantage" limb of section 36.[72]

B. Australian Jurisprudence

Three different approaches to what constitutes the taking advantage of market power have emerged under the Australian case law, the counterfactual test, the "Justice Deane" approach and the "materially facilitated" test.

1. Counterfactual Test

A focal point of the Australian case-law has been upon the so-called "counterfactual test." The foundation case for this test is *Queensland Wire Industries Ltd v. The Broken Hill Pty. Co. Ltd.* ("*Q.W.I.*").[73] The Broken Hill Proprietary Company ("B.H.P.") produced around 97% of steel made in Australia. It also supplied around 85% of the steel and steel products consumed by Australia.[74] One of B.H.P.'s products was a "Y-bar"—a crucial part for the manufacture of rural star picket fences. Imports accounted for only around 1% of such fences.[75] B.H.P. only sold its Y-bar to a subsidiary company, Australian Wire Industries ("A.W.I.").[76] Queensland Wire Industries ("Q.W.I."), a competitor of B.H.P., attempted to secure an order of Y-bar from B.H.P. so that it could commence its own manufacture of star picket fences. B.H.P. first refused to supply, and then offered to supply at prices which were extraordinarily high—to the point of amounting to a constructive refusal to deal.[77]

Q.W.I. successfully brought an action against B.H.P. for monopolization. Four of the five High Court of Australia judges held that a firm does not improperly take advantage of its power if it acts in the same manner as it would have in a

---

[72] There are two other main limbs to section 36. First, there is the threshold question as to whether the defendant has a "substantial degree of market power." The case-law on this concept has centered upon identifying whether there is power that enables a corporation to behave independently of competition. *See Eastern Express Pty. Ltd. v General Newspapers Pty. Ltd.* [1992] 35 FCR 43, 62-63 (Austl.). Also it has centered on whether there is an absence of competitive constraint. *See Boral Besser Masonry Ltd. v Australian Competition and Consumer Commission* [2003] 215 CLR 374, 121, 136, 137-38 (Austl.). Assuming that a firm meets the market power threshold under section 36, and is found to have taken advantage of that power, there is a final inquiry as to whether it has the requisite anti-competitive purpose under section 36(2)(a) to (c). The test for purpose here is again "an objective one but evidence of subjective purpose can be addressed and taken into account in assessing objective purpose." *See ANZCO Foods Waitara Ltd. v AFFCO N.Z. Ltd.* [2006] 3 NZLR 351 (CA) 404, para 255.

[73] [1989] 167 CLR 177 (Austl.).

[74] *Id.* at 183-84.

[75] *Id.*

[76] *Id.*

[77] *Id.* at 184.

competitive market.[78] There was no specific analysis on how this counterfactual test may properly address the policy concerns of monopolization. Rather, on the facts of that case, it was seen as a pragmatic way to assess the claim. However, the test went on to take on a life of its own.

In all subsequent cases, the counterfactual test has been a focal point, either in name or in application.[79] However, some limits have been placed on the application of the counterfactual test as the sole or dominant test. In *Melway Publishing Pty. Ltd. v. Robert Hicks Ltd*., the High Court of Australia stated that the counterfactual test should be considered in all cases, but should only be undertaken where this can be done with sufficiency cogency.[80] *Melway* recognized that other tests should apply where counterfactual analysis could not be cogently undertaken.[81]

2. The "Justice Deane" Approach

In *Q.W.I.*, one of the judges used a different test to determine whether B.H.P. had taken advantage of its market power. Justice Deane stated:

> [B.H.P.'s] refusal to supply Y-bar to Q.W.I. otherwise than at an unrealistic price was for the purpose of preventing Q.W.I. from becoming a manufacturer or wholesaler of star pickets. That purpose could only be, and has only been, achieved by such a refusal to supply by virtue of B.H.P.'s substantial power in all sections of the Australian steel market as the dominant supplier of steel and steel products. In refusing to supply in order to achieve that purpose, B.H.P. has clearly taken advantage of that substantial power in that market.[82]

This test is based upon an assessment of purpose, and recognises that the concepts of taking advantage and purpose should not be evaluated in isolation of each other. This test has been referred to with approval in subsequent cases. In *Melway*, the High Court noted that "Justice Deane's approach was different" to the counterfactual test formulated in *Q.W.I.*.[83] Justice Deane's approach relies upon direct observation of purpose and conduct, and does not involve any comparative assessment of the kind envisaged under the counterfactual test.

---

[78] *Id.* at 192 (per Mason C.J. and Wilson J.), 202 (per Dawson J.), 216 (per Toohey J.).

[79] *See* Paul G. Scott, *Taking a Wrong Turn: The Supreme Court and Section 36 of the Commerce Act*, 17 N.Z. Bus. L.Q. 260, 264-71 (2011).

[80] [2001] HCA 13 (Austl.).

[81] *Id.* at paras 22, 24.

[82] *See Commerce Comm'n v Air New Zealand Ltd*., (unreported) High Court, Auckland, CIV 2008-404-008352, 24 August 2011, at paras 197-98; *Re Queensland Co-operative Milling Ass'n v Defiance Holdings Ltd.*, 25 FLR 169 (1976).

[83] *Melway Publishing Pty. Ltd. v Robert Hicks Pty. Ltd.* [2001] HCA 13 at 22. *See also N.T. Power Generation Pty. Ltd. v Power and Water Authority* [2004] HCA 48 at paras 149-50 (Austl.) (noting that Deane J. had adopted an "alternate approach").

3. The "Materially Facilitated" Test

A third approach foreshadowed in *Melway,* the "materially facilitated" test, was discussed in the following terms:

> Dawson J's conclusion that B.H.P.'s refusal to supply Q.W.I. with Y-bar was made possible only by the absence of competitive conditions does not exclude the possibility that, in a given case, it may be proper to conclude that a firm is taking advantage of market power where it does something that is materially facilitated by the existence of the power, even though it may not have been absolutely impossible without the power. To that extent, one may accept the submission made on behalf of the ACCC, intervening in the present case, that s 46 would be contravened if the market power which a corporation had made it easier for the corporation to act for the proscribed purpose than otherwise would be the case.[84]

This test, like Justice Deane's test, is not framed in comparative terms. The material facilitation test has been recognised in subsequent Australian cases as another basis upon which to determine the taking advantage limb of section 46.[85] However, there is no further articulation of the test in these cases, and it has not to date provided a basis upon which any monopolization case has been decided in Australia.

C. New Zealand Jurisprudence

Until 2004, the Judicial Council of the Privy Council sat as New Zealand's highest appellate court. In July 2004, the Supreme Court of New Zealand was established and this assumed the appellate function previously performed by the Privy Council. The journey through the jurisprudence on section 36 begins with two decisions of the Privy Council and ends with a recent Supreme Court decision.

The first case in this saga was *Telecom Corp. of N.Z. Ltd. v. Clear Communications Ltd.* ("*Telecom/Clear*").[86] This case involved a dispute over the access price Clear had to pay Telecom to connect to its fixed copper Public Service Telecommunications Network. It centered upon the application of the Efficient Component Pricing Rule. Telecom argued that it would not be abusing its dominant market position if it demanded a price equal to the revenue it would have received had it provided the services itself. This premise relied upon the prevailing arguments in *Q.W.I.* That is, if Telecom's prices were no higher than those which a hypothetical firm would seek in a perfectly competitive market, Telecom was not abusing its dominant position.[87] This lead the Privy Council to fashion

---

[84] *Melway*, HCA 13 at 51.

[85] *See Australian Competition and Consumer Comm'n v Australian Safeway Stores Pty. Ltd.* [2003] FCAFC 149, 325-33 (discussing how to determine if a corporation has taken advantage of its market power through material facilitation).

[86] *Telecom Corp. of N.Z. Ltd. v Clear Comm. Ltd.* [1995] NZLR 385 (P.C.).

[87] *Id.* at para 403.

the following statement of principle on the taking advantage, or use, limb of section 36:[88]

> [I]t cannot be said that a person in a dominant market position "uses" that position for the purposes of s 36 [if] he acts in a way which a person not in a dominant position but otherwise in the same circumstances would have acted.

This solely counterfactual approach was affirmed by the Privy Council in a later case, *Carter Holt Harvey Building Products Group Ltd. v. Commerce Commission.*[89] In *Carter Holt Harvey* the Privy Council said that it was both legitimate and necessary to apply the counterfactual test to determine if a firm had abused its dominance.[90] Accordingly, the effect of *Telecom v. Clear* and *Carter Holt Harvey* was to impose on New Zealand a sole, counterfactual test. To be fair, the Privy Council simply relied on the counterfactual arguments before it,[91] and was not asked to consider whether either the Justice Deane or the material facilitation tests may apply.

This background sets the scene for the decision of the Supreme Court in *Commerce Commission v. Telecom Corp. of N.Z. Ltd.* ("*0867*").[92] Prior to this appeal, all New Zealand courts had been bound to follow the counterfactual test previously set down by the Privy Council. The *0867* appeal provided the Supreme Court with an opportunity to make a choice; would it continue to follow the sole counterfactual approach set down by the Privy Council, or would it prefer the wider approach adopted by the High Court of Australia?

Regrettably, the Supreme Court's misinterpretation of Australian case law squandered this opportunity. The Supreme Court convinced itself that, when appropriately analysed, all of the Australian tests could be regarded as involving a comparison between actual and hypothetical markets.[93] It also asserted that the predictability of outcome would be harmed by the application of a range of tests.[94] This reading of Australian case law is clearly problematic, given the clear expression that, within the jurisdiction, there are different and alternate tests apart from the counterfactual test, as noted above.

Against this background, the Supreme Court formulated the following comparative exercise test, which is in all but name, an endorsement of the sole counterfactual test:

---

[88] *Id.* at para 402. *See, e.g.*, *Commerce Comm'n v Bay of Plenty Elec. Ltd.* (unreported) High Court, Wellington, CIV 2001-485-917, 13 December 2007, at 311 (HC) (discussing how courts have held since this amendment that the concept of "use" and "take advantage" have parallel application under section 36).

[89] *Carter Holt Harvey Bldg. Prod. Group Ltd. v Commerce Comm'n* [2006] NZLR 145 (P.C.).

[90] *Id.* at para 60.

[91] It should also be noted that the minority in *Carter Holt Harvey* did express concerns about the reliability of a test based on the identification of a hypothetical comparator. *Id.* at para 78.

[92] *Commerce Comm'n v Telecom Corp. of N.Z. Ltd.* [2011] NZLR 577 (SC).

[93] *Id.* at paras 17, 21.

[94] *Id.* at para 30.

> A firm with a substantial degree of market power had the potential to use that power for a proscribed purpose. To breach s 36 it must actually use that power in seeking to achieve the proscribed purpose. Anyone asserting a breach of s36 must establish there has been the necessary actual use (taking advantage) of market power. To do so it must be shown, on the balance of probabilities, that the firm in question would not have acted as it did in a workably competitive market, that is, if it had not been dominant.[95]

In its statements, the Supreme Court provided some additional guidance on the application of this comparative test. The Court stressed that the question of what a firm with a substantial degree of market power would do in a hypothetically competitive market is a matter of practical business or commercial judgment, and is not necessarily a matter of economic analysis.[96] Further, in determining the hypothetical market, a court must strip away all aspects of the firm's dominance.[97]

In the limited time since the delivery of this decision, it has received strong criticism. The leading commentary to date concludes that:

> The Supreme Court has missed the point, misread Australian law and taken a wrong turn by confirming the counterfactual test as the sole determinant for "use" or "taking advantage of substantial market power". It has left no room for alternative tests.[98]

Such criticism has also been coupled with calls for legislative change to section 36.[99] For the time being, however, section 36 remains constrained to the world of a sole counterfactual (or comparative) test.

D. Critique

The judicial preference for a counterfactual test in Australasia is problematic. Nonetheless, it has prevailed—notwithstanding strong criticism from commenta-

---

[95] *Id.* at para 34. There is the possibility that the Supreme Court did attempt to expand the test to include material facilitation. For example, at one point it said: "market power gives some advantage if it makes easier – that is, materially facilitates – the conduct in issue." *Id.* at para 33. However, this passing reference is difficult to elevate to a new test having regard to the express endorsement throughout the decision of the sole counterfactual approach. *See, e.g.*, *id.* at para 31 stating,

> [T]he essential point is that if a dominant firm would, as a matter of commercial judgment, have acted in the same way in a hypothetically competitive market, it cannot logically be said that dominance has given it the advantage that is implied in the concepts of using or taking advantage of. . . a substantial degree of market power.

[96] *Id.* at para 30.

[97] *Id.*

[98] Scott, *supra* note 79, at 282. *See* Matt Sumpter, *Competition Law*, 2012 N.Z. L. REV. 113, 123 (missing the fundamental point that the Australian case-law before the Supreme Court was that which pre-dated the 2007 and 2008 amendments to the Competition and Consumer Act).

[99] Scott, *supra* note 79, at 283; *see also* Oliver Meech, *"Taking Advantage" of Market Power*, 2010 N.Z. L.J. 389, 392.

tors over the years.[100] The continued application of this test is highly problematic for the following reasons:

First, the application of the test is plagued with uncertainty. The first step in performing the test is to construct the hypothetically competitive market comparator. The construct that a court may accept here is highly unpredictable.[101] Further, assuming the identification of such a hypothetically competitive market, there is an issue as to how reliably can it be predicted how the monopolist would act in it. Little guidance or comfort can be taken from the Supreme Court's "commercial judgment" test in *0867*.[102]

Second, from a policy perspective, relative market performance assessments are inappropriate. It is not difficult to identify instances where unilateral conduct may be of no concern, or even pro-competitive, when undertaken by a non-dominant firm in a competitive market, but may well be anticompetitive and cause consumer harm when engaged in by a dominant firm. These concerns are of potentially greater resonance in a small market economy such as New Zealand. Take, for example, the case study of exclusive dealing where a dominant firm's exclusive dealing arrangements exist in markets with high entry barriers and where the extent of these arrangements results in the foreclosure of either upstream or downstream competition. Under the sole counterfactual test we are required to construct a hypothetically competitive market comparator which will bear no resemblance to the real world problem. Would the now non-dominant monopolist have imposed the same exclusive dealing requirements in this artificial competitive market? The answer will probably be yes because exclusive dealing may be economically rational and may have pro-competitive effects in the hypothetically competitive market. On this analysis, the plaintiff in a monopoly case in New Zealand faces insurmountable problems in seeking relief in circumstances where it may well be warranted. This kind of analysis has the potential to play out in much the same way in other situations where section 36 applies.[103]

For the moment, New Zealand monopolization law sits in an unfortunate position. While the legislation itself presents no particular problems, the judicial analysis of the Act has seriously narrowed its application. Pragmatically, the only way forward is to adopt an amendment to section 36. Hopefully, any such legis-

---

[100] For references to this commentary, *see* Scott, *supra* note 79, at 282; *see also* Gal, *supra* note 12, 99-106.

[101] *See* Mark N. Berry, *The Uncertainty of Monopolistic Conduct: a Comparative Review of Three Jurisdictions*, 32 L. & POL'Y IN INT'L BUS. 263, 312 (2001) (discussing the construction of a hypothetical competitive market model utilizing monopolistic conduct). *See also Commerce Comm'n v Telecom Corp. of N.Z. Ltd.* (2009) 12 TCLR 457, 74 (discussing the resultant prolonged litigation that would stem from a suggested solution to the uncertainty found in the Court of Appeal decision in *0867*, which is that the Court should determine this matter as a preliminary question).

[102] *See* Jeffrey M. Cross, J. Douglas Richards, Maurice E. Stucke & Spencer Weber Waller, *Use of Dominance, Unlawful Conduct and Causation under Section 36 of New Zealand's Commerce Act 1986: A United States Perspective*, 18 N.Z. BUS. L.Q. 333 (2012) (for a discussion on the reluctance of the U.S. courts to engage in but-for analysis).

[103] There are also observations under U.S. law which reflect that the but-for analysis is too differential to the monopolist. *See U.S. v. Microsoft Corp.*, 253 F.3d 34, 79 (D.C. Cir. 2001) (per curiam).

lative review will not be confined to the potential adoption of the revised monopolization provisions now contained in section 46 of the Competition and Consumer Act. As noted above, counterfactual analysis is unreliable and controversial in its application. Further, the content and application of the Justice Deane and material facilitation tests are unclear and uncertain.

A properly informed review of section 36 will require an international survey of the subject. There is no easy solution to the problem; indeed, the history of antitrust reflects a "continuing, and perhaps never ending, search for an appropriate [monopolization] rule."[104] In any such review, close consideration should be given to U.S. monopolization law which focuses upon the likely or actual competitive effects of the defendant's conduct.[105] At the least, such a test endeavours to address the real-world harm that may attach to monopolistic conduct and this is clearly preferable to hypothetical thought experiments.

V. Merger Analysis

Outside observers may, at first glance, be surprised at the levels of concentration which have been permitted under New Zealand merger approvals. The table below sets out a sample schedule of mergers which were approved in 2010 and 2011. This table has been constructed in random sequence, so as to preserve confidentiality of market share details. The market share for the merged entity is included, together with the three-firm concentration ratio.

MERGER APPROVALS 2010 – 2011

Mergers	Market Shares	3 Firm Concentration Ratio
A	19% and 42%	56% and 60%
B	98%	100%
C	82%	100%
D	72%, 38%, 28% and 58%	100%, 97%, 90%, 100 %
E	30% - 41%	78% - 93%
F	38% and 93%	87% and 100%
G	30% - 36%	83% - 88%
H	54%, 41% and 43%	91%,7 4% and 74%
I	7%, 19% and 46%	100%, 70% and 97%
J	56%, 71% and 89%	75%, 100% and 95%
K	68%	80%
L	31% and 41%	95% and 67%
M	93%	100%
N	42% and 38%	100%
O	97%	100%
P	100%	100%
Q	48%	92%
R	84%	100%

[104] *See* Berry, *supra* note 101, at 264.

[105] *See e.g.*, Cross et al., *supra* note 102 (for an outline of this test and its relevance to New Zealand).

There is, however, a need to observe these levels of concentration in the context of a small market economy. If mergers involving this level of concentration are not permitted, then this would significantly suppress merger activity and prohibition of such mergers would potentially deny the opportunity for the emergence of firms of sufficient size to achieve efficient levels of production.

As it happens, New Zealand has a conventional merger prohibition by international standards. Section 47(1) prohibits acquisitions of assets of a business or shares which would have, or would be likely to have, the effect of substantially lessening competition in a market.[106] There is a voluntary pre-merger notification regime which means that merger parties have three procedural options. First, if merger parties believe that their transaction does not contravene section 47 they can implement the merger without reference to the Commerce Commission.[107] Second, parties may apply to the Commission for clearance of their proposal before carrying out the merger. The Commission is required to give clearance under section 66 if it is satisfied that the merger will not contravene the section 47 test. Finally, in more problematic cases where mergers are likely to result in a substantial lessening of competition, applicants can seek authorisation on the basis that there are public benefits which outweigh the detriments flowing from the potential lessening of competition.

The substantive approach to the analysis of the section 47 substantial lessening of competition test follows international norms for the most part. Readers of the New Zealand Commerce Commission Mergers and Acquisitions Guidelines[108] will observe that its content bears a striking resemblance to the substance of earlier versions of the U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines.

There is, nonetheless, one crucial matter of difference. The view has been taken in this part of the world that the substantial lessening of competition test, by its very language, begs a comparative assessment. What will be the comparative competitive state of the markets both with and without the merger? This comparative question has become known under New Zealand antitrust law as yet another so-called "counterfactual" test. This test has become regarded as elementary to the analysis of section 47.[109]

---

[106] *See Commerce Comm'n v Port Nelson Ltd.* [1995] 6 TCLR 406, 441 (discussing the dominance test contained in this provision from 1986 to 2001; a test that was interpreted as one that required the establishment of more than high market power). *See also Telecom Corp. of N.Z. Ltd. v Commerce Comm'n* [1992] 3 NZLR 429 CA 442 (discussing further how the provision was considered to relate only to unilateral and not co-coordinated effects). For further background on this amendment, *see* Mark N. Berry & Morag Bond, *The Redirection of the Merger Threshold* in COMMERCIAL LAW ESSAYS: A NEW ZEALAND COLLECTION 119, 122-23 (David Rowe & Cynthia Hawes eds., 2003) (discussing how the introduction of the substantial lessening of the competition test under the Commerce Amendment Act 2001 was intended to lower the market power threshold under section 47, and require that merger analysis extend to take account of the potential for collusive or oligopolistic behaviour).

[107] *See Commerce Comm'n v New Zealand Bus Ltd.* (2006) 11 TCLR 679 (discussing how enforcement action may be taken by the Commission if it has competition concerns).

[108] Commerce Comm'n, *Mergers & Acquisitions Guidelines* (2003).

[109] *Commerce Comm'n v Woolworths Ltd.* [2008] NZCA 276 at para 4 (CA).

The courts have developed principles which govern the application of this counterfactual test. First, the counterfactual test "focuses upon a possible change along the spectrum of market power rather than whether or not a particular position on that spectrum, i.e. dominance has been attained."[110] In other words, it is necessary to plot the points of the merger (the factual) and the likely state of affairs without the merger (the counterfactual) along the market power continuum ranging from perfect competition at one end to monopoly at the other. It is this comparative market power assessment of the factual and counterfactual which forms the essential basis for determining whether there may be a substantial difference between the two identified levels of market power.

Another key interpretative matter, which flows from the above principle, is: what approach is taken in relation to the identification of the counterfactual? Inevitably, this forward-looking assessment will be highly problematic in many cases. In some cases it could be that more than one counterfactual may be likely. The test for likelihood requires only that the counterfactual be "more than possible" and that "it need not be more probable than not."[111] In *Woolworths Ltd. v. Commerce Commission*, the Court reflected on this possibility and enunciated the following principles for cases where more than one counterfactual may be possible:

> We consider that the correct approach is that we must assess what are the possibilities. We are to discard those possibilities that have only remote prospects of occurring. We are to consider each of the possibilities that are real and substantial possibilities. Each of these real and substantial possibilities become counterfactuals against which the factual is to be assessed. If in the factual as compared with any of the relevant counterfactuals competition is substantially lessened then the acquisition has a "likely" effect of substantially lessening competition in a market.[112]

An obvious related question which arises under this multiple counterfactual approach is whether any given merger decision should take into account the possibility that one of the identified counterfactuals may be most likely to occur. On this point, the Court considered that "where there is more than one real and substantial counterfactual it is not a case of choosing the one that we think has the greater prospect of succeeding."[113] Accordingly, merger analysis is now directed at identifying all likely counterfactuals and making the competition assessment in respect of the least favourable counterfactual, even if it may not be the most likely counterfactual.[114]

---

[110] *Air New Zealand Ltd. v Commerce Comm'n (No. 6)* (2004) 11 TCLR 347 at para 42 (HC).

[111] *Woolworths Ltd. v Commerce Comm'n* (2008) 8 NZBLC at para 112 (HC).

[112] *Id.* at para 122.

[113] *Id.* at para 118.

[114] New Zealand merger jurisprudence largely follows Australian precedent. Section 50 of the Australian Act also contains a substantial lessening of competition threshold. However, while counterfactual analysis is also required in Australia, the multiple counterfactual approach outlined in *Woolworths* has not been expressly contemplated under Australian case-law. *See, e.g.*, *Australian Competition & Consumer Comm'n v Metcash Trading Ltd.* [2011] FCAFC at paras 226-37 (Fed. C.).

Counterfactual analysis can be problematic because predictions as to the future structure and workings of markets are inherently uncertain. The alternative of taking the status quo as the point for comparison is not necessarily any more reliable. In small economies markets can foreseeably change, at times with some degree of speed. In a number of cases, there are only some three to four competitors in any given market. The investigation into such mergers can often reveal future market plans that reflect likely changes in the scale and scope of competition. In such cases, status quo counterfactuals would be inappropriate. Accordingly, the Australasian counterfactual approach is perhaps more fit for purpose than status quo assumptions in a small market economy. However, the multiple counterfactual approach formulated in *Woolworths* is problematic. The central objection to this approach is the risk of false negatives. Decision-makers are placed in an unfortunate position when they are required to decline a merger approval because one possible counterfactual does not pass the test, notwithstanding that there may be a more likely counterfactual under which approval would be given.[115]

Apart from this current framework problem, it is fair to say that the traffic of merger cases over the first twenty-five years of the Commerce Act have travelled well enough.

VI. A Window on the Efficiencies Defense

A final part of the Commerce Act which warrants comment is the authorisation (or efficiencies defense) process under the Act. As already mentioned, where parties propose to enter into, or give effect to any restrictive trade practice which may breach any section of the Act (other than the monopolization provision), they may seek prior authorisation of the practice from the Commerce Commission. Section 61(6) requires that the Commission must authorise any such application where it is likely that there is "a benefit to the public which would outweigh the lessening of competition" that would result or would be likely to result from the practice. A similar provision applies in respect of mergers which may not be cleared on substantial lessening of competition grounds. Such mergers can, nonetheless, be authorised under section 67(3) on the grounds that it will be likely to result "in such a benefit to the public that it should be permitted."[116] As already noted, the public benefit test centers upon efficiencies.[117]

---

[115] For wider discussion of the multiple counterfactual problem, *see* Mark N. Berry & Paul G. Scott, *Merger Analysis of Failing or Exiting Firms Under the Substantial Lessening of Competition Threshold*, 16 Canterbury L. Rev. 272, 287-88 (2010).

[116] The efficiencies defense has been applied in parallel manner under both sections 61(6) and 67(3), notwithstanding the different wording of the authorisation test. Commerce Act 1986 §5 (N.Z.); *Godfrey Hirst N.Z. Ltd. v Commerce Comm'n* (2011) 9 NZBLC at paras 82-90 (HC).

[117] The inquiry nonetheless extends beyond efficiency gains. *See Air New Zealand Ltd. v Commerce Comm'n (No. 6)* (2004) 11 TCLR 347 at para 319 (HC) (the high court noted "[b]enefits include efficiency gains § 3A of the Act and anything of value to the community generally."). Other points to note from *Air New Zealand*, *id.*, are that only net benefits are to be included. Any costs incurred in achieving efficiencies must be taken into account, and transfers of wealth which achieve no benefit to society as a whole should be disregarded. *Id.* Further, the claimed benefits must result from the acquisition. *Id.* Benefits which may be likely without the merger are not to be included. *Id.*

A recent case, *Godfrey Hirst N.Z. Ltd. v Commerce Commission*,[118] serves to illustrate the workings of the efficiencies defense in New Zealand in the merger law context. As earlier outlined, the authorisation process under section 67(3) requires the Commission to consider whether a merger should be permitted on grounds of countervailing public benefits, notwithstanding a finding of a likely substantial lessening of competition. The standard methodology for undertaking this assessment is first to assess detriments (or welfare losses) as quantified to the extent possible under three categories of efficiency losses, namely allocative, productive and dynamic.[119] These detriments must then be measured against public benefits. These benefits include efficiency benefits (or welfare gains), consistent with section 3A, and these must also be quantified to the extent possible. Such benefits are also assessed under parallel efficiency criteria namely, likely allocative, productive and dynamic efficiency gains. Other benefits may be advanced by the applicant—although in practice it is rare for any such benefits to carry much weight. The Commission is required to form a view on the range, magnitude and likelihood of all claimed benefits. Both a qualitative and quantitative judgment call is required. The outcome ultimately rests on where the balance lies between the detriments and the benefits.

A. Background

Godfrey Hirst is a case study of a two-to-one merger situation. The case concerned the proposed merger of New Zealand's two remaining wool scours, namely Cavalier and New Zealand Wool Services.

The relevant markets in this case were defined as being the North and South Island markets for the supply of wool scouring services.[120] Wool scouring is the process by which wool clipped from sheep is cleaned and prepared for use in other processes. Not all wool grown in New Zealand is scoured. Some wool is exported in greasy form. At present 78% of New Zealand's wool clip is exported (predominantly to China), and of these exports, 22% of the clip is greasy wool.[121]

Wool scouring is a high fixed cost, low variable cost business. Further, the industry is experiencing significant over-capacity in wool scouring facilities and this has driven the need for rationalisation. Between 1983 and the present day, New Zealand's sheep flock has declined 53% (from a peak of 70 million to 33 million sheep).[122] Cavalier had three wool scouring plants in the North Island and one in the South Island. New Zealand Wool Services had one plant in each Island. Cavalier proposed, post-merger, to close one plant in each Island and to work towards achieving related rationalisation benefits.

The two largest domestic customers of scoured wool in New Zealand are Cavalier and Godfrey Hirst, and they compete in the market for the manufacture of

[118] *Godfrey Hirst*, 9 NZBLC at paras 82-90.

[119] *Id.* at para 53.

[120] *Id.* at para 54.

[121] *Id.* at para 17.

[122] *Id.* at para 16.

carpets. Godfrey Hirst owned a wool scour previously, but sold this to Cavalier in 2009. At the time of the sale Godfrey Hirst entered into a fixed-term contract with Cavalier for the provision of scouring services.[123] Godfrey Hirst opposed the Cavalier-New Zealand Wool Services merger because of the risk it saw in being beholden to wool scouring services from its major rival in the carpets market. While it was dependent on such services for the term of its contract with Cavalier, Godfrey Hirst still thought it important that the threat of switching to New Zealand Wool Services should remain.

B. The Detriments

On the question of allocative inefficiency losses, the Commission was required to assess likely price increases post-merger. Critical factors here in the assessment of market power included the prospect of new entry and the prospect of increased export of greasy wool to China. It was this threat of new entry and the threat of export of greasy wool to China that was seen as the ultimate price cap. The Commission modeled allocative inefficiency losses over a range of demand elasticities (-0.05, - 0.5 and -1.0) and over a range of price increase assumptions (5%, 10% and 15%). The Commission made a judgment call that a detriment value corresponding to a 10% price increase and a demand elasticity of -1.0 was the most likely allocative inefficiency loss. This equated to the likely allocative efficiency loss as being a net present value of $14.7 million over a five year period.[124] This finding was upheld on appeal.[125]

Turning to potential productive efficiency losses, the High Court again endorsed the Commission's findings on this highly speculative subject matter.[126] This matter addresses losses that may arise from reduced incentives to minimise costs and to avoid loss in the absence of competitive pressure. However, forward-looking assessments of potential organisational slack are notoriously difficult to make and depend substantially on surrounding market circumstances. Ongoing competitive threats in the form of new entry or the China export constraint, coupled with shareholder incentives to drive productive efficiencies, were material to the Commission's findings. The Commission considered that the productive efficiency loss may be in the range of 1% and 5% of pre-merger variable costs. It made a qualitative judgment at a mid-point range of 3%.

Dynamic efficiency losses, like productive efficiency losses, are notoriously difficult to quantify. While monopolists may lack the pressure to invest and innovate compared with a competitive market setting, there is no robust methodology for making the calculation. The Commission in this case focused on the long-term competitive threat of China's scouring industry and considered that this would spur innovation. Further, the key innovations in this market came from outside the market, in the form of equipment manufacturer innovations. These

[123] *Id.* at para 29.

[124] *Id.* at paras 127-29.

[125] *Id.* at para 190.

[126] *Id.* at paras 191-201.

factors suggested that any losses in dynamic efficiencies were likely to be limited.

Consistent with earlier authorisation decisions, the Commission attempted to quantify this detriment by multiplying total revenue by a factor. Given the perceived smallness of the detriment, the Commission used a range of losses of 0 to 1% and took a mid-point to reach its final decision.

The High Court took issue with the Commission using a start point of 0 on this range essentially because the removal of New Zealand Wool Services would be likely to remove at least some potential dynamic efficiency from the market.[127] Nonetheless, the Court accepted that the Commission's use of a mid-point (0.5% of industry revenue) was not wrong.[128] In so doing, the Court recognised the need for pragmatism in this assessment.

C. The Public Benefits

A range of countervailing benefits were claimed by the applicant, Cavalier. First, there were productive efficiency gains in the form of operating and administrative cost savings. The challenge for the applicant was to establish that these cost savings would be likely achieved, and that they would not otherwise occur in the counterfactual (without the merger). The applicant established to the Commission's satisfaction that cost savings in the order of 14% of pre-merger operating and administrative costs would be likely. Significant among these cost savings were energy costs, repairs and maintenance costs, and administration expenses (primarily salaries). Some claimed savings relating to fringe benefits for cars and council rates were rejected because these were viewed as "transfers" rather than public benefits.[129]

On appeal, the High Court rejected Godfrey Hirst's argument that these cost savings were functionless because they concerned fewer resources (electricity, gas, land, labour) being used to scour the same volume of wool.[130] Overall, the Court endorsed the Commission's findings on this category of public benefit.[131]

The next head of public benefit concerned the sale of surplus land and buildings. As mentioned earlier this merger, if implemented, would result in the closure of two existing wool scour plants. Throughout the Commission's deliberations, it was accepted that freeing-up surplus land and buildings was a public benefit as those resources could then be deployed to other productive uses. Godfrey Hirst used the appeal as an opportunity to test this proposition. The Court accepted that this was appropriately a head of public benefit because fewer land and building resources were needed for the scouring operations in the factual compared with the counterfactual, thereby releasing land for other produc-

[127] *Id.* at para 229.

[128] *Id.* at para 247.

[129] *Id.* at para 250.

[130] *Id.* at para 271.

[131] *Id.* at para 281.

tive uses.[132] Further, the Court endorsed the value of $8 million for this surplus land and buildings.[133]

It is noteworthy here to mention that the acceptance of the claimed benefits thus far was sufficient to outweigh the quantified detriments.[134] The public version of the decision does not, of course, reveal the precise numbers, because confidentiality attached to significant portions of the quantification before the Commission and the Court.

Finally, the Commission emphasised that the ultimate decision was not undertaken purely on a quantitative basis. This, it said, was supplemented by a qualitative assessment. The Court observed that this method involved some circularity, and that it was not clear what had gone into the qualitative assessment other than the quantitative assessment of most likely detriments and benefits.[135] While there is some validity to this view, it needs to be appreciated that there is a significant overlap between quantitative and qualitative methods. One does inform the other. It is not always possible to say that both methods of analysis involve discrete decision-making paths. However, the ability to stand back and make an overall qualitative assessment after the quantification has been done is desirable. This final check may provide appropriate push back in cases where instinctively the numbers in the final assessment may not look right.

VII. Some Concluding Thoughts

New Zealand competition policy and jurisprudence has come far in the first twenty-five years of the operation of the Commerce Act. Admittedly, there has been a good deal of free-riding on international experience throughout this journey.

The efficiency policy framework of the Act appears sound, although its application in a small economy always poses tensions. High concentration to enable productive efficiency has the potential to benefit consumers. But, at times, it might give rise to the prospect of the exercise of undue market power. This tension is almost always present.

---

[132] *Id.* at para 296.

[133] There were two other claimed heads of public benefit which were not ultimately determinative of this case. Cavalier had argued that the merger would enable it to create a wool superstore. *Id.* at para 321. This, it was argued, would lead to efficiencies (including freight savings) by eliminating duplication of resources in the storage and handling of wool (including wool sorting, cleansing and testing at one site, rather than at multiple sites). The Court concluded that this development may also be likely to occur in the counterfactual and indicated that if this matter had been crucial to the outcome it may have referred the matter back to the Commission for reconsideration. *Id.* The final benefit claim, quality improvements with brighter wool, also involved a difference of opinion between the Commission and the Court. Cavalier argued that with the merger there would be the likelihood that it could achieve improved quality, it being accepted that increase in brightness could increase wool value by 4 cents per kilogram. *Id.* The Commission reached the view that these benefits could be achieved in the counterfactual. In this case the Court thought that this may not be so and again indicated that if the case had turned on this point, it would have referred the matter back to the Commission for further consideration. *Id.*

[134] *Id.*

[135] *Id.* at para 323.

While there has been limited traffic under our catch-all section 27 provision relating to trade practices, the formulation of its tests and their application does not appear to pose any particular concerns. The analysis in cases such as *Fisher & Paykel* and *Kapuni* is likely to be regarded as internationally acceptable, depending on policy preferences. The problems surrounding the per se price fixing rule, section 30, are of no great magnitude. They are in the nature of bedding down. This provision will, of course, take on a new life with the likely introduction of criminalisation in the near future.

Merger analysis has also been robust in its approach and application. There are good reasons for the application of a forward-looking counterfactual approach to mergers in a small market economy, notwithstanding that in some cases this may involve some difficult future predictions. The one problem area under New Zealand merger law is the multiple counterfactual approach, as formulated by the High Court in *Woolworths*. This is a matter requiring further thought given the false negative risk that it inevitably introduces.

Finally, the current state of the jurisprudence on monopolization is the low point of New Zealand antitrust over the first twenty-five years. The decision of the Supreme Court in *0867* has serious implications for section 36. The application of monopoly rules based on hypothetical thought experiments, involving the creation of make-believe market structures and predictions of behaviour in make-believe worlds, is highly problematic. Section 36 is in urgent need of amendment.

Appendix

Key Provisions of the Commerce Act, 1986 (New Zealand)

Section 27(1): Contracts, arrangements, or understandings substantially lessening competition prohibited

No person shall enter into a contract or arrangement, or arrive at an understanding, containing a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

Section 27(2): No person shall give effect to a provision of a contract, arrangement, or understanding that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

Section 30: Certain provisions of contracts, etc, with respect to prices deemed to substantially lessen competition

(1) Without limiting the generality of section 27, a provision of a contract, arrangement, or understanding shall be deemed for the purposes of that section to have the purpose, or to have or to be likely to have the effect, of substantially lessening competition in a market if the provision has the purpose, or has or is likely to have the effect of fixing, controlling, or maintaining, or providing for the fixing, controlling, or maintaining, of the price for goods or services, or any discount, allowance, rebate, or credit in relation to goods or services, that are

(a) supplied or acquired by the parties to the contract, arrangement, or understanding, or by any of them, or by any bodies corporate that are interconnected with any of them, in competition with each other; or

(b) resupplied by persons to whom the goods are supplied by the parties to the contract, arrangement, or understanding, or by any of them, or by any bodies corporate that are interconnected with any of them in competition with each other.

Section 36: Taking advantage of market power

(2) A person that has a substantial degree of power in a market must not take advantage of that power for the purpose of

(a) restricting the entry of a person into that or any other market; or

(b) preventing or deterring a person from engaging in competitive conduct in that or any other market; or

(c) eliminating a person from that or any other market.

Section 47: Certain acquisitions prohibited

(1) A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.

A Study on the Efficacy of the Kampala Amendments for Suppression of Aggression: Examined by the Case of Armed Conflicts in the Korean Peninsula

Nu Ri Jung[†]

I. Introduction

On March 25, 2010, a warship of the Republic of Korea (South Korea), ROKS Cheonan, was severed in two and sunk near the sea border with the Democratic People's Republic of Korea (North Korea), after an explosion at the rear of the ship.[1] Of among 104 people on board at the time of sinking, 58 sailors were rescued while another 46 sailors went unaccounted for.[2] The cause of the sinking was not identified at that time. An international investigation by the Joint Civilian-Military Investigation Group (JIG)[3] officially concluded on May 20, 2010

[†] Nu Ri Jung is an Assistant Professor of Law, Division of International Studies at Ewha Womans University in Seoul, South Korea.

[1] Yonhap, *Report: South Korean Navy Ship Sinks*, CNN World (Mar. 26, 2010), http://articles.cnn.com/2010-03-26/world/south.korea.ship.sinking_1_korean-broadcasting-system-kbs-north-korea?_s=PM:WORLD.

[2] Tae-hoon Lee, *Chronology of the Cheonan Sinking*, Korea Times (Apr. 29, 2010), http://www.koreatimes.co.kr/www/news/nation/2011/04/116_65091.html.

[3] *See* Press Release, The Joint Civilian-Military Investigation Group, Investigation Result on the Sinking of ROKS "Cheonan" (May 20, 2010), *available at* http://news.bbc.co.uk/nol/shared/bsp/hi/pdfs/20_05_10jigreport.pdf (explaining that the JIG was an international commission which investigated the sinking of the Cheonan with 25 domestic South Korean experts from 10 domestic professional institutes, 22 military experts, 3 experts recommended by the National Assembly and 24 foreign experts from the United States, Australia, the United Kingdom and Sweden, and that the JIG was composed of four teams

that the Cheonan was sunk by a torpedo attack launched by a North Korean submarine.[4]

Six months later, on November 23, 2010, following a South Korean regular military exercise at waters in the south,[5] North Korea fired approximately 170 artillery rounds at Yeonpyeong Island.[6] Among those 170 shells, 80 hit the island.[7] Some 20 of them hit an artillery company.[8] According to one news report, "The attack damaged military facilities, destroyed 29 homes, and set hillsides and fields blaze."[9] Moreover, the attack killed two soldiers and two civilians,[10] and injured sixteen soldiers and three civilians.[11]

These two armed attacks allegedly carried out by North Korea are clear violations of international law, including the Charter of the United Nations (UN Charter) and the United Nations (UN) General Assembly Resolution 3314, entitled "Definition of Aggression," adopted by the UN General Assembly on December 14, 1974.[12] As a result, South Korea is authorized to act in self-defense against those aggressive acts.

Nevertheless, South Korea has endeavored to settle the disputes by international law rather than by force as follows. On June 4, 2010, South Korea referred the matter of the sinking of the Cheonan to the UN Security Council.[13] In November and December 2010, South Korean citizens and students[14] sent several communications conveying information regarding the shelling of Yeonpyeong

– Scientific Investigation Team, Explosive Analysis Team, Ship Structure Management Team and Intelligence Analysis Team).

[4] *Id.*

[5] *Korea Crisis: Yeonpyeong War Games Increase Tension*, BBC NEWS ASIA-PACIFIC (Dec. 20, 2010), http://www.bbc.co.uk/news/world-asia-pacific-12033330. According to South Korean military official, shells fired as part of the exercise were directed at waters in the south-west, away from North Korea. *Id.*

[6] Walter T. Harn IV, *Eighth Army Marks First Anniversary of Yeonpyeong Island Attack*, OFFICIAL HOMEPAGE U.S. ARMY (Nov. 23, 2011), http://www.army.mil/article/69799/Eighth_Army_marks_first_anniversary_of_Yeonpyeong_Island_attack/.

[7] *Satellite Images Show S. Korean Shelling Ineffective*, STATESMAN (Calcutta), Dec. 2, 2010, *available at* 2010 WLNR 23966825.

[8] *South Seeks Revenge for Yeonpyeong Shelling*, KOREA TIMES (Nov. 21, 2011), http://www.koreatimes.co.kr/www/news/nation/2011/12/205_99230.html.

[9] *Satellite Images Suggest Casualties in N. Korea: Lawmaker*, BANGLA NEWS (Dec. 2, 2010), http://www.banglanews24.com/English/detailsnews.php?nssl=ab49b208848abe14418090d95df0d590&nttl=201204199656.

[10] *South Korea Remembers Yeonpyeong Island Attack*, BBC NEWS ASIA (Nov. 23, 2011), http://www.bbc.co.uk/news/world-asia-15849625.

[11] *Seoul Warns of 'Severe Punishment' over N. Korean Attack*, CHOSUNILBO (Nov. 24, 2010), http://english.chosun.com/site/data/html_dir/2010/11/24/2010112400306.html.

[12] G.A. Res. 3314 (XXIX), Annex, U.N. Doc. A/RES/3314 (Dec. 14, 1974).

[13] Permanent Rep. of ROK, *Letter dated 4 June 2010 from the Permanent Representative of the Republic of Korea to the United Nations addressed to the President of the Security Council*, U.N. Doc. S/2010/281 (June 4, 2010), *available at* http://www.securitycouncilreport.org/atf/cf/%7B65BFCF9B-6D27-4E9C-8CD3-CF6E4FF96FF9%7D/DPRK%20S%202010%20281%20SKorea%20Letter%20and%20Cheonan%20Report.pdf.

[14] *See* Associated Press, *International Court Investigating North Korea*, FOX NEWS (Dec. 7, 2010), http://www.foxnews.com/world/2010/12/07/international-court-investigating-north-korea/ (reporting that Luis Moreno-Ocampo, the Chief Prosecutor of the International Criminal Court told reporters that "[n]o

Island to the Office of the Prosecutor (OTP or the "Office") of the ICC.[15] Some, however, see international law as largely a matter of international politics and policy.[16]

Following the referral by South Korea on July 9, 2010, the Security Council adopted a presidential statement that merely condemned the attack that led to the sinking of the Cheonan, without assigning any specific blame.[17] That is to say, the Security Council did not take any substantial action after the Cheonan incident. Even some traditional allies of North Korea, such as China and Russia, have voiced reservations about the outcome of the international investigation into the sinking of the Cheonan.[18]

The communications and subsequent allegations on December 6, 2012 regarding the Cheonan triggered the OTP to announce the opening of a preliminary examination to evaluate the situation in South Korea, including the sinking of the Cheonan and the shelling of Yeonpyeong Island, pursuant to the Rome Statute of the International Criminal Court (Rome Statute or the "Statute").[19] The preliminary examination has not been closed as of the time of writing, and thus the OTP's decision as to whether there is a reasonable basis to proceed with an investigation or not is still pending.

Because the ICC cannot exercise its jurisdiction over the crime of aggression yet, the Court's actual preliminary examination of the situation in South Korea would be limited to war crimes. However, the ICC would not be likely to exercise its war crimes jurisdiction over the two incidents. This is firstly because unlike the incident of Yeonpyeong, the attacker of the Cheonan was not identified at the time of the attack. Thus, it would be difficult to establish criminal liability of North Korea beyond a reasonable doubt based on the evidence so far discovered.[20] Secondly, it is not quite certain whether the incident of Yeonpyeong Island would meet threshold some of the admissibility requirements, including, but not limited to, military necessity, proportionality and grav-

state requested our intervention. . .We received no official communication," and stressed to reporters that "(South) Korean citizens sent us communications. Students sent us communications.").

15 Office of the Prosecutor, ICC, *Report on Preliminary Examination Activities*, ¶ 44 (Dec. 13, 2011), *available at* http://www.icc-cpi.int/NR/rdonlyres/63682F4E-49C8-445D-8C13-F310A4F3AEC2/284116/OTPReportonPreliminaryExaminations13December2011.pdf.

16 Michael Stokes Paulsen, *The Constitutional Power to Interpret International Law*, 118 YALE L.J. 1762, 1804 (2009).

17 *See* Press Release, Security Council, in Presidential Statement, Security Council Condemns Attack on Republic of Korea Naval Ship 'Cheonan', Stresses Need to Prevent Further Attacks, Other Hostilities in Region, U.N. Press Release SC/9975 (July 9, 2010), *available at* http://www.un.org/News/Press/docs/2010/sc9975.doc.htm (calling for adherence to the Korean Armistice Agreement and encouraging the peaceful settlement of outstanding issues on the Korean peninsula).

18 *UN Security Council Understands Probe into Ship Sinking*, KOREA TIMES (June 15, 2010), http://www.koreatimes.co.kr/www/news/nation/2010/06/113_67651.html.

19 Press Release, Office of the Prosecutor, ICC, ICC Prosecutor: Alleged War Crimes in the Territory of the Republic of Korea under Preliminary Examination (Dec. 6, 2010), *available at* http://www.icc-cpi.int/en_menus/icc/press%20and%20media/press%20releases/press%20releases%20%282010%29/Pages/pr608.aspx.

20 *See* Nu Ri Jung, *Is the Shelling of Yeonpyeong Island a War Crime? A Review under Article 8 of the Rome Statute of the International Criminal Court*, 124 KOREAN J. INT'L L. 157, 158 n.9 (2011).

ity. Accordingly, it is possible that the Court would deny admissibility of both incidents.

The problem here is that although there were indeed illegal uses of force, unlawful armed attacks or acts of aggression, neither the UN nor the ICC would be able to properly deal with such incidents. In order to overcome this kind of problem, after years of negotiation and discussion, the Review Conference of the Rome Statute of the International Criminal Court (the "Review Conference"), which took place in Kampala, Uganda, from May 31 to June 11 in 2010,[21] finally adopted a resolution to amend the Rome Statute to include a definition of the crime of aggression and the conditions necessary for jurisdiction.[22]

The purpose of this paper is to examine the efficacy of the amendments to the Rome Statute on the Crime of Aggression (the "Kampala amendments") for suppression of aggression, by analyzing the aforementioned situation in South Korea currently under the preliminary examination by the OTP. As previously mentioned, the ICC cannot exercise its jurisdiction over the crime of aggression yet, but incidents like the sinking of the Choenan and the shelling of Yeonpyeong Island may occur again in the future after the Kampala amendments become effective. Accordingly, for purposes of discussion, this paper hypothesizes that the Court's jurisdiction *ratione temporis* over the crime of aggression is already established.

The paper first introduces the overview of the Kampala amendments. Then the paper discusses the applicability of the definition of the crime of aggression under the Rome Statute and the exercisability of the ICC's crime of aggression jurisdiction over North Korea's aggression against South Korea. Lastly, the paper analyzes the legal implications of the Kampala amendments on the Korean Peninsula and on the greater international community in regard to suppression of aggression and makes policy recommendations on the Kampala amendments for future reform.

II. The Rise of the Kampala Amendments

As Michelle Caianiello notes, "The Review Conference in Kampala represented the first opportunity to consider amendments to the Rome Statute from its entry into force in 2002, and to take stock of its implementation and impact."[23] At the conference, the attending States Parties discussed amendments including: (1) expanding the definition of war crimes under Article 8 to include certain weapons that are used in non-conflict situations at the global stage; (2) Article 124; and (3) the definition of the crime of aggression.[24] Among these three, the

[21] *Delivering on the Promise of a Fair, Effective and Independent Court, Review Conference of the Rome Statute*, COAL. FOR THE INT'L CRIMINAL COURT, http://www.iccnow.org/?mod=review (last visited Apr. 10, 2013).

[22] Ryan McClure, *International Adjudication Options in Response to State-Sponsored Cyber-Attacks against Outer-Space Satellites*, 18 NEW ENG. J. INT'L & COMP. L. 431, 440 (2012).

[23] Michele Caianiello, *Law of Evidence at the International Criminal Court: Blending Accusatorial and Inquisitorial Models*, 36 N.C. J. INT'L L. & COM. REG. 287, 311 n.84 (2011).

[24] David H. Lim, *Beyond Kampala: The U.S.' Role in Supporting the International Criminal Court's Mission*, 39 SYRACUSE J. INT'L. L. & COM. 441, 456-57 (2012).

Conference facilitated consensus on the first and the third, but could not reach a consensus on the second.[25] Among those amendments, the most important result achieved is considered to be the inclusion of the definition of the crime of aggression,[26] which is the focus of this paper.

The crime of aggression, descended from the crime against peace in Article 6(a) of the Charter of the International Military Tribunal at Nuremberg,[27] has long been thought of as the ultimate evil or supreme international crime.[28] Defining and prosecuting aggressive war, although not uncontroversial, proved relatively easy following the complete defeat of the States responsible for acts of aggression in the Second World War.[29] However, when the international community turned its attention to building what would eventually be known as the ICC, controversies emerged to stymie efforts to codify the crime of aggression for more general application in the future.[30]

The International Law Commission, the first body to undertake the effort, was unable to agree on the definition of the crime of aggression.[31] Starting in 1967, the UN General Assembly tasked several committees to define the crime of aggression, which ultimately led to a consensus definition in General Assembly Resolution 3314 of 14 December 1974.[32] While influential, the definition of aggression in Resolution 3314 did not easily lend itself to a penal context.[33] When the Rome Statute was negotiated and drafted in 1998, among the four crimes falling within the jurisdiction of the ICC—genocide, crimes against humanity, war crimes, and the crime of aggression[34]— only the crime of aggression was left undefined. As a result, unlike the other three crimes, the ICC's exercise of

---

[25] *Id*. at 457-60.

[26] Caianiello, *supra* note 23, at 311 n.84. *See* Jennifer Trahan, *A Meaningful Definition of the Crime of Aggression: A Response to Michael Glennon*, 33 U. PA. J. INT'L L. 907, 912-13 (2012) ("State Parties in Kampala created a historic achievement, advancing the rule of law, when they reached agreement on the definition of the crime of aggression and conditions by which the ICC may in the future, subject to certain procedural prerequisites, exercise jurisdiction over the crime.").

[27] Noah Weisbord, *Evolutions of the Jus Ad Bellum: The Crime of Aggression*, 103 AM. SOC'Y INT'L L. PROC. 438, 439 (2009). *See* Charter of the International Military Tribunal, Annexed to London Agreement for the Prosecution and Punishment of the Major War Criminals of the European Axis art. 6(a), Aug. 8, 1945, 59 Stat. 1544, 82 U.N.T.S. 279 (defining the term "crime against peace" as "planning, preparation, initiation or waging of a war of aggression, or a war in violation of international treaties, agreements or assurances, or participation in a common plan or conspiracy for the accomplishment of any of the foregoing").

[28] Chance Cammack, *The Stuxnet and Potential Prosecution by the International Criminal Court under the Newly Defined Crime of Aggression*, 20 TUL. J. INT'L & COMP. L. 303, 304 (2011).

[29] Beth Van Schaack, *Negotiating at the Interface of Power and Law: The Crime of Aggression*, 49 COLUM. J. TRANSNAT'L L. 505, 510 (2011).

[30] *Id.* at 510-11.

[31] *Id.* at 511.

[32] *Id.*

[33] *Id.*

[34] Rome Statute of the International Criminal Court art. 5, July 17, 1998, 2187 U.N.T.S. 90 (entered into force July 1, 2002).

jurisdiction over the crime of aggression did not commence when the Court was formally established in 2002.[35]

Shortly after the ICC came into force in 2002, the Assembly of State Parties to the Rome Statute established the Special Working Group on the Crime of Aggression (the "Special Working Group") to propose a definition of aggression and establish the conditions for the exercise of jurisdiction.[36] The Special Working Group made slow progress toward an acceptable definition and trigger mechanism for aggression from 2003 to 2009,[37] laying the foundations for the Kampala amendments adopted by the Review Conference in June 2010. The Special Working Group's draft definition was adopted without changes at the Review Conference, and the Assembly of State Parties reached a consensus compromise over the laden issues of jurisdiction and the entry into force of the amendments.[38]

As a result of the Kampala amendments, Articles 8 *bis*, 15 *bis*, and 15 *ter* were inserted into the Rome Statute with regard to the inclusion of the crime of aggression within the jurisdiction of the ICC. Article 8 *bis* consists of two paragraphs. The first paragraph provides a general definition of crime of aggression and the second paragraph stipulates a definition and a list of acts of aggression, incorporated from Resolution 3314. Articles 15 *bis* and 15 *ter* regulate the ICC's exercise of jurisdiction over the crime of aggression.

According to Articles 15 *bis* (2) and (3) and 15 *ter* (2) and (3) of the Rome Statute, the ICC may exercise jurisdiction over the crime of aggression, subject to a decision to be taken after January 1, 2017 by a two-thirds majority of States Parties and further subject to the ratification of the amendments by thirty State Parties.[39] Because the procedural hurdles for activating the ICC's crime of aggression jurisdiction have not yet been met[40] as of the time of writing, the Court cannot exercise its jurisdiction over the crime of aggression. Even though the ICC has yet to consider a charge of aggression,[41] the inclusion of restrictive juris-

---

[35] Article 5(2) of the Rome Statute was deleted by the ICC's Resolution RC/Res.6 on June 11, 2010. *See id.* art. 5 n.1. (stating "The Court shall exercise jurisdiction over the crime of aggression once a provision is adopted . . . defining the crime and setting out the conditions under which the Court shall exercise jurisdiction with respect to this crime. . . .).

[36] Kari M. Fletcher, *Defining the Crime of Aggression: Is There an Answer to the International Criminal Court's Dilemma?*, 65 A.F. L. REV. 229, 230 (2010).

[37] Michael P. Scharf, *Universal Jurisdiction and the Crime of Aggression*, 53 HARV. INT'L L.J. 357, 361-62 (2012).

[38] Noah Weisbord, *Judging Aggression*, 50 COLUM. J. TRANSNAT'L L. 82, 86 (2011).

[39] *See* Rome Statute of the International Criminal Court, *supra* note 34, art. 15 *bis* (2) & 15 *ter* (2) ("The Court may exercise jurisdiction only with respect to crimes of aggression committed one year after the ratification or acceptance of the amendments by thirty State Parties."); *see also id*. art. 15 *bis* (3) & 15 *ter* (3) ("The Court may exercise jurisdiction over the crime of aggression . . . subject to a decision to be taken after 1 January 2017 by the same majority of States Parties as is required for the adoption of an amendment to the Statute.").

[40] Jennifer Trahan, *Potential Future Rome Statute Amendments*, 18 NEW ENG. J. INT'L & COMP. L. 331, 335 (2012).

[41] Aaron M. Riggio, *The International Criminal Court and Domestic Military Justice*, 5 PHX. L. REV. 99, 105 (2011).

dictional paths through which the ICC can actually obtain jurisdiction over allegations of criminal aggression[42] has already been the subject of much criticism.[43]

The following discussion studies relevant issues by hypothetically applying the ICC's crime of aggression jurisdiction to North Korea's aggression against South Korea, substantiated by the sinking of the Choenan and the shelling of Yeonpyeong Island.

III. Applicability of the Definition of the Crime of Aggression Under Article 8 *bis* of the Rome Statute to North Korea's Aggression Against South Korea

A. Overview

Article 8 *bis* of the Rome Statute defines "crime of aggression" as: "the planning, preparation, initiation or execution, by a person in a position effectively to exercise control over or to direct the political or military action of a *State*, of an act of aggression which, by its character, gravity and scale, constitutes a manifest violation of the [UN Charter]",[44] and "act of aggression" as "the use of armed force by a *State* against the sovereignty, territorial integrity or political independence of another *State*, or in any other manner inconsistent with the [UN Charter]."[45]

In other words, according to the Rome Statute, only a State's act of aggression against another State can constitute a crime of aggression, and only a State's official can be held criminally liable for a crime of aggression. In this regard, two primary legal issues should be clarified in order for North Korea's aggression against South Korea to fall within the definition of the crime of aggression under Article 8 *bis*. One is an issue of statehood for North and South Korea, which is related to North Korea's capacity to commit aggression against South Korea under the Rome Statute. The other is an issue of the status quo of armistice in the Korean Peninsula, which is related to characteristics of North Korea's aggression against South Korea. Each is discussed separately below.

B. North Korea's Capacity to Commit Aggression Against South Korea Under the Rome Statute

Under Article 8 *bis* of the Rome Statute, the establishment of the crime of aggression requires both aggressor and victim to be States. Accordingly, the relationship between an aggressor and a victim within the purview of the Rome Statute should be international. As a result, in order for military provocations by North Korea against South Korea to constitute acts of aggression, both North and South Korea should be separate, individual States.

---

[42] Timothy Meyer, *Codifying Custom*, 160 U. PA. L. REV. 995, 1019 (2012).

[43] Andrew Trotter, *Of Aggression and Diplomacy: The Security Council, the International Criminal Court, and Jus Ad Bellum*, 18 NEW ENG. J. INT'L & COMP. L. 351, 351 (2012) ("The formulation of the crime of aggression reached in Kampala . . . has been the subject of much criticism.").

[44] Rome Statute of the International Criminal Court, *supra* note 34, art. 8 *bis* (1) (emphasis added).

[45] *Id.* art. 8 *bis* (2) (emphasis added).

Ever since the division of Korea into North Korea and South Korea, each has claimed to be the only legitimate representative of the Korean nation.[46] For example, Article 1 of the Socialist Constitution of the Democratic People's Republic of Korea claims that: "The Democratic People's Republic of Korea is an independent socialist State representing the interests of *all the Korean people*."[47]. On the other hand, Article 3 of the Constitution of the Republic of Korea (the "Constitution") declares that: "The territory of the Republic of Korea shall consist of *the Korean peninsula and its adjacent islands*."[48] Theoretically, as a result, North Korea is not a recognized State to South Korea, and vice versa.

South Korea's argument of being the only lawful government in Korea relies on the UN General Assembly Resolution 195 (III),[49] entitled, "The Problem of the Independence of Korea," and adopted by the General Assembly on December 12, 1948. It declares that "there has been established a lawful government (the Government of [the] Republic of Korea) having effective control and jurisdiction over that part in Korea where the Temporary Commission was able to observe and consult."[50] The South Korean Supreme Court has held that North Korea is not a State[51] and:

> The North region is a part of the Korean Peninsula which belongs to the Republic of Korea [as affirmed in Article 3 of the Constitution], so only the sovereignty of the Republic of Korea is valid in that region, and any other politics of sovereignty against the sovereignty of the Republic of Korea cannot be admitted in legal theory.[52]

For these reasons, to South Korea, North Korea is technically not a State but only a *de facto* local government vis-à-vis South Korea, and thus the relationship between North and South Korea cannot be a State-to-State relationship.[53]

Meanwhile, South Korea and North Korea were admitted to the membership of the UN on September 17, 1992 and have entered into several agreements together. However, on each occasion, both made it clear through their respective government statements and press conferences that they were not explicitly or implicitly recognizing each other as a State at all.[54] For example, the Preamble to the Agreement on Reconciliation, Non-aggression and Exchanges and Coopera-

---

[46] Derek J. Vanderwood, *The Korean Reconciliation Treaty and the German Basic Treaty: Comparable Foundations for Unification?*, 2 PAC. RIM. L. & POL'Y J. 411, 413 (1993).

[47] SOCIALIST CONSTITUTION OF THE DEMOCRATIC PEOPLE'S REPUBLIC OF KOREA Sept. 5, 1998, art. 1.

[48] CONSTITUTION OF THE REPUBLIC OF KOREA Jul. 17, 1948, art. 3.

[49] Kuk Cho, *Tension between the National Security Law and Constitutionalism in South Korea: Security for What?*, 15 B.U. INT'L L.J. 125, 158 (1997).

[50] G.A. Res. 195 (III) art. 2, U.N. Doc. A/RES/195 (III) (Dec. 8, 1948).

[51] Cho, *supra* note 49, at 158. *See also* Supreme Court [S. Ct.], 92Do1244, Oct. 18, 1992 (S. Kor.); Supreme Court [S. Ct.], 91Do2341, Nov. 22, 1991 (S. Kor.); Supreme Court [S. Ct.], 91Do212, Apr. 23, 1991 (S. Kor.).

[52] Cho, *supra* note 49, at 158 n.199. *See also* Supreme Court [S. Ct.], 4249 Haeng Sang 48, Sept. 28, 1961 (S. Kor.).

[53] Jin Lee, *A Millennium Hope for Korea: Lessons from German Unification*, 9 MSU-DCL J. INT'L L. 453, 508 (2000).

[54] *Id.* at 507.

tion between the South and the North (the "Basic Agreement"), signed on December 13, 1991, states that "[t]he South and the North [recognize] that their relations, not being a relationship between States, constitute a special interim relationship stemming from the process towards unification."[55]

Under these circumstances, any agreement between North and South Korea cannot, in theory, be a treaty between two States. Accordingly, the South Korean government considers such agreements an agreement between two governments—the *de jure* central government and a *de facto* local government—and thus does not obtain consent from the National Assembly for the agreement as required for a treaty under the Constitution.[56] The Constitutional Court of the Republic of Korea also considers the Basic Agreement a type of a joint declaration or a "gentlemen's agreement" that does not have legal validity because the South Korean government did not obtain consent from the National Assembly after signing it.[57] In addition, North and South Korea further agreed not to register the agreement with the Secretariat of the United Nations as required for every treaty and international agreement under Article 102 of the UN Charter.[58]

Although both Koreas deny each other's statehood, the statehood of South Korea is recognized by the ICC, as can be inferred from the fact that South Korea has been admitted to the Rome Statute as a State Party.[59] South Korea signed the Rome Statute on March 8, 2000, and deposited its instrument of ratification of the Rome Statute on November 13, 2002.[60] Subsequently, the Rome Statute entered into force in South Korea on February 1, 2003 in accordance with Article 126(2).[61]

In the meantime, whether the ICC would recognize the statehood of North Korea is not certain as of the time of writing, because North Korea is not yet a party to the Rome Statute and the ICC has not yet made any comment on this issue. As discussed earlier, the ICC's jurisdiction over the crime of aggression is confined to conflicts between States. The requirement that an act of aggression be by a State subsequently excludes non-State aggressors such as terrorists.[62]

---

[55] Agreement on Reconciliation, Nonaggression, and Exchanges and Cooperation between South and North, N. Kor.-S. Kor., Dec. 13, 1991.

[56] Jin Lee, *supra* note 53, at 509-12.

[57] Seong-Ho Jhe, *Four Major Agreements on Inter-Korean Economic Cooperation: Legal Measures for Implementation*, 16 E. ASIAN REV. 19, 22-23 (2004). According to Article 60(1) of the Constitution of the Republic of Korea,

> The National Assembly shall have the right to consent to the conclusion and ratification of treaties pertaining to mutual assistance or mutual security; treaties concerning important international organizations; treaties of friendship, trade and navigation; treaties pertaining to any restriction to sovereignty; peace treaties; treaties which will burden the State or people with an important financial obligation; or treaties related to legislative matters.

THE CONSTITUTION OF THE REPUBLIC OF KOREA, July 12, 1948, art. 60(1).

[58] Lee, *supra* note 53, at 509-10.

[59] Jung, *supra* note 20, at 163.

[60] *Republic of Korea*, INT'L CRIMINAL COURT, http://www.icc-cpi.int/Menus/ASP/states+parties/Asian+States/Republic+of+Korea.htm (last visited Apr. 10, 2013).

[61] Rome Statute of the International Criminal Court, *supra* note 34, art. 126(2).

[62] Trotter, *supra* note 43, at 357-58.

Accordingly, the issue of North Korea's statehood is directly related to the issue of North Korea's capacity to commit acts of aggression. If the ICC considers North Korea a State, North Korea is capable of committing acts of aggression, but if not, it is incapable.

The ICC is an independent organization that acts under its own authority and applies its own law,[63] and thus would make its own decision on the statehood of North Korea,[64] despite the aforementioned discussions revolving around the relationship between North and South Korea. This is confirmed in the Draft Policy Paper on Preliminary Examinations by the OTP on October 4, 2010, which states that: "The preliminary examination process is conducted by the Office on the basis of the facts and information available and in the context of the overarching principles of *independence, impartiality and objectivity*."[65]

According to Article 1 of the Montevideo Convention on Rights and Duties of States, which is the most widely accepted formulation of the criteria of a statehood in international law,[66] and Article 201 of the Restatement (Third) of Foreign Relations Law of the United States, a State is an entity that has a defined territory, a permanent population, a government and the capacity to enter into relations with other States.[67] Recognition, however, is not a required element of statehood.[68] North Korea possesses a defined territory as set under the Armistice Agreement, a permanent population, a government currently under the regime of Kim Jong-Un, and the capacity to enter into relations with other States (such as China) and international organizations (such as the UN).[69]

Therefore, it is highly possible the ICC would consider North Korea a separate State from South Korea,[70] and then North Korea would become capable of committing acts of aggression against South Korea as defined by the Rome Statute.

---

[63] Joshua B. Bevitz, *Flawed Foreign Policy: Hypocritical U.S. Attitudes toward International Criminal Forums*, 53 HASTINGS L.J. 931, 946 (2002).

[64] Jung, *supra* note 20, at 165.

[65] Office of the Prosecutor, International Criminal Court, Draft Policy Paper on Preliminary Examinations, ¶ 33, (2010), *available at* http://www.icc-cpi.int/NR/rdonlyres/E278F5A2-A4F9-43D7-83D2-6A2C9CF5D7D7/282515/OTP_Draftpolicypaperonpreliminaryexaminations04101.pdf (emphasis added).

[66] MALCOLM N. SHAW, INTERNATIONAL LAW 178 (5th ed. 2003).

[67] Montevideo Convention on Rights and Duties of States, art. 1, Dec. 26, 1933, 165 L.N.T.S. 19 (entered into force Dec. 26, 1934); RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 201 (1987).

[68] *See* RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES, *supra* note 67, § 202, cmt. b ("An entity that meets the definition of a state is a state, whether or not its statehood is formally recognized by other states."). *See also* Charter of the Organization of American States, art. 13, Apr. 30, 1948, 119 U.N.T.S. 3 (entered into force Dec. 3, 1951) ("The political existence of the State is independent of recognition of other States.").

[69] Jung, *supra* note 20, at 166.

[70] *Id.* In the updated Situation in Palestine issued on April 3, 2012, the Office of Prosecutor of the ICC rejected a request by the Palestinian National Authority calling for investigations into Israeli crimes during the war in Gaza in 2008 on the grounds that Palestine is not a Member State of the UN and thus could not sign the Rome Statute. *See* Press Release, Office of the Prosecutor, ICC, Situation in Palestine (Apr. 3, 2012), *available at* http://www.icc-cpi.int/NR/rdonlyres/C6162BBF-FEB9-4FAF-AFA9-836106D2694A/28438 7/SituationinPalestine030412ENG.pdf; *Programme Summary of Al-Jazeera TV News 0500 GMT 4 Apr 12*, BBC INTERNATIONAL REPORTS (MIDDLE EAST) (Apr. 4, 2012), *available at* 4/4/12 BBC Monitoring Middle E. 00:35:16; *Rights Groups Denounce ICC Ruling against Palestine Request*,

C. Characteristics of North Korea's Aggression Against South Korea Under the Status Quo of Armistice in the Korean Peninsula

The Korean War, which lasted for three years from 1950 to 1953, ended with the Military Armistice in Korea and Temporary Supplementary Agreement (the "Korean Armistice Agreement" or "Armistice Agreement") between the Commander-in-Chief of the United Nations Command, representing UN Forces, and the Supreme Commander of the Korean People's Army and the Commander of the Chinese People's Volunteers, representing North Korean and Chinese forces on July 27, 1953.[71] In addition to the ceasefire agreement itself, the Korean Armistice Agreement established a military demarcation line and demilitarized zone and created the Military Armistice Commission to supervise the Agreement.[72]

However, there have been a series of military clashes between North and South Korea—although not as severe as the Korean War—particularly in the Yellow Sea off the west coast of the Korean Peninsula ever since then. A recent report by South Korea's Ministry of National Defense disclosed that North Korea has violated the Armistice Agreement 221 times and conducted an actual military attack up to 26 times since 1953.[73] Such circumstances lead to questioning the status quo of armistice in the Korean Peninsula today—namely, whether the Korean Peninsula is now in wartime or peacetime. If the former is the case, new aggression by North Korea against South Korea is an issue of resuming the suspended hostilities. If the latter, it is an issue of commencing new hostilities.

Black's Law Dictionary defines armistice, ceasefire or truce as "a suspension or temporary cessation of hostilities by agreement between belligerent powers."[74] According to such traditional notion of armistice, the Korean Peninsula under the state of armistice is technically still at war. This traditional perspective is reflected in pertinent articles of the Hague Convention of 1907. The Hague Convention was recognized by the Nuremberg Tribunal as articulating customary international law,[75] and thus is considered to have achieved almost universal acceptance[76]—binding even non-contracting parties such as North and South Korea to the Hague Convention.

PALESTINE NEWS & INFO. AGENCY (Apr. 7, 2012), *available at* 4/9/12 Palestine News & Info. Agency (WAFA) 06:01:36. It can be inferred from this decision that the ICC's legal determination of statehood hinges on an entity's UN membership. Because North Korea is a UN Member State, it is highly likely that the ICC would recognize North Korea as a State.

71 Military Armistice in Korea and Temporary Supplementary Agreement, July 27, 1953, 4 U.S.T. 234, 1953 U.N.Y.B. 136, U.N. Sales No. 1954.1.15, *available at* http://news.findlaw.com/hdocs/docs/korea/kwarmagr072753.html [hereinafter Korean Armistice Agreement].

72 Charles J. Moxley, Jr., *The Sword in the Mirror – The Lawfulness of North Korea's Use and Threat of Use of Nuclear Weapons Based on the United States' Legitimation of Nuclear Weapons*, 27 FORDHAM INT'L L.J. 1379, 1401-02 (2004).

73 Hae-in Shin, *N.K. Commits 221 Provocations since 1953*, KOREA HERALD (Jan. 5, 2011), http://www.koreaherald.com/national/Detail.jsp?newsMLId=20110105000563.

74 BLACK'S LAW DICTIONARY 1546 (8th ed. 2004).

75 David M. Morriss, *From War to Peace: A Study of Cease-Fire Agreements and the Evolving Role of the United Nations*, 36 VA. J. INT'L L. 801, 810 (1996).

76 M.J. Peterson, *On the Inadequate Reach of Humanitarian and Human Rights Law and the Need for a New Instrument*, 77 AM. J. INT'L L. 589, 590 (1983).

According to Article 36 of the Hague Convention, an armistice merely suspends military operations between the belligerent parties.[77] Article 36 further states that "[i]f its duration is not defined, *the belligerent parties may resume operations at any time*, provided always that the enemy is warned within the time agreed upon, in accordance with the terms of the armistice."[78] In addition, Article 40 provides that "[a]ny serious violation of the armistice by one of the parties gives the other party the right of denouncing it, and even, in cases of urgency, or recommencing hostilities immediately." [79]

The Preamble to the Korean Armistice Agreement provides that: "an armistice [would] insure a complete cessation of hostilities and of all acts of armed force in Korea *until a final peaceful settlement is achieved*."[80] This, along with the Hague Convention, indicates that the Korean Armistice Agreement is not a final peace settlement to the Korean War. A peace treaty, although not defined by the Hague Convention, is by ancient custom the final comprehensive ending of hostilities which extinguishes the state of war and all corresponding belligerent rights between the parties.[81]

Thus, under this traditional perspective of an armistice, the relationship between South Korea and North Korea is still technically in a state of war today[82] because the Korean War ended in an armistice rather than a final peace treaty. The UN General Assembly Resolution 3390B (XXX), dealing "Questions of Korea," in 1975, also acknowledged that "a durable peace cannot be expected so long as the present state of armistice is kept as it is in Korea."[83] In this paradigm, a breach of an armistice agreement effectively does not have any relevant legal consequences, because an armistice agreement only suspends hostilities without ending the state of war.[84]

Subsequently, a military provocation by North Korea is not an act of aggression, but rather a breach of the Korean Armistice Agreement—particularly Article II, Paragraph 12 (requesting the Commanders of both South and North Korea to order and enforce "a complete cessation of all hostilities in Korea by all armed forces under their control")[85] as well as Article II, Paragraph 17 (requesting these

---

[77] Convention Respecting the Laws and Customs of War on Land, Oct. 18, 1907, art. 36, 36 Stat. 2277, 2305, 205 Consol. T.S. 277, 295 ("An armistice suspends military operations by mutual agreement between the belligerent parties.").

[78] *Id.* art. 36 (emphasis added).

[79] *Id.* art. 40.

[80] Korean Armistice Agreement, *supra* note 71, pmbl (emphasis added).

[81] Morriss, *supra* note 75, at 810.

[82] Cecilia Y. Oh, *The Effect of Reunification of North and South Korea on Treaty Status*, 16 EMORY INT'L L. REV. 311, 311-12 (2002).

[83] G.A. Res. 3390B (XXX), pmbl., U.N. Doc. A/RES/3390(XXX) (Nov. 18, 1975).

[84] Andrej Lang, *"Modus Operandi" and the ICJ's Appraisal of the Lusaka Ceasefire Agreement in the Armed Activities Case: The Role of Peace Agreements in International Conflict Resolution*, 40 N.Y.U. INT'L L. & POL. 107, 145 (2008).

[85] Korean Armistice Agreement, *supra* note 71, art. II, ¶ 12 ("The Commanders of the opposing sides shall order and enforce a complete cessation of all hostilities in Korea by all armed forces under their control, including all units and personnel of the ground, naval and air forces, effective twelve hours after this armistice agreement is signed.")

Commanders to establish "all measures and procedures necessary to insure complete compliance with all of the provisions.")[86] Pursuant to Article 40 of the Hague Convention, the breach of the Armistice Agreement would provide grounds for denunciation of the Armistice Agreement and even, in cases of urgency, immediate recommencement of hostilities by South Korea. This inherently temporary and limited nature of the Armistice Agreement illustrates the traditional perspective that views an armistice agreement as a suspension, not a termination, of war.

Even after sixty years, however, a peace treaty has not yet been signed to formally end the hostilities.[87] As a result, the Korean Armistice Agreement, which was originally intended as only a temporary measure by its own terms, has continued in force and will continue so long as it is observed. In the meantime, *de facto* "peace" has been maintained over the past half century[88] in the Korean Peninsula, despite some occasional conflicts between North and South Korea.

Accordingly, in contrast to the aforementioned traditional perspective, the new perspective views that the role of an armistice agreement has substantially changed in the past decades[89] and the rules laid down in the Hague Convention are no longer reflected by state practice.[90] In the current practice of states, an "armistice" chiefly denotes a termination of hostilities, completely divesting the parties of the right to renew military operations under any circumstances whatsoever, and thus puts an end to war and does not merely suspend the combat.[91]

As stated earlier, the Preamble to the Korean Armistice Agreement invites "a *complete* cessation of hostilities and of all acts of armed force in Korea,"[92] and Article II, Paragraph 12 of the Korean Armistice Agreement requests "a *complete* cessation of all hostilities in Korea by all armed forces."[93] This may suggest that the effect of the Armistice Agreement's entry into force was not restricted to a mere suspension of military operations,[94] but was rather extended to a termination of military operations.

In addition, Article V, Paragraph 62 of the Korean Armistice Agreement stipulates that: "The Articles and Paragraphs of this Armistice Agreement shall re-

---

[86] *Id.* art. II, ¶ 17 (stating,

> Responsibility for compliance with and enforcement of the terms and provision of this Armistice Agreement is that of the signatories hereto and their successors in command. The Commanders of the opposing sides shall establish within their respective commands all measures and procedures necessary to insure complete compliance with all of the provisions hereof by all elements of their commands.).

[87] John M. Leitner, *To Post or Not to Post: Korean Criminal Sanctions for Online Expression*, 25 TEMP. INT'L & COMP. L.J. 43, 52 (2011).

[88] Sung-Yoon Lee, *The Mythical Nuclear Kingdom of North Korea*, 29 FLETCHER F. WORLD AFF. 125, 134 (2005).

[89] Lang, *supra* note 84, at 146 n.147.

[90] Wolff Heintschel von Heinegg, *Factors in War to Peace Transitions*, 27 HARV. J.L. & PUB. POL'Y 843, 849 (2004).

[91] YORAM DINSTEIN, WAR, AGGRESSION AND SELF-DEFENCE 42 (4th ed. 2005).

[92] Korean Armistice Agreement, *supra* note 71, pmbl (emphasis added).

[93] *Id.* art. II, ¶ 12 (emphasis added).

[94] Heinegg, *supra* note 90, at 849-50.

main in effect until expressly superseded either by mutually acceptable amendments and additions or by provision in an appropriate agreement for a peaceful settlement at a political level between both sides."[95] This provision can be construed to preclude the right of either party to resume hostilities.[96] Such a construction can be interpreted as to give a permanency rather than a temporality.[97] The fact that the Korean Armistice Agreement includes the term of a "final peaceful settlement" in the Preamble would not justify a conclusion to the contrary.[98]

The new perspective of armistice demonstrates that armistices and peace agreements are today nearly identical concepts.[99] In fact, contemporary state practice belies the traditional assumption of a sharp distinction between peace and war.[100] Consequently, should any of the former belligerents plunge again into hostilities, this would be considered the unleashing of a new war and not the resumption of fighting in an ongoing armed conflict.[101]

Hence, under this new perspective, the relationship between South Korea and North Korea is no longer a state of war today. In this paradigm, a military provocation by North Korea would be subject to not only the Korean Armistice Agreement, but also the rules of *jus ad bellum*, or the principles of just war, because an armistice agreement technically terminates the state of war and thus subsequent hostilities would be considered to be the beginning of new hostilities.

To summarize, if the customary rules governing armistice under the Hague Convention that view an armistice as a mere suspension of hostilities are resorted to, the Korean Peninsula is still in a state of war. On the other hand, if the position that the status of armistice has ripened into a termination of hostilities tantamount to a peace treaty is taken, the state of war has already ended in the Korean Peninsula without a formal peace treaty.

What should be noted here, however, is that two Koreas, as UN members, are subject to obligations under the provisions of the UN Charter regardless of whether the Korean Peninsula is in wartime or peacetime. The UN Charter is the primary source for the modern rules of *jus ad bellum*,[102] which establishes when the use of armed force is authorized under international law.[103] A violation of *jus ad bellum* constitutes the crime of aggression under the Rome Statute when the use of armed force by a State against the sovereignty, territorial integrity or polit-

---

[95] Korean Armistice Agreement, *supra* note 71, art. V, ¶ 62.

[96] Ernest A. Simon, *The Operation of the Korean Armistice Agreement*, 47 MIL. L. REV. 105, 113 (1970).

[97] *Id.*

[98] Heinegg, *supra* note 90, at 850.

[99] Lang, *supra* note 84, at 144.

[100] Robert D. Sloane, *The Cost of Conflation: Preserving the Dualism of Jus Ad Bellum and Jus In Bello in the Contemporary Law of War*, 34 YALE J. INT'L L. 47, 67 (2009).

[101] DINSTEIN, *supra* note 91, at 46.

[102] Sean Kanuck, *Sovereign Discourse on Cyber Conflict under International Law*, 88 TEX. L. REV. 1571, 1585 (2010).

[103] Stephenie Gosnell Handler, *The New Cyber Face of Battle: Developing a Legal Approach to Accommodate Emerging Trends in Warfare*, 48 STAN. J. INT'L L. 209, 220 (2012).

ical independence of another State, or in any other manner inconsistent with the UN Charter amounts to a manifest violation of the UN Charter.[104]

The Preamble to the UN Charter proclaims that "armed force shall not be used, save in common interest."[105] Article 1(1) of the UN Charter provides that one of purposes of the UN is "[t]o maintain international peace and security, and to that end: to take effective collective measures for the prevention and removal of threats to the peace, and for the suppression of acts of aggression or other breaches of the peace."[106] In pursuit of the Charter's purposes, Article 2(3) requires that "[a]ll members shall settle their international disputes by peaceful means in such a manner that international peace and security, and justice, are not endangered."[107] More importantly Article 2(4) asserts, "[a]ll Members shall refrain in their international relations from the threat or use of force against the territorial integrity or political independence of any State, or in any other manner inconsistent with the Purposes of the United Nations."[108] The UN Charter provides two exceptions to the strict prohibition against the use of force set forth in Article 2(4). One is Article 51, which permits a state to act in self-defense against an armed attack.[109] The other is Article 42, which provides the UN Security Council the so-called "Chapter VII powers"[110] to authorize a state to use force.[111]

Accordingly, if the Korean Peninsula is in the state of peace (where the state of war is terminated as under the new perspective concept of armistice) a military provocation by North Korea constitutes not only a breach of the Korean Armistice Agreement but also a violation of the UN Charter—most gravely Article 2(4)—unless such force is authorized by the Security Council. This, in return, triggers South Korea's right of self-defense under Article 51 of the UN Charter.

---

[104] *See* Rome Statute of the International Criminal Court, *supra* note 34, art. 8 *bis* (1) (defining the crime of aggression as,

> the planning, preparation, initiation or execution, by a person in a position effectively to exercise control over or to direct the political or military action of a State, of an act of aggression which, by its character, gravity and scale, constitutes *a manifest violation of the Charter of the United Nations*.

(emphasis added). Article 8 *bis* (2) of the Rome Statute stipulates a list of acts of aggression. *See generally id.* art. 8 *bis* (2).

[105] U.N. Charter pmbl.

[106] *Id.* art. 1, ¶ 1.

[107] *Id.* art. 2, ¶ 3.

[108] *Id.* art. 2, ¶ 4. Controversy has revolved around the meaning of "force" in Article 2(4) of the UN Charter – whether the term refers to armed force only or includes other types of force as well. This paper discusses the topic within the scope of the law of armed conflict. Thus, as clarified in the body, the term at issue here refers to only "armed force" for the purpose of this paper.

[109] *Id*. art. 51 ("Nothing in the present Charter shall impair the inherent right of individual or collective self-defense [*sic*] if an armed attack occurs against a Member of the United Nations, until the Security Council has taken measures necessary to maintain international peace and security.").

[110] *See generally* ERIKA DE WET, THE CHAPTER VII POWERS OF THE UNITED NATIONS SECURITY COUNCIL (2004) (providing an overview of the limits to the Security Council's discretion under Article 42 of the UN Charter).

[111] U.N. Charter, *supra* note 105, art. 42 ("Should the Security Council consider that measures provided for in Article 41 would be inadequate or have proved to be inadequate, it may take such action by air, sea, or land forces as may be necessary to maintain or restore international peace and security.").

The significant part is that this analysis is also valid under the traditional perspective where the Korean Peninsula is still in the state of war, because both Koreas are subject to obligations under the UN Charter. According to the traditional perspective, a military provocation by North Korea would be a simple resumption of military operations allowed under the aforementioned Article 36 of the Hague Convention. However, as clearly affirmed in Article 103 of the UN Charter, the UN Charter is hierarchically superior to all other international treaties so that its provisions prevail in the event of a conflict with another treaty provision. [112]

Accordingly, although the Korean Armistice Agreement has constituted the state of armistice in the Korean Peninsula, the Armistice Agreement is not the primary or sole legal source of the status quo of armistice in the Korean Peninsula. In other words, the situation in the Korean Peninsula is sustained primarily by the UN Charter, a legal source superior to the Armistice Agreement. Even in a situation where the Korean Armistice Agreement is abolished or hostilities are recommenced properly pursuant to relevant rules of the Hague Convention, the use of force against each other is still prohibited fundamentally by the UN Charter.

Therefore, the use of armed force by North Korea against South Korea, unless justified by the right of self-defense or authorized by the Security Council, is a problematic matter related to violations of the UN Charter, and is beyond the scope of the Korean Armistice Agreement or the Hague Convention. This is further confirmed from the fact that North Korea argues the right of self-defense as an excuse for the shelling of Yeonpyeong Island.[113] Subsequently, it would be more appropriate to interpret the status quo of the Korean Peninsula as practically in peacetime rather than in the continuous phase of wartime. In this regard, it may be further considered that the state of war, in the technical sense, has ended in the Korean Peninsula. It is not only due to the changes in state practice regarding an armistice under the new perspective but also, more importantly, due to the UN system.

If an act of aggression by North Korea constitutes a manifest violation of the UN Charter, then such conduct may further constitute a crime of aggression under Article 8 *bis* of the Rome Statute. For example, among seven acts of aggression stipulated in Article 8 *bis* (2) of the Rome Statute, the sinking of ROKS Cheonan may be qualify as "[a]n attack by the armed forces of a State on the land, sea or air forces, or marine and air fleets of another State" under Article 8

---

[112] Gregory Shaffer, *A Transnational Take on Krisch's Pluralist Postnational Law*, 23 EUR. J. INT'L L. 565, 568 (2012). Article 103 of the UN Charter provides that: "In the event of a conflict between the obligations of the Members of the United Nations under the present Charter and their obligations under any other international agreement, their obligations under the present Charter shall prevail." U.N. Charter, *supra* note 105, art. 103.

[113] In regard to these two incidents, North Korea denies that it was responsible for the sinking of the Cheonan, and claims that its artillery strike on Yeonpyeong Island was in self-defense provoked by the South Korean maneuvers in disputed waters. *See* U.N. Dep't of Public Info., Press Conference on Situation in Korean Peninsula (June 15, 2010), *available at* http://www.un.org/News/briefings/docs/2010/100615_Cheonan.doc.htm; *US Supercarrier to Join Drills with S. Korea in Feb.*, KOREA TIMES (Feb. 15, 2011), http://www.koreatimes.co.kr/www/news/nation/2011/02/113_81400.html.

bis (2)(d).[114] Alternatively, the shelling of Yeonpyeong Island would be the "[b]ombardment by the armed forces of a State against the territory of another State or the use of any weapons by a State against the territory of another State" under Article 8 *bis* (2)(b).[115]

IV. Exercisability of the ICC's Crime of Aggression Jurisdiction Under Article 15 *bis* of the Rome Statute over North Korea's Aggression Against South Korea

As mentioned earlier, the ICC cannot exercise jurisdiction over the crime of aggression at least until after January 1, 2017. However, even if the Kampala amendments enter into force, the Court may exercise its crime of aggression jurisdiction only when certain conditions—more restricted than cases involving the crime of genocide, crimes against humanity and war crimes[116]—are satisfied, with the exception of cases of Security Council referrals.

According to Article 15 *bis* (5) of the Rome Statute, "[i]n respect of a State that is not a party to this Statute, the Court shall not exercise its jurisdiction over the crime of aggression when committed by that State's nationals or on its territory."[117] This exemption of the ICC's crime of aggression jurisdiction for Non-Party States applies to situations triggered either by State referrals or by *proprio motu* investigations of the Prosecutor. The Court may exercise jurisdiction over a crime of aggression arising from an act of aggression committed by a State Party, but only when the State Party has not previously declared to opt out of the amendments in accordance with Article 15 *bis* (4).[118] In the meantime, the Prosecutor may initiate an investigation *proprio motu* in respect of a crime of aggression committed by a State Party only when either the Security Council has made a determination that an act of aggression committed by the State concerned or, where no such determination is made within six month of an incident, the Court's Pre-Trial Division authorizes the Prosecutor to proceed with the investigation.[119] However, "[a] determination of an act of aggression by an organ outside the

---

[114] *See* Rome Statute of the International Criminal Court, *supra* note 34, art. 8 *bis* (2)(d).

[115] *Id.* art. 8 *bis* (2)(b).

[116] The ICC can exercise jurisdiction over the crime of genocide, crimes against humanity and war crimes in the following situations: (1) a situation in which one or more of such crimes appears to have been committed by a State Party's national(s) or on a State Party's territory, when either the situation is referred to the Prosecutor by a State Party, or the Prosecutor initiates an investigation *proprio motu*; or (2) a situation in which one or more of such crimes appears to have been committed is referred to the Prosecutor by the Security Council acting under Chapter VII of the UN Charter. *See* Rome Statute of the International Criminal Court, *supra* note 34, arts. 12-15.

[117] *Id.* art. 15 *bis* (5).

[118] *Id.* art. 15 *bis* (4) stating,

> The Court may . . . exercise jurisdiction over a crime of aggression, arising from an act of aggression committed by a State Party, unless that State Party has previously declared that it does not accept such jurisdiction by lodging a declaration with the Registrar. The withdrawal of such a declaration may be effected at any time and shall be considered by the State Party within three years.

Id.

[119] *Id.* art. 15 *bis* (6)-(8).

Court shall be without prejudice to the Court's own findings under [the] Statute."[120]

Accordingly, North Korea's acts of aggression cannot be subject to the ICC's crime of aggression jurisdiction with respect to State referrals or the Prosecutor's *proprio motu* investigations, because North Korea is not a State Party to the Rome Statute and Non-Party States are exempt from such jurisdiction. In other words, North Korea's alleged sinking of the Cheonan and the shelling of Yeonpyeong Island do not satisfy the preconditions to the ICC's exercise of jurisdiction over the crime of aggression even though these incidents occurred within the territory of South Korea.

Although the Court's exercise of jurisdiction is not subject to such constraints in cases of Security Council referrals, considering the fact that China and Russia are traditional allies of North Korea among the five permanent members of the UN Security Council and posseses the power to veto substantive votes, a situation involving North Korea would not be easily referred by the Security Council to the ICC. In fact, as mentioned earlier, when South Korea referred the incident of the Choenan to the Security Council, China and Russia did not accept the outcome of the JIG's investigation of the sinking of the Choenan. Rather, China and Russia succeeded in diluting the Security Council's presidential statement by avoiding directly linking the incident to North Korea[121] and including North Korea's denial of involvement in the incident.[122] In addition, there have been only two Security Council referrals in the history of the ICC since 2002.[123]

Therefore, under the Kampala amendments, the ICC will not be able to exercise jurisdiction over the crime of aggression against North Korea absent a Security Council Referral, which will not be an easy case to make.

V. Legal Implications of the Kampala Amendments and Policy Recommendations

As previously discussed, under Article 15 *bis* of the Rome Statute, the ICC's crime of aggression jurisdiction would be limited to an instance where a crime of aggression stems from an act of aggression committed by a State Party and the State Party has not opted out of such jurisdiction against another State Party. In other words, even after the activation of the ICC's crime of aggression jurisdiction, absent a Security Council referral under Article 15 *ter*, the Court cannot exercise such jurisdiction where a crime of aggression is committed by a Non-Party State's nationals or on a Non-Party State's territory.

---

[120] *Id.* art. 15 *bis* (9).

[121] Doo-hyong Hwang, *Key Security Council Members Agree to Draft on Cheonan's Sinking*, YONHAP (July 9, 2010), http://english.yonhapnews.co.kr/national/2010/07/09/81/0301000000AEN20100709003700315F.HTML.

[122] *U.N. Condemns Attack of S. Korean Warship without Naming N. Korea*, YONHAP (July 9, 2010), http://english.yonhapnews.co.kr/national/2010/07/09/81/0301000000AEN20100709003700315F.HTML.

[123] The Security Council referred the ICC the situation in Darfur, Sudan in 2005 and the situation in Libya in 2011. *See* Press Release, Security Council Refers Situation in Darfur, Sudan, to Prosecutor of International Criminal Court, U.N Press Release SC/8351 (Mar. 31, 2005); Press Release, In Swift, Decisive Action, Security Council Imposes Tough Measures on Libyan Regime, Adopting Resolution 1970 in Wake of Crackdown on Protesters, U.N. Press Release SC /10187/Rev.1 (Feb. 26, 2011).

Among several concerns that may be raised by such limitations, this paper focuses on prospective implications of such limitations upon the relationship between North and South Korea. In regard to aggression between North and South Korea, two scenarios can be envisaged. Scenario 1 is a situation similar to the sinking of the Cheonan or the shelling of Yeonpyeong Island in which North Korea commits a crime of aggression against South Korea. Scenario 2 is an opposite situation from Scenario 1, in which South Korea commits a crime of aggression against North Korea.

Under the current circumstances where North Korea is not a State Party and only South Korea is a State Party, the ICC cannot exercise its crime of aggression jurisdiction in either scenario, with respect to State referrals or *proprio motu* investigations of the Prosecutor, irrespective of whether South Korea has opted out of such jurisdiction or not. In Scenario 1, the Court's crime of aggression jurisdiction is not established because the crime of aggression at issue is committed by a Non-Party State, or by the nationals of a Non-Party State. In Scenario 2, the Court's such jurisdiction is not established because the crime of aggression at issue is committed against a Non-Party State, or on the territory of a Non-Party State. In sum, according to Article 15 *bis*, the Court cannot exercise its crime of aggression jurisdiction over a situation involving a Non-Party State, regardless of whether a Non-Party State attacks a State Party or a State Party attacks a Non-Party State.

Considering the frequency of military provocations by North Korea against South Korea, Scenario 1, in which North Korea is an aggressor, is much more likely to happen than Scenario 2, in which North Korea is a victim. In other words, North Korea would tend to be a potential perpetrator rather than a potential victim, whereas South Korea would tend to be a potential victim than a potential perpetrator. In this regard, the most problematic part of the Kampala amendments in relation to aggression between North and South Korea is that the ICC has no jurisdiction over a situation where a Non-Party State attacks a State Party. While Security Council referrals as to aggression committed by North Korea against South Korea would be still possible, China and Russia would likely stand by North Korea and may veto any such attempted referral.

It is highly unlikely that North Korea would join the Rome Statute. However, even if North Korea were to join the Rome Statute, North Korea could still—and would—exercise an opt-out declaration to avoid the ICC's jurisdiction over the crime of aggression triggered by a State Party referral or a *proprio motu* action of the Prosecutor. In this kind of situation, it would be strategically better for South Korea to exercise an opt-out declaration, even though South Korea might see itself as a potential victim State rather than a potential aggressor State. Otherwise only a crime of aggression committed by South Korea as in Scenario 2 would be subject to the Court's jurisdiction, while such jurisdiction would be excluded for a crime of aggression committed by North Korea as in Scenario 1.

As can be seen from the above analysis of Scenarios 1 and 2, the limitations upon the ICC's ability to exercise jurisdiction over the crime of aggression provide no incentive for either North or South Korea to accept the Court's crime of aggression jurisdiction. In addition, because of such limitations, the Court's

crime of aggression jurisdiction would be established mostly through a Security Council referral, which is seldom the case. As a result, the Kampala amendments do not have any significant legal implications on the relationship between North and South Korea except to the extent that the door for a Security Council referral is opened for the crime of aggression.

In sum, the Kampala amendments are inadequate to suppress aggression between North and South Korea and thus do not leverage peace and security on the Korean Peninsula under armistice. The scope of the ICC's jurisdiction over the crime of aggression should be the same as the Court's jurisdiction over the other three crimes under Article 12(2) of the Rome Statute in order to suppress future crimes of aggression—at least in regard to State referrals—considering that the crime of aggression inherently involves acts of aggression committed by perpetrators in foreign territories.[124]

In accordance with Article 12(2), absent Security Council referrals, the ICC may exercise jurisdiction over genocide, crimes against humanity and war crimes where one or more of such crimes appears to have been committed either by a State Party's nationals or on a State Party's territory.[125] Accordingly, the sinking of the Cheonan and the shelling of Yeonpyeong Island, which occurred within the territory of South Korea,[126] satisfy the preconditions to the ICC's exercise of jurisdiction over war crimes, irrespective of nationality of the perpetrator.

---

[124] *See* Steven Nicholas Haskos, *An Argument for the Deletion of the Crime of Aggression from the Rome Statute of the International Criminal Court*, 23 PACE INT'L L. REV. 249, 258 (2011) ("The crime of aggression inherently involves action[s] taken by individuals in foreign territories.").

[125] Rome Statute of the International Criminal Court, *supra* note 34, art. 12(2).

[126] Both the sinking of ROKS Cheonan and the shelling of Yeonpyeong Island occurred in the South Korean side of the Northern Limit Line (hereinafter NLL). Yeonpyeong Island is just two miles from the NLL and only eight miles from the North Korean mainland. In the meantime, the location where the Cheonan was allegedly sunk by a North Korean torpedo is about one nautical mile off the southwest coast of Baengnyeong Island, ten miles from the North Korean shore, in the Yellow Sea. *See* Sung-ki Jung, *US to Join in Search for Missing S. Korean Sailors*, KOREA TIMES (Mar. 28, 2010), http://www.koreatimes.co.kr/www/news/nation/2010/03/205_63162.html; Robert Mackey, *A Line in the Sea Divides the Two Koreas*, THE LEDE (Nov. 23, 2010, 9:56 AM), http://thelede.blogs.nytimes.com/2010/11/23/a-line-in-the-sea-divides-the-two-koreas/; Leigh Montgomery, *East Asia's Top 5 Island Disputes*, CHRISTIAN SCI. MONITOR (Aug. 3, 2011), http://www.csmonitor.com/World/Asia-Pacific/2011/0803/East-Asia-s-top-5-island-disputes/Takeshima-Dokdo-islands-claimed-by-Japan-and-South-Korea; Sang-Hun Choe, *Korea Exchange Fire at Sea, Adding to Tension*, N.Y. TIMES (Jan. 27, 2010), http://www.nytimes.com/2010/01/27/world/asia/27korea.html?_r=0; *Report: South Korean Navy Ship Sinks*, CNN WORLD (Mar. 26, 2010), http://articles.cnn.com/2010-03-26/world/south.korea.ship.sinking_1_korean-broadcasting-system-kbs-north-korea?_s=PM:WORLD. North Korea refuses to recognize the NLL, insisting that the line was drawn unilaterally by the UN Command at the conclusion of the Korean War. *See* Andrew Salmon, *Why Border Hot-spot Is Korean War Relic*, BBC NEWS ASIA-PACIFIC (Nov. 25, 2010), http://www.bbc.co.uk/news/world-asia-pacific-11839284. For example, North Korea has claimed a "North Korean Military Demarcation Line in the West Sea (Yellow Sea)" since 1999, demanding the border line be drawn further to the south. *See* Zou Keyuan, *Disputing or Maintaining the Marine Legal Order in East Asia?*, 2 CHINESE J. INT'L L. 449, 486-87 (2002); *N. Korea Warns of Military Action over Naval Clash*, KOREA TIMES (Nov. 13, 2009), http://www.koreatimes.co.kr/www/news/nation/2009/11/113_55432.html. However, the NLL is still considered to be the *de facto* maritime demarcation line in the Yellow Sea between North and South Korea, and the current demarcation of the NLL would most likely remain for some time. *See* Terence Roehrig, *Korean Dispute over the Northern Limit Line: Security, Economics, or International Law?*, 2008 MD. SERIES IN CONTEMP. ASIAN STUD. 1, 58 (2008), *available at* http://digitalcommons.law.umaryland.edu/mscas/vol2008/iss3/1.

Likewise, if those preconditions to the ICC's exercise of jurisdiction under Article 12 become applicable to the Court's jurisdiction over the crime of aggression, Scenario 1 may fall within the jurisdiction of the Court. This change might subsequently lead to the deletion of Article 15 *bis* (5) as well, and then Scenario 2 may also fall within the jurisdiction of the Court. Even if the opt-out clause of Article 15 *bis* (4) survives, there will be less chance that South Korea, or State Parties that sees themselves as potential victims, would exercise such right under the proposed circumstances than under the current Kampala amendments. In these circumstances, moreover, the opt-out clause might be able to work to entice North Korea or Non-Party States that sees themselves as potential aggressors to join the ICC.

VI. Conclusion

The inclusion of the crime of aggression under the jurisdiction of the ICC is indispensable to fulfill the Court's raison d'être, including putting an end of impunity, preventing the commission of future crimes, fostering respect for international justice,[127] and reaffirming the purposes and principles of the UN Charter, in particular that all States shall refrain from the threat or use of force against the territorial integrity or political independent of any State.[128] The ICC's long awaited jurisdiction *ratione materiae* over the substantive crime of aggression,[129] however, does not seem to be enough to fulfill those goals.

This paper has so far examined the issue of whether the Kampala amendments, upon activation, would be adequate to put an end of impunity for the crime of aggression, prevent the commission of future crimes of aggression and eventually guarantee peace and security in the international community—particularly in the Korean Peninsula under armistice. The paper has approached the issue by examining the applicability of the definition of the crime of aggression under the Rome Statute and the exercisability of the ICC's crime of aggression jurisdiction over North Korea's aggression against South Korea. In discussing the legal implications of the Kampala amendments, the paper has further considered the opposite situation as well—South Korea's aggression against North Korea (although far less likely to occur).

In short, the Kampala amendments would not sufficiently function effectively enough to suppress aggression between North and South Korea—or, furthermore, between a Non-Party State and a State Party—and thus cannot leverage peace and security in the Korean Peninsula or otherwise benefit the international community. It is mainly because the ICC cannot exercise its crime of aggression

[127] Stuart Ford, *A Social Psychology Model of the Perceived Legitimacy of International Criminal Courts: Implications for the Success of Transitional Justice Mechanisms*, 45 VAND. J. TRANSNAT'L L. 405, 472 n.339 (2012) (". . . the Rome Statute's preamble mentions various goals for the International Criminal Court, including: putting an end to impunity, preventing the commission of future crimes, and fostering respect for international justice."); *see also* Regina E. Rauxloh, *Negotiated History: The Historical Record in International Criminal Law and Plea Bargaining*, 10 INT'L CRIM. L. REV. 739, 739 (2010) ("The most important function of international criminal justice is the restoration of peace.").

[128] Rome Statute of the International Criminal Court, *supra* note 34, pmbl.

[129] Charles Chernor Jalloh, *Africa and the International Criminal Court: Collision Course or Cooperation?*, 34 N.C. CENT. L. REV. 203, 221 (2012).

jurisdiction over a situation involving a Non-Party State, regardless of whether a Non-Party State attacks a State Party or vice versa.

Article 15 *bis* of the Rome Statute would inherently restrict the ICC's crime of aggression jurisdiction to where a crime of aggression stems from an act of aggression committed by a State Party that has not opted out of such jurisdiction against another State Party. In other words, even after the activation of the ICC's crime of aggression jurisdiction, the Court cannot exercise such jurisdiction where a crime of aggression is committed by a Non-Party State's nationals or on a Non-Party State's territory absent a Security Council referral under Article 15 *ter*.

Therefore, for the suppression of future crimes of aggression, at least in regard to State referrals, the scope of the ICC's jurisdiction over the crime of aggression should be made the same as the Court's jurisdiction over other three crimes under Article 12(2) of the Rome Statute. If that were so, the Court would be able to exercise its jurisdiction where a crime of aggression is committed either by a State Party's nationals or in a State Party's territory. Under this suggested modification, the Court's jurisdiction may include a crime of aggression committed either by a Non-Party State against a State Party or by a State Party against a Non-Party State. Future crimes of aggression would thereupon become more effectively suppressed and subsequently peace and security in the international community, as well as the Korean Peninsula, would be more secured. North Korea's recent missile test in December 2012[130] and nuclear test in February 2013[131] as well as its ongoing series of escalating war threats as of the time of writing[132] may additionally indicate the necessity of such modification on the ICC's crime of aggression jurisdiction.

---

[130] North Korea launched a long-range rocket on December 12, 2012. North Korea has frequently dismissed accusations that it uses rocket launches as a cover to test its ballistic missile technology, which, if perfected, could give the regime a projectile capable of reaching the U.S. mainland. North Korea insists that the rocket launch was intended to send an Earth observation satellite into orbit. Justin McCurry & Tania Branigan, *North Korea Launches Successful Rocket in Fact of Criticism*, GUARDIAN (Dec. 12, 2012), http://www.guardian.co.uk/world/2012/dec/12/north-korea-launches-rocket.

[131] On February 12, 2013, North Korea announced that it had conducted its third underground nuclear test in seven years and further claimed that the test detonated a miniaturized and lighter nuclear device. *North Korea's Nuclear Tests*, BBC NEWS ASIA (Feb. 12, 2013), http://www.bbc.co.uk/news/world-asia-17823706.

[132] North Korea has raised political tensions on the Korean Peninsula with a barrage of bombastic comments directed at its enemies South Korea and the United States. Chelsea J. Carter & Kevin Voigt, *North Korea's War of Words Escalates – Timeline of a Crisis*, CNN (Apr. 11, 2013), http://edition.cnn.com/2013/04/10/world/asia/north-korea-threats-timeline. For example, on March 8, 2013, North Korea announced that it was withdrawing from all non-aggression pacts with South Korea, closing its Red Cross hotline between Pyongyang and Seoul and shutting its shared border point. *North Korea Ends Peace Pacts with South*, BBC WORLD ASIA (Mar. 8, 2013), http://www.bbc.co.uk/news/world-asia-21709917. On March 13, 2013, North Korea confirmed that it has shredded the 1953 Armistice Agreement and warned that the next step was an act of merciless military retaliation against its enemies. Agence France-Presse, *North Korea Confirms End of War Armistice*, JAKARTA GLOBE (Mar. 13, 2013), http://www.thejakartaglobe.com/international/north-korea-confirms-end-of-war-armistice/579452/. On April 9, 2013, North Korea warned foreigners that they might want to leave South Korea because the peninsula was on the brink of nuclear war. Sang-hun Choe & David E. Sanger, *North Korea Warns It Is on Brink of Nuclear War with South*, N.Y. TIMES (Apr. 9, 2013), http://www.nytimes.com/2013/04/10/world/asia/south-korean-leader-seeks-to-end-vicious-cycle-with-north.html?pagewanted=all&_r=0.

Australia's Clean Energy Act: A New Measure in the Global Carbon Market

Dr. Bruno Zeller & Dr. Michael Longo[†]

I. Introduction

The compromise reached at Durban on December 11, 2011 ("Durban Compromise") on a climate action roadmap committed states to negotiating a legal agreement by 2015, which would prospectively come into force in 2020. It represents a limited success on the international stage. The agreement will oblige major greenhouse gas emitters such as China, India and the USA to agree to legally binding greenhouse gas emission targets in the future via a new protocol, another legal instrument, or an agreed outcome with legal force. In the interim, the Kyoto commitments will be extended for at least another five years.

Notwithstanding this apparent success, there are inevitable doubts and uncertainties about the nature and scope of any future agreement. This reality should not, however, diminish the responsibility of individual states to develop and then link their carbon schemes to achieve desired environmental outcomes pending a concerted international effort. Ideological cleavages, narrowly construed interpretations of the national interest, and the usual political maneuvering between states have acted to impede a binding global bargain on numerous occasions.

However, key regional and national players have largely kept the momentum for climate action going through domestic (or regional) action and limited transboundary linkages. Europe has led the way. Others have followed. The Durban Compromise, if successful, will likely bring all major emitters into a global network of carbon mitigation schemes. It will be instructive to assess how states at the forefront of climate action are situating themselves on the path to carbon reduction. States and interest groups have lessons to learn and pitfalls to avoid as they embark on the task of formulating and implementing carbon reduction schemes which seek to balance the needs of the community, business and the environment.

[†] Dr. Bruno Zeller is an Associate Professor at Victoria University, an Adjunct Professor at the School of Law, Murdoch University – Perth, and an Associate at the Institute for Logistics and Supply Chain Management, Victoria University, Visiting Professor at Stetson University and Humboldt University in Berlin. Dr. Michael Longo is an Associate Professor at Victoria Law School, Victoria University.

Despite the absence of an informed debate in Australia on the most effective, equitable and efficient means of mitigating climate change and reservations from many interest groups on the policy choices ultimately made, the Australian experience can prove enlightening. Australia became the latest participant in the world of emissions trading—following the European Union and New Zealand—in passing the *Clean Energy Act* 2011 (the "Act"). The Act may not represent the optimum solution, but it does nonetheless present valuable lessons for other states (or regions within a state), including China,[1] South Korea,[2] J apan[3] and the United States,[4] where similar legislation.

II. The Australian Legislation

The *Clean Energy Act* passed the Australian Senate on November 8, 2011 following a tumultuous period in Australian politics.[5] The Act came into force on July 1, 2012. Despite intense interest in the political maneuverings surrounding the legislation and the compensation package attending it, there was surprisingly little public debate on which carbon reduction method was best suited for Australia. While academics debated the merits of a carbon tax over an emissions trading scheme[6] and called for a genuine debate,[7] the debate rarely spilled over into the public sphere. Of particular concern is that there was little discussion of how the carbon tax and emissions trading scheme would affect the competitiveness of Australian businesses or of its impact on related trade policies.

It is instructive to follow the path from the *Clean Energy Bill* (the "Bill") to the Act as passed. By providing an analysis of the commentary to the exposure draft and associated provisions, it is hoped this article will be of assistance to policy makers in other countries contemplating the introduction of carbon mitigation legislation.

On July 10, 2011, the Gillard Government released its anticipated proposals[8] to reduce carbon through a carbon tax. The Bill, together with the associated

---

[1] China will be piloting an emissions trading scheme in six regions starting in 2013.

[2] South Korea's emissions trading scheme is planned for 2015.

[3] Japan's emissions trading legislation is currently on hold.

[4] While the US had abandoned its planned national scheme, California's emissions trading scheme will commence in 2013 and the RGGI, a climate action initiative encompassing ten northern US states, is already in existence.

[5] Clean Energy Act (Act No. 131/2011) (Austl.).

[6] *See, e.g.*, John Sheehan, *Carbon Taxation Versus Emissions Trading Schemes?*, 15 DEAKIN L. REV. 99 (2009); Lidia Xynas, *Climate Change Mitigation: Carbon Tax – Is It the Better Answer for Australia?*, 26 AUSTL. TAX FORUM 340 (2011); Wayne Gumley & Natalie Stoianoff, *Carbon Pricing Options for a Post-Kyoto Response to Climate Change in Australia*, 39 FED. L. REV. 132, 132-59 (2011).

[7] Sheehan, *supra* note 6; *Call for Genuine Debate on Which Carbon Reduction Path Best Suits Australia*, DEAKIN UNIV. NEWSROOM (Sep. 27, 2010), http://www.deakin.edu.au/news/2010/27092010 carbontax.php.

[8] AUSTL. GOV'T, SECURING A CLEAN ENERGY FUTURE: THE AUSTRALIAN GOVERNMENT'S CLIMATE CHANGE PLAN (2011), *available at* http://www.cleanenergyfuture.gov.au/wp-content/uploads/2012/06/CleanEnergyPlan-20120628-3.pdf.

commentaries, was released on July 28 for public comment[9] and introduced into Parliament on September 13 despite claims that the government had not done enough to secure community support for the scheme. The government's intention is to reduce "carbon pollution by 5 per cent from 2000 levels by 2020 irrespective of what other countries do."[10]

The essential question for any policymaker is whether any policy—and in this case the Clean Energy Act—will achieve its desired result. The exposure draft spelled out the objects of the mechanisms as follows:

> To give effect to Australia's international obligations on addressing climate change under the Climate Change Convention and the Kyoto Protocol;
>
> To support the development of an effective global response to climate change; and
>
> To take action directed towards meeting Australia's long term target of reducing net greenhouse gas emissions to 80 per cent below 2000 levels by 2050 and take that action in a flexible and cost effective way.[11]

A carbon reduction scheme must seek to reduce carbon as flexibly and efficiently as possible, taking into account the unique features of the domestic economy and hence the national interest. Considering that the Act envisages the introduction of a substantial tax on carbon ($AUD23 per tonne) to be followed by an internationally linked emissions trading system—which will forever change the Australian economic landscape—it was imperative that policymakers carefully assessed the extent to which international legal commitments and the state of the global economy would affect Australia's interests. Such a far-reaching, momentous change warrants a careful approach.

Recent debate in Australia on a carbon tax has been fractured and excessively politicised to the extent that real doubts have emerged as to the Act's value. At the height of the political contestation, there appeared to be a widely-held belief in the community that the Bill was a premature and ill-fitting proposal, having significant and poorly studied flow-on effects in the economy which no amount of adjustments or compensation could remedy. Public perceptions aside, it is the view of the authors that the *Clean Energy Act* fails to give adequate consideration to how Free Trade Agreements and Bilateral Investment Treaties will affect domestic outcomes of the Carbon Price Scheme. It is argued that the timing of its introduction is sub-optimal in light of ongoing EU and US financial and economic problems as well as the scheme's potential to generate economic jolts domestically by virtue of the size of the tax. Whether the timing was so inauspicious as to warrant a postponement of the scheme was a matter for deliberation and decision. Instead, it was hardly discussed.

---

[9] *Commentary on Provisions*, Australian Gov't Dep't of Climate Change & Energy Efficiency (July 28, 2011), *available at* http://www.climatechange.gov.au/government/submissions/closed-consultations/clean-energy-legislative-package/clean-energy-bill-2011/commentary.aspx.

[10] *Id.* at 11.

[11] *Id.* at 27.

It has been argued that "Australia is best-placed when it plays in as many leagues as it can simultaneously."[12] However, the Act may have the effect of reducing the competitiveness of key emission-intensive, trade-exposed industries and thereby jeopardise Australia's capacity to play competitively in certain leagues. While the Carbon Price package includes a program worth $AUD9.2 billion of industry assistance and adjustment in the first three years to support jobs and competitiveness in industries affected by the introduction of a carbon price,[13] the tax still has the capacity to affect the balance of trade as consumers may opt for cheaper imported goods. It is apparent that under the Act, importers will not be subject to the carbon tax, which has the effect of making imports cheaper and eroding the competitiveness of Australian exporters and manufacturers. The Act therefore raises questions as to how Australia will fare if it prices carbon at $AUD23 a tonne, rising by 2.5% per annum in real terms, when many of its important trading partners have not priced carbon at all.

While this article questions the path set by the Act for its poor timing and its potentially less than positive effects on the economy, it is strongly supportive of measures to decrease the carbon footprint. Though the climate science may be beyond challenge, the government's modeling on emissions and targets is not always so. Nevertheless, it is not in dispute that "[t]aking into account existing climate change policies, Australia's emissions are expected to be around 22 per cent higher than 2000 levels in 2020."[14] Australia has adopted binding obligations in respect of emissions reductions that require serious and effective climate action.

However, well-intended policy does not excuse imprudent policy formulation or implementation. It has been argued elsewhere that a targeted, bottom-up approach[15] can, if properly supported and implemented, make incremental and substantial contributions to the reduction of carbon emissions while simultaneously reducing risks to the Australian economy.[16] A smaller carbon tax with less focus on compensation and more focus on investment in renewable energy with complementary policies covering energy efficiency would perhaps have offered a more modest and effective alternative to the grand scheme that Australia has opted for.

Examination of voluntary schemes such as the Regional Greenhouse Gas Initiative (RGGI) in the United States reveals that carbon is currently priced well below the price proposed by the Gillard government. In the auction on September

---

[12] Greg Sheridan, *Now Is Australia's Time: World Bank Chief Robert Zoellick*, THE AUSTRALIAN, Aug. 13, 2011, at 23.

[13] CCH PARLIAMENT AUSTRALIA, CARBON PRICING SUMMARY REPORT, 4 (2011), http://www.cch.com.au/DocLibrary/Order-form-Carbon-pricing-summary-report-July11.pdf.

[14] *Id.*

[15] By bottom-up is meant an industry driven approach. *See* Bruno Zeller, *Carbon Reduction Schemes and the Energy Sector: A Bottom Up Approach*, 28(5) ENVTL. & PLAN. L.J. 332 (2011).

[16] *See* Bruno Zeller & Michael Longo, *Carbon Reduction Legislation in Australia — What Next?*, 8 MACQUARIE J. BUS. L. 182 (2011). The bottom-up approach would see the introduction of an initially small tax on all fossil fuel users with receipts invested in a range of energy projects with a low carbon footprint.

7, 2011, the price was $US1.89 per ton. More telling is the fact that 42,189,685 permits were offered but only 7,487,000 were sold with total proceeds of $US14,150,430, down from the month before.[17] This is perhaps a consequence of the decline in economic output, which sees companies sitting on excess carbon permits and not needing to purchase new ones.[18] This is equally the case in Europe.[19]

The distance between the proposed carbon price and market realities bring into question the ability of market forces to achieve the sort of emission reductions required to stabilize global warming. Unsurprisingly, in the present politically-charged environment, a carbon price of $AUD23—well above the EU and US price—is also being touted as overkill, economically irresponsible and difficult to justify with regard to its potentially negative effects.

It may be observed that the whole process leading to the release of the Bill and associated supporting Bills[20] exemplified political "deal making," which raises doubt whether the Act is based on sound economic, social and environmental reasons at all. In keeping with the politically charged, media-driven debate, it was argued by Tom Dusevic of *The Australian* that Prime Minister Gillard "kept the [Multi Party Climate Change Committee] on track."[21] Dusevic further noted that there is "firm evidence how the Prime Minister governs; a creature of process, the queen of consensus is a deal maker first and last."[22] Paul Kelly, also of *The Australian*, went even further by noting that:

> This is Julia Gillard's finest achievement as a political fixer. She has become a carbon pricer, a tax reformer and a renewable energy champion rolled into one. Gillard is carrying the parliament but faces the unlikely task of persuading the nation at an election. The package is a triumph for Labour-Green shared values. That is its tactical strength and its core defect.[23]

While it is accepted that politics is rarely far removed from the legislative process, it is especially apparent that politics has played an instrumental and de-

---

[17] The RGGI states distribute most CO2 allowances through quarterly, regional CO2 allowance auctions. For price updates *See Auction Results*, REGIONAL GREENHOUSE GAS INITIATIVE, http://www.rggi.org/market/co2_auctions/results (last visited Mar. 11, 2013).

[18] Adam Morton, *The Heat Is On*, THE AGE, Sep. 13, 2011, at 11.

[19] It is apparent that the economic crisis following the Global Financial Crisis largely contributed to a drop in total EU-27 GHG emissions in 2009 compared to 2008. According to the European Environment Agency, total EU-27 emissions were estimated to be 6.9% below 2008 levels. *See Deep emission cuts give the EU a head start under the Kyoto Protocol*, EUROPEAN ENV'T AGENCY (Oct. 12, 2010), http://www.eea.europa.eu/pressroom/newsreleases/deep-emission-cuts-give-the.

[20] *See e.g.*, Australian Energy Market Amendment (National Energy Retail Law) Bill 2011; Australian National Registry of Emissions Units Bill 2011; Australian Renewable Energy Agency Bill 2011.

[21] Tom Dusevic, *How the Queen of Consensus and Her Team Kept the Negotiations on Track as Conflicting Political Demands Threatened to Derail a Delicate Process*, THE AUSTRALIAN, July 11, 2011, at 8.

[22] *Id.*

[23] Paul Kelly, *ALP-Green Values Triumph in Julia's Finest Political Fix*, THE AUSTRALIAN, July 11, 2011, at 1.

cisive part in the policy processes of climate change in Australia. The political machinations of climate change policy have been evident in the life of the 43rd Parliament no less than the previous Parliament, which saw the acrimonious dumping of Prime Minister Rudd in favour of Gillard after a string of policy failings including the shelving of Rudd's emission trading scheme. This has regrettably entrenched a view of climate change policy as inherently political and open to grandstanding. The Australian Government Productivity Commission's Annual Report for 2009/10 stated that "good public policy combines evidence-based analysis with a good process, one that is systematic, inclusive and transparent."[24] Arguably, energy and climate change policy in Australia have not met these standards. As Helen Sullivan notes:

> Unfortunately lay knowledge may be marginalised in public policymaking because it is considered to be of less value than other sources of knowledge such as professional expertise or political wisdom. This reflects the power relationships that exist between politicians, professionals and particular service users or communities. Frameworks of evidence-based policymaking can exacerbate this marginalisation as the emphasis on "robust" evidence tends to privilege a particular kind of evidence, collected in a particular kind of way, and can lead to the dismissal of lay knowledge as "anecdotal" and so not relevant.[25]

Perhaps not surprisingly, current climate action has been buried under the weight of the compensation package (without which, it is thought, a carbon tax would be impossible to sell). Indeed the Commentary notes that "over 50% percent of the carbon price revenue will be spent on households," mainly as tax relief.[26] The Commentary notes further that "40% of revenue from the mechanism [will be used] to help business and support jobs."[27] Such comments beg the question: why tax 500 firms $AUD23 per tonne of carbon pollution if most of the revenue is to be redirected into support packages instead of being invested in the development of clean energy? The Commentary makes it clear that the government believes that business will drive the carbon reduction, as the price on carbon will have two effects:

> It creates a powerful incentive for all business to cut their pollution by investing in clean technology or finding more efficient ways of operating. A price on carbon will also create economic incentives to reduce pollution in the cheapest possible ways, rather than relying on more costly approaches such as government regulation and direct subsidies.[28]

---

[24] Posting of Helen Sullivan, CentreEvents@artsit.unimelb.edu.au (Oct. 24, 2011) (on file with author).

[25] *Id.*

[26] *Commentary on Provisions*, *supra* note 9, at 13.

[27] *Id.* at 14.

[28] *Commentary on Provisions*, *supra* note 9, at 11.

The carbon tax strategy is premised on the assumption that businesses will adopt carbon reduction techniques as long as the cost of doing so is less than the tax that is otherwise payable.[29] It must be noted, however, that business has already found efficient ways to contribute to the reduction of carbon by simply cutting out waste and improving operations in a cost effective way.[30]

The Act arguably contributes little to the understandings of business of the actual means by which to reduce carbon, as business tends to take a long-term view and pursue solutions, which may not necessarily be contemplated by the Act. Furthermore, the legislative scheme encompasses administrative and compliance costs which, arguably, do not facilitate the stated objective of encouraging business to invest in efficient ways to reduce greenhouse gases.

Undoubtedly, governments around the world have been reluctant to introduce carbon taxes because new taxes are typically viewed as unpopular. For this reason many governments resort to increasing taxes on gasoline or introducing a variety of administrative requirements such as automobile mileage standards, standards on bio-fuels and production technology standards including minimum renewable fuel inputs for electricity generation.[31] The experience of the successful introduction of a Goods and Services Tax[32] by the previous Howard government may have lead the current government into believing that negative community attitudes on tax can be reversed by strong evidence of need and effective campaigning. While the task is usually harder than at first appears, in reality the minority labour government's need for support from the Australian Greens meant that carbon tax policy became a political imperative for the government. Nonetheless, it is apparent that the government has thus far failed to educate the public on the need for the tax and its multiple effects. It remains to be seen whether negative public sentiment will interfere with the Act's implementation.

The higher costs of production attending a carbon tax will, where possible, be charged to consumers. Basic economic theory informs us that consumers would respond to the tax-induced cost increase of emissions intensive products by reducing their consumption of those goods and services in favour of cheaper products.[33] However, the vast sums of money to be spent on the compensation package suggests that while business will still pass the tax on to consumers—potentially necessitating changes to the tax system—consumers may not be encouraged to change their consumption choices. Only when business is finally convinced that investing in changed production techniques is financially more attractive than paying the carbon tax, will innovation in clean energy facilitate a change.

This already drawn-out process is further extended by the artifice of widespread compensation of polluting industries, which, though thought necessary, is

---

[29] Martin Feldstein, *Cap-and-Trade Protectionism?*, THE INT'L ECON., Summer 2009, at 42.

[30] As seen specifically in the Swiss efforts to reduce greenhouse gases through the bottom up approach. *See e.g.*, Zeller & Longo, *supra* note 16.

[31] Feldstein, *supra* note 29, at 43.

[32] *A New Tax System (Goods and Services Tax) Act 1999* (Act 55/1999) (Austl.).

[33] *Id.* at 42-3.

ultimately self-defeating. It is accepted that subsidies can have a distortive effect and are costly and complex if not properly administered. The Productivity Commission has warned that the government ought to "scrap renewable energy subsidies,"[34] while Reserve Bank board member, Warwick McKibbon, has warned that "the plan would drive up the cost of cutting emissions."[35] The Commission currently estimates that the subsidies to wind farms and solar panels run at up to $AUD1000 a tonne.[36] The argument is that subsidies ought to be reduced to a more sustainable level in order to keep the price of electricity down. This has happened in Australia where states have reduced the subsidy to a level which makes the installation of solar panels too expensive. The outcome is that the only manufacturer of solar panels in Australia was forced to close business and locate overseas.

While the payment of subsidies in respect of, say, solar panels will at least result in emission reductions, a carbon tax levied on a business which is then passed on to consumers will have no effect on the reduction of carbon. Indeed, it can be argued that it will have a detrimental effect as the resulting compliance costs will increase indirectly the carbon output through the creation of a new level of bureaucracy associated with increased energy needs just to drive the mechanism.

Furthermore, charges will be imposed for the creation of an emission unit, the effect of which is that complying industries will pay for the auction of carbon units, adding further to the costs of compliance.[37] These factors do not by themselves make these carbon mitigation measures untenable. However, they emphasise the need for coherence in climate action and giving proper consideration to likely causes and effects.

Additionally, new governance arrangements will be implemented and the Productivity Commission's functions will be expanded. A new Clean Energy Regulator (the "Regulator") will be established to administer the carbon pricing mechanism and the Climate Change Authority (the "Authority") will advise on pollution caps, on meeting targets and reviewing the carbon price mechanism. New commissions will be created to give financial support for innovations in clean energy technology. These new commissions are the Clean Energy Finance Corporation (CEFC), with a budget of $AUD10 billion, and the Australian Renewable Energy Agency (ARENA), with a budget of $AUD3.2 billion.[38] At first glance the administrative overlay appears to be quite excessive and this raises the

[34] Siobhain Ryan, *Warnings Ignored as Renewables Get Billions*, THE AUSTRALIAN, July 11, 2011, at 1, *available at* http://www.theaustralian.com.au/national-affairs/carbon-tax/biggest-single-investment-ever-made-in-renewable-energy/story-fn99tjf2-1226091910294.

[35] *Id.*

[36] *Id.* at 9.

[37] *Commentary on Provisions*, *supra* note 9, at 104.

[38] *See e.g.*, *Expert Review*, CLEAN ENERGY FIN. CORP., http://www.cefcexpertreview.gov.au/content/Content.aspx?doc=thecefc.htm (last visited Apr. 29, 2013); *Australian Renewable Energy Act*, AUSTRALIAN GOV'T DEP'T OF RES., ENERGY & TOURISM, http://www.ret.gov.au/energy/clean/arena/Pages/arena.aspx (last visited Apr. 29, 2013).

question whether the plethora of authorities can deliver expected outcomes. Cuellar makes the general comment that the law

> . . . Take[s] shape through administrative decisions and legal interpretation rooted in agency practices. When choosing these practices, agencies seldom escape the influence of their external context. . . . This makes it difficult to see how the behavior of agencies can be explained without paying serious attention to . . . the strategic behaviour of people with agendas inside and outside the organisation. . .[39]

If organisations ultimately shape laws and their implementation, the question is whether the model of "agendas"—within and between the organisations—is the best possible design to implement an already "politically burdened" legislation. It is argued that the dangers of not achieving the goal due to bureaucratic roadblocks outweigh the purpose of the Act. A simpler structure and system would be far more appropriate given the current unstable political and economic landscape in Australia and globally.

III. Outline of the Act

The Act came into operation on July 1, 2012. The full introduction will move through two stages. For the first three years the tax will be fixed at $AUD23 per tonne with an adjustment of 2.5% every year.[40] In 2015, it will develop into a cap and trade system.[41] Perusal of the cap and trade section of the Act suggests that aspects of the previous Rudd Bill have been resurrected. Despite the fact that the government originally let the Rudd Bill lapse due to its unpopularity, it has now resurfaced in a new context. Inevitably, the question arises whether the dual system of a fixed price for three years to be followed by a price set by the market from July 2015 overcomes the defects of the previous Rudd emissions trading system ("ETS").

Moreover, the metamorphosis from a carbon tax system—a compliance regime—into a new, fundamentally different ETS will impose further compliance costs on industry. This raises a related point; it may be premature to lock in legislation on the establishment of a trading system. A trading system requires a cap, which cannot be predicted at this stage as it depends on the effects of the carbon tax. This point seems to be acknowledged by the government in the Commentary to the Act: "business will reduce their pollution when it is cheaper to do so than pay the [tax]."[42] The government assumes wrongly that because of the tax, "the market will create incentives to cut carbon pollution."[43] The only incentive to cut pollution by the market is the profit motive. Of course, it is also the

---

[39] Mariano-Florentino Cuéllar, *Refugee Security and the Organizational Logic of Legal Mandates*, 37 GEO. J. INT'L L. 583, 689-90 (2006).

[40] *Commentary on Provisions*, *supra* note 9, at 12.

[41] *Id.* at 27.

[42] *Commentary on Provisions*, *supra* note 9, at 27.

[43] *Id.*

case that legislation has a powerful effect on compliance by virtue of the threat of prosecution for non-compliance.

A potential problem with the Act is that over half of the revenue generated by it will be ploughed back into the economy in benefits, which are only necessitated because of the carbon tax. In addition, under the cap and trade system the government will issue a fixed number of carbon units every year, some of which will be sold and others allocated to key industries without charge. The point is that as long as industry can pass the extra costs onto consumers—and due to tax incentives the purchasing power of the economy will not have decreased appreciably—there will be no real incentive to reduce carbon until competition forces action such as consumers switching to imported goods. The government has realised that industry has a real option to relocate and it intends to minimise carbon leakage through the introduction of the Jobs and Competiveness Program.[44]

In effect, industry will be subsidised through free carbon units or money allocated through the various programs. It is acknowledged that subsidies and other adjustments may be required as the effects on the Australian economy can be detrimental, especially as no other country in the Asian region has yet introduced a similar carbon reduction scheme.[45]

Before the proliferation of free trade agreements (FTAs), the rules of origin, which were linked to customs duties, cushioned the effect of imports on the domestic market. However, the definition of rules of origin and the application of import duties have been changed pursuant to FTAs, and arguably not to Australia's benefit. From this point of view, carbon leakage is an economy-wide risk, with the possible exception of the energy sector. However, carbon leakage is still a possibility in this sector—not in the physical sense—but through the reluctance of companies to invest in the energy sector in Australia. The Clean Development Mechanism (CDM) and Joint Implementation (JI) programs under the Kyoto Protocol have created attractive investment opportunities in developing countries which are superior to those currently on offer in Australia.

This article therefore argues that the political compromises made in drafting the legislation have produced a potentially incoherent scheme and a degree of uncertainty. With or without the Act, Australia can work towards a smaller carbon footprint by encouraging innovative and grassroots developments including localised developments that have been successfully implemented in other parts of the world, most notably Europe and the US.[46] These grassroots developments represent low-cost, low-risk, economically-sound approaches to the carbon problem. Innovative projects in themselves can be important drivers of competition and can encourage industry to develop experimental technologies. Public investment in renewable energy can accelerate the process. There are advantages for Australia in strategically positioning itself in the Asia-Pacific region through the

[44] *Id.* at 32.

[45] South Korea is developing a scheme which is due to commence in 2015; Japan has put its legislation on hold; China is piloting six trading schemes in parts of China, though a national scheme is probably some way off. *See* Morton, *supra* note 18.

[46] *See generally*, Zeller & Longo, *supra* note 16.

development of innovative localised projects with export potential.[47] Indeed, the potential to sell self-contained innovative projects—especially in the use of waste to generate electricity—to developing countries can create a significant export opportunity for Australia, a lucrative spin-off.

IV. Liable Entities and Covered Emissions

The Act covers a broad range of industries affecting around sixty percent of Australia's emissions. However, the statement that treasury modeling shows "a broad-based carbon price will encourage pollution reductions across all sectors of the economy,"[48] cannot be accepted on face value. It is difficult to imagine that the transport industry would be in a position to reduce the carbon output with or without a carbon tax or equivalent carbon price.

It might be far-fetched, for instance, to argue that an owner-driver transporting goods from Melbourne to Sydney has any option but to use diesel, irrespective of the price. A reduction of carbon emissions in this instance is not a credible outcome as demonstrated by the following hypothetical example: A national transport company has trained its drivers to drive in the most efficient way. Where legislation allows, the company has switched to night deliveries. If greater efficiencies were possible, the company would certainly have implemented changes to achieve operational improvements because they affect its bottom line. One fact appears certain: a carbon tax or equivalent price on petrol would merely raise transport costs. Those additional costs would be passed on and/or would drive transporters—especially owner-drivers—out of the industry. The likely outcome is that consumers switch to cheaper imported goods as those imported goods do not incorporate a carbon tax or the domestic transport costs at their place of manufacture. This point is further strengthened by the "virtual absence of the transport sector from [CDM projects]."[49] Arguably, if industry were able to include transport in CDM projects, it would have done so.

In general, the operator of a facility is responsible for the control of emissions and hence, for payment. It is interesting to note that the Commentary states: "The person with operational control will also generally hold the contracts for sale of the output of the facility, and will be in the best position to pass through the carbon price to customers of the facility."[50] The purpose of the Act is arguably defeated if the effect is simply to pass on the extra costs associated with the carbon tax to customers and eventually to consumers. In such a case, it may be appropriate to question whether the existing goods and services tax—with an established compliance structure—might not instead have been deployed to fund innovation in renewable energy.

---

[47] Morton notes that China is now investing "far more in renewable energy than any other nation, motivated in part by its extraordinary export potential." *See* Morton, *supra* note 18, at 4.

[48] *Commentary on Provisions*, *supra* note 9, at 41.

[49] Adam Millard-Ball & Leonardo Ortolano, *Constructing Carbon Offsets: The Obstacles to Quantifying Emission Reductions*, ENERGY POL'Y, Nov. 1, 2009, at 533, 545, *available at* http://www.elsevier.com/locate/enpol.

[50] *Commentary on Provisions*, *supra* note 9, at 45-6.

It is understood that not all operators of a facility can be liable for the tax, as other points in the supply chain may be better situated to collect the tax. The treatment of natural gas retailers is a case in point and the Act has recognised this fact.[51] Re-introduced from the Rudd Bill, the system of Obligation Transfer Numbers (OTNs) has the purpose of transferring the obligation to the person or entity best suited to manage the liability of paying the tax. If a tax must be levied, then the creation of OTNs is the best option. However, to tax all natural gas users is not an optimal solution.

In the short term at least, as we target dirty brown coal energy production, there will be heavy reliance on natural gas to generate electricity. Yet natural gas will be subject to the tax despite the Act's purpose to reduce the carbon footprint. This appears counterintuitive. It is accepted that once the trading system is operational, the gas-fired electricity generators might recover some costs by selling carbon credits with the extent of recovery being dependent on the ceiling set by the government. However, at the outset, the introduction of electricity generation with a smaller footprint than brown coal will be made more difficult and costly than it needs to be.

V. Pollution Caps and Emission Units

Pivotal to any carbon reduction scheme is the premise that pollution output will be reduced over time. Under the second stage of the scheme—the emissions trading system—eligible units will be traded on the market. The Act envisages that emission units will either be sold at auction or issued for free by the Federal Government to eligible industries. The pollution cap, which will be set every year, will determine the total volume of units for distribution. Affected businesses will be able to choose between reducing the carbon output domestically or purchasing emission units from overseas. There is no doubt that every business will make this calculation very carefully as competitiveness within the industry is paramount. Two criteria will affect these decisions, namely, the setting of the cap and the cost and availability of eligible emission units which can be surrendered in Australia.

The setting of the cap is problematic. The Act takes a "one size fits all" approach. Matters that need to be taken into account include, among others, Australia's international obligations under relevant agreements and the report by the relevant Authority.[52] It appears the Government will have some limited room to move in the cap it sets, as the minister may also "have regard to twelve additional factors,"[53] the most significant of which allow the minister to give consideration to:

---

[51] For example, the Act recognises the direct taxation of natural gas retailers is impracticalas it can lead to double accounting. *See Commentary on Provisions*, *supra* note 9, at para 1.149 (quoting an OTN allows the OTN holder to take on liability for the emissions embodied in the natural gas they receive). The OTN holder then becomes a liable entity under the mechanism. *Id.*

[52] *Commentary on Provisions*, *supra* note 9, at 84.

[53] *Id.*

> The economic and social implications associated with various levels of pollution caps, including implications of the carbon price . . .[and] the extent of actions voluntarily taken to reduce Australia's greenhouse gas emissions.[54]

Such considerations would effectively drive a less formalistic approach. It is argued that a bottom-up approach affords governments the ability to test the two factors above in a more nuanced manner, that is, industry-by-industry. This can subsequently pave a path towards the eventual introduction of a carbon price and/or emissions trading scheme. Importantly, this chronology can give a government the opportunity to more effectively study the trajectory of carbon abatement and model, the likely effects that emission units in a cap and trade system would have on the economy.

The problem with the premature introduction of a cap and trade system is that there are currently only two official systems in operation—in New Zealand and the EU. The New Zealand system is too young to extract any meaningful conclusions and the EU system is subject to the problem of carbon leakage, and is thus is not strictly comparable. It must be noted that emission trading, which was based on experience with US criteria pollutant trading programs, could "reduce compliance costs by increasing compliance options, making a greater spectrum of marginal abatement costs available to each Annex B Party."[55]

A further problem is that the carbon units—being personal property—are classified differently in the EU. For example, Austria classifies the units as commodities whereas others (including Australia in the system proposed under the Rudd Bill) classify them as financial products. The result is that the trading aspect is different. As the trading of financial products requires a licence, the question of how to accommodate two different classes of personal property remains unanswered. Furthermore, the Commentary notes that as tradable units they are "allocated to the most highly valued uses across the economy."[56] However, as they are tradable, businesses will see a potential profit in "playing the market." Accordingly, an incentive to reduce carbon might be diminished if the trading is, in effect, superior to the abatement cost.

Nonetheless, not all international units are eligible—they are judged by the Authority on the criteria of being credible. The question is whether the criteria used by the Authority mirrors the trading aspect in the EU and New Zealand as the "mechanism is linked to other international emissions trading markets."[57] It appears, however, that the decision has already been made as the Commentary

---

[54] *Id.* at 85.

[55] Tyson Dyck, *Enforcing Environmental Integrity: Emissions Auditing and the Extended Arm of the Clean Development Mechanism*, 36 COLUM. J. ENVTL. L. 259, 267 (2011). It should also be noted that while this was a US initiative, the US has not yet signed the Kyoto Protocol. Though a regional scheme is in operation (the RGGI) in the North-East of the country, and California is pushing ahead with carbon pricing, nationally, the US is not on the same path.

[56] *Commentary on Provisions*, *supra* note 9, at 89.

[57] *Id.* at 92.

notes that the criteria includes "whether the units are accepted by either the European Union or New Zealand schemes."[58]

Having a unit judged as credible by an Australian authority has its own complexities, as the Authority needs to also see whether the units are traded in the EU and New Zealand. Such a combination is fraught with danger. If the Authority judges a unit not to be credible but it is nonetheless traded in both the EU and New Zealand, the confidence of traders will be tested.

It would make more sense to simply follow the criteria set out by the Kyoto Protocol, which embeds three trading mechanisms for Annex B Parties. In brief, Annex B countries can: trade their units among each other; trade JI units (which are units from new investments in Annex B countries); and trade CDM units (which are clean development projects in developing countries).[59] As the Act pronounces that one of its purposes is to fulfil the promise made under the Kyoto Protocol, it follows that it should fulfil the requirements set out in the Protocol and honour all three mechanisms established under the protocol.

VI. Trading of Units

The Act gives rise to further uncertainty. The carbon units can be traded on domestic as well as international carbon exchanges, which are kept in registries. Comparison may be drawn with financial securities kept by intermediated securities registries under the principle of trust law. As the Regulator transfers and makes entries for the units in the Registry account, the question is whether the system is a trust system similar or equivalent to that used for the transfer of securities.

Furthermore, as carbon units are traded it has to be assumed that the government is prepared to consider that the carbon trade will in all likelihood have a negative impact on the balance of trade. This assumption is based on the fact that CDM and JI units, as well as all those traded on the major EU floors, are eligible units. The fact is that currently, all these units are cheaper than currently proposed in Australia. Arguably, there is therefore a real incentive to buy carbon units from overseas, which could negatively affect the desire to reduce the carbon output. This argument is supported by the fact that for the first three years of the ETS period a price ceiling and floor will be set. Thus, "[the price] will be set at $20 above the expected international price in 2015-16."[60]

The Act, in effect, also introduces hidden subsidies that cover costs for some industries—costs which will only have arisen as a consequence of the introduction of the Act. Arguably, they do little to realistically reduce carbon emissions. A person might not, for example, wish to surrender carbon units which were issued free of charge. The example provided in the Commentary is self-explana-

[58] *Id.* at 93.

[59] *See* U.N. FCCC, 3rd Sess., Dec. 1997, Kyoto Protocol to the United Nations Framework Convention on Climate Change, U.N. Doc. FCCC/CP/1997/L.7Add.1, arts. 6, 12, 16, *reprinted in* 37 I.L.M. 22 (1998).

[60] *Commentary on Provisions*, *supra* note 9, at 98.

tory and arguably constitutes a breach of, or is at least not in the spirit of, FTAs, BITs, and WTO regulations. It states:

> A person might receive units for the cost increase it faces from:
> - Its use of electricity in an emission-intensive-trade exposed activity; or
> - From the cost increase it faces that is related to the upstream emissions from the extraction, processing and transportation of natural gas and its components used as feedstock in an emission-intensive-trade-exposed activity.

The person may wish to sell these units to receive cash, which can then be used to offset the increase in monetary costs it faces due to its use of electricity or natural gas and its components as a feedstock, rather than hold these units for surrender.[61]

It can be assumed that the Act would not introduce such a system if the industry were small or the monetary value insignificant. The question is then, why take with one hand and give back with the other when the same result can be achieved by setting a smaller amount which can be more easily digested by industry and also achieve a clear reduction of carbon emissions? Arguably, the system the Act proposes will, on paper, achieve the Kyoto reduction obligation, but it will in fact fall short as industry is governed by cost factors, and the question will always arise whether a reduction of carbon or trading out of the obligation would be cheaper.

VII. Jobs and Competitiveness Program

By proposing to enter into "closure contracts with highly emissions intensive coal fired generators,"[62] the government acknowledges and seeks to give effect to its international obligations in relation to carbon abatement.[63] It also intends to link the allocation of free carbon units to this policy. In the long-term, a significant carbon reduction will be achieved, but the costs will depend on the length of the buyback attempt. The downside is that the generators will not invest in the generator facilities and the question of who pays for the write-down of the value of the asset will remain an important focal point in the government's endeavour to compensate foreign-owned electricity companies. Furthermore, the success of the policy is dependent on the pace of generating alternative electricity facilities.

The question posed above, which appears to be unanswered, is why a tax should be imposed on gas, which is used to generate electricity with fewer emissions than coal. The result is that the inevitable cost increase is unnecessarily pushed further as cheap brown coal generation is replaced by higher cost gas generation. To put it differently, coal is the cheapest electricity generator and any other facility will drive up electricity costs (at least in the short term). If imple-

[61] *Id.* at 100.

[62] *Id.*

[63] *Id.*

mented slowly, the Australian economy can absorb the increases. The buyback proposition is generally sound, however, if executed properly.

The Act recognises that the carbon price will impact the international competitiveness of its industries.[64] To address this, support for jobs and emissions-intensive, trade-exposed industries is proposed. However, the main aim is to avoid the risk of carbon leakage.[65] Arguably this is not the greatest risk as the generation of FTAs has produced a more than favourless playing field for importers. The rules of origin are already being used to avoid otherwise applicable import duties and the Act has not addressed this problem.

The US too may at some stage seriously consider a carbon price/tax. If this comes to fruition, the US will arguably shift its focus onto "dirty" imported goods, as the US always looks to border measures to adjust for loss of competitiveness. This will especially be the case in the light of current economic and political problems. Once the US engages with the issue, others will follow. Anecdotally, the EU is also considering what to do about "dirty" imports. Certainly, there are different approaches that can be taken.

When the carbon price or the cost of ETS permits is high enough to have a significant effect on carbon emissions, political pressure will grow for the introduction of tariffs on imports to offset the advantages that countries with no, or a low, carbon or permit price have.[66] There are numerous complexities in comparing and adjusting for carbon abatement policies among countries. Feldman remarks that a "system of complex differential tariffs" is precisely the kind of protectionism that governments have been working to eliminate for more than fifty years under the GATT and now the WTO.[67]

The introduction of offsetting tariffs is thought by many to threaten the global system of free trade.[68] Others consider that some form of border tax adjustment ("BTA") is reasonable and necessary in order to maintain the competitiveness of domestic producers.[69] However, problems of WTO compatibility aside, there are significant doubts and challenges attending the calculation of BTAs. Some of these have been canvassed by Whalley:

> One of the difficulties is that border adjustments used to offset cost disadvantages imposed on domestic producers would reflect added production costs not only occurring directly but also indirectly (e.g., emissions involved in the production of the steel that goes into a car as well as the carbon emitted assembling the car). Also, the chain of component inputs would itself need to be followed across (potentially many) borders. Another complication is that such calculations should presumably be relative to costs abroad and not just based on home markets. There would thus be

---

64 *Commentary on Provisions*, *supra* note 9, at 127.

65 *Id.*

66 Feldstein, *supra* note 29, at 43.

67 *Id.*

68 Feldstein, *supra* note 29, at 43.

69 *Id.*

> gradations of adjustments across supplying countries, together with potentially complex rules of origin as now occur in preferential trade agreements.[70]

A carbon tax on imports could potentially put Australia in breach of international trade agreements, so Australia will probably not tax imports. This means that Australian companies competing with importers will be disadvantaged. At the same time, Australian carbon exports will be taxed with the possibility of subsidies being paid to export companies which would otherwise be disadvantaged. The issue is highly complex and belies a simple trade adjustment, as a rebate greater than the value of the tax may constitute an actionable export subsidy. It will be essential to ensure that competition corrections are WTO-compliant to avoid litigation and unwinnable trade wars with powerful economies.[71] There is therefore a risk that a carbon tax will compromise the trade competiveness of Australian industry by penalising the export sector without affecting imports.[72] The competitiveness of Australian producers will potentially slide until there is an adjustment to wages and the exchange rate.[73]

In recognition of the potential trade difficulties arising from such action, the Act in Part 7 acknowledges that the jobs and competitiveness program has to be consistent with Australia's international trade obligations.[74] The assistance is also linked to production levels and "provided on the basis that production continues in Australia."[75] Thus:

> The linking of assistance to production levels, and not future emission levels, means that the allocation of free carbon units will maintain the financial incentives for firms to reduce their emissions intensity.[76]

The veracity of this statement depends not on what happens in the Australian economic climate, but rather on the price structures of their overseas competitors. At first glance, it appears to be wishful thinking to expect a company to reduce their carbon levels if they cannot or are hard pushed to compete against imports under the current economic climate.

As the carbon price will be reflected in the price of a producer's products, the carbon tax affects that producer's international competitiveness. The Act recognises that "some entities are constrained in their ability to pass on the costs

---

[70] John Whalley, *On the Effectiveness of Carbon-Motivated Border Tax Adjustments* 4-5 (Asia-Pac. Research & Training Network on Trade Working Paper Series, No. 63, 2009), *available at* http://www.unescap.org/tid/artnet/pub/qp6309.pdf.

[71] *Media Release*, *Trade Competitiveness at Risk from Carbon Tax: Trade Expert*, AUSTRALIAN CHAMBER OF COM. & INDUSTRY (Mar. 23, 2011), http://www.acci.asn.au/Research-and-Publications/Media-Centre/Media-Releases-and-Transcripts/Global-Engagement/TRADE-COMPETITIVENESS-AT-RISK-FROM-CARBON-TAX—TRA.

[72] *Id.*

[73] Peter Gallagher, *CO2 Tax: A Tax On Trade*, AUSTRALIAN CHAMBER OF COM. & INDUSTRY (Mar. 22, 2011), http://www.acci.asn.au/Files/Peter-Gallagher-Carbon-Tax-Presentation-to-ACCI-Tr.

[74] *Commentary on Provisions*, *supra* note 9, at 128.

[75] *Id.*

[76] *Id.*

of the carbon price while competitors do not face similar costs which have been imposed through . . . regulatory mechanisms."[77] Arguably, this assessment, though correct, is only linked to the desire of the government to reduce carbon leakage. In effect, carbon leakage is the least serious problem arising. Issues such as cheaper imports, a general increase in prices in Australia (which have the effect of reducing consumption), and the capital flight of potential investors are far more serious issues.

VIII. Conclusion

In the light of current international and domestic economic difficulties, the *Clean Energy Act* may be viewed as untimely and excessively ambitious. Considering that the Act has far reaching consequences into the future, the lessons learned from the inception of CDM projects should be heeded. First, "when time is measured in centuries, the creation of durable institutions and frameworks seems both logically prior to and more important than [the] choice of a particular policy program that will also most surely be viewed as too strong or too weak within a decade."[78] This is shown to be true if the historical development of the CDM experience is considered. As Dyck succinctly stated, "[i]t was a policy choice before it was an institution, and in practice its administration has involved the constant struggle to reconcile a grand vision with bureaucratic realities."[79] The track record of climate change projects and policies in Australia confirms this view.

Two alternative solutions to reduce carbon emissions are immediately discernable. The first is simply to attach a cost such as a tax to all polluters, private or business, which is digestible by all. The Swiss system takes this approach.[80] Persistently, literature recognises the point that a "single group of decision-makers may be ill equipped to develop a consistent framework across sectors and incorporate both engineering and economic phenomena."[81]

Second, a bottom-up approach, in conjunction with a small charge, may be preferred. In the bottom-up approach, the collected tax becomes the seed fund for new developments and the government becomes a partner in these projects. Such a system has been envisaged by the Australian government and is already proposed by establishing the new ten billion dollar commercially-oriented Clean Energy Finance Corporation.[82] It will not only build on available opportunities, it will also bring about a change of attitudes among inventors and investors, who will take the necessary steps to invest in new and exciting projects. This option will therefore encourage and speed up a process which has already begun in Australia, albeit in a haphazard way. Simply put, the paddock into which the

[77] *Id.* at 135.

[78] Richard Schmalenseem, *Greenhouse Policy Architectures and Institutions*, *in* ECONOMICS & POLICY ISSUES IN CLIMATE CHANGE 137, 141 (William D. Nodhaus ed., 1998).

[79] Dyck, *supra* note 55, at 357.

[80] Zeller & Longo, *supra* note 16, at 196.

[81] Millard-Ball & Ortolano, *supra* note 49, at 545.

[82] *Commentary on Provisions*, *supra* note 9, at 15.

government wishes to sow the carbon reduction seeds has not been adequately prepared. It is well known that one can only reap if the seeds are viable and the soil is prepared. On examination, the Act's language reveals that more preparatory work needs to be done to achieve the desired results. The Act's political foundation is all too evident and pervasive and this has detracted from the viability of the proposals.

Furthermore, in order to change the reliance on dirty coal-fired generators and break the reliance of the Australian economy on highly polluting export-oriented industries, investments need to be made. In developing a carbon abatement scheme, the consideration that investing in CDM projects in developing countries gives higher returns than in a developed country should be cause for concern. Dyck observed that "[a]s of May 15, 2011, more that 3000 projects had been registered with the CDM with over 2,500 more in the pipeline for registration."[83] It is obvious that Australia needs to compete for investments and this can only be done in a secure, uncomplicated and cost effective environment. Considering the strength of the Australian dollar, the high cost of Australian labour and the higher compliance costs relative to developing countries, procuring investments may prove difficult.

It is plausible to argue for measured, proportionate and effective steps on carbon abatement by states pending a binding global agreement which secures emissions reductions in the post Kyoto period. Governments should refrain from playing politics on an issue where the "boundary between politics and policy is often blurred."[84] It is acknowledged that a carbon price will be necessary in order to achieve the Australian target of an eighty percent reduction by 2050, though a hefty price on carbon at this point in time is not necessarily the best or only way of tackling the problem.[85] States should strive for policy coherence and consistency between climate change policies and related policies. Innovation in renewable energy is imperative. European initiatives in waste management are highly successful and are at the forefront of carbon reduction efforts.[86] These and other innovative grassroots projects would have the added benefit of not unduly advantaging imported goods over domestic goods. They deserve to be seriously considered.

[83] Dyck, *supra* note 55, at 15. This number has grown considerably. As of April 24, 2013 registered projects had reached 6713.

[84] Posting of Helen Sullivan, *supra* note 24.

[85] *Commentary on Provisions*, *supra* note 9, at 27.

[86] Zeller & Longo, *supra* note 16.

Corporate Liability Under the Alien Tort Statute: Can Corporations Have Their Cake and Eat It Too?

Alison Bensimon[†]

I. Introduction

The Alien Tort Statute ("ATS"), often referred to as the Alien Tort Claims Act, an old but relatively unknown law, in its entirety consists of the following passage:

> "The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the *laws of nations* or a treaty of the United States."[1]

The ATS, enacted as part of the first United State's Judiciary Act in 1789,[2] has obtained new life after laying dormant for almost two hundred years—becoming the subject of heated debate following a 1978 Paraguayan lawsuit that accused a former Paraguayan official of torture.[3] Subsequently, hundreds of plaintiffs filed

[†] J.D. Expected May 2013, Loyola University Chicago School of Law.

[1] 28 U.S.C. §1350 (2012) (emphasis added).

[2] Jonathan C. Drimmer & Sarah R. Lamoree, *Think Globally, Sue Locally: Trends and Out-of-Court Tactics in Transnational Tort Actions*, 29 Berkeley J. Int'l L. 456, 459 (2011).

[3] Jonathan C. Drimmer, *Is Second Circuit Ruling a "Talisman" Against Alien Tort Statute Suits?*, Legal Backgrounder, Feb. 12, 2001 (citing *Filartiga v. Pena-Irala*, 630 F.2d 876 (2d Cir. 1980) (holding that torture violated the law of nations as understood under the ATS and remanded the case to the district court for further proceedings consistent with its holding that federal jurisdiction existed for claims of torture under the ATS). This case involved Dr. Joel Filartiga and his daughter who brought a

under the ATS to seek redress for a variety of alleged human rights violations committed across the globe.[4] Today, the ATS represents the primary tool for United States courts to consider international norms and human rights violations against nation-states, state actors, private individuals, and corporations that are actually, or allegedly accused of violating international law.[5]

The ATS is a powerful tool as it permits alien plaintiffs to sue foreign defendants in United State courts for violations of international laws committed abroad.[6] The ATS has evolved into a final option for victims seeking civil remedies.[7] Consequently, the ATS is rapidly growing as a risk for multi-national corporations.[8] *Kiobel v. Royal Dutch Petroleum*[9]—the most recent case involving the ATS and the second case to reach the Supreme Court of the United States—represents an opportunity for foreign plaintiffs to obtain a legal victory against corporate America.[10] In February 2012, the Court heard oral arguments on whether corporations can be sued under the ATS for human rights violations, but

---

suit against America Norberto Pena-Irala, the Inspector General of Police in Asuncion, Paraguay, for wrongfully torturing and killing Filartiga's son, Joelito, in retaliation for Filartiga's political opposition. *Id.*

[4] *Id.*

[5] Donald J. Kochan, *No Longer Little Known But Now a Door Ajar: An Overview of the Evolving and Dangerous Role of the Alien Tort Statute in Human Rights and International Law Jurisprudence*, 8 CHAP. L. REV. 103, 104 (2005).

[6] Ron A. Ghatan, *The Alien Tort Statute and Prudential Exhaustion*, 96 CORNELL L. REV. 1273, 1273 (2011).

[7] Michael Bobelian, *Supreme Court Eyes Scope Of Controversial Alien Tort Statute*, FORBES (Mar. 23, 2012, 12:16 P.M.), http://www.forbes.com/sites/michaelbobelian/2012/03/23/supreme-court-eyes-scope-of-controversial-alien-tort-statute/2/; *see also* Ghatan, *supra* note 6, at 1297 (explaining the benefits of the ATS). The three major benefits include:

> *First*. . .ATS suits can promote accountability and provide a public voice to victims of terrible human rights abuses when no other forum is available. . . *Second*, is that ATS litigation may help to raise public and political awareness of human rights abuses that might not gain attention otherwise. . . *Third*, ATS litigation might advance U.S. participation in the development of customary international law.

Id.

[8] *Id.*

[9] *Kiobel v. Royal Dutch Petroleum*, 621 F.3d 111, 117 (2d Cir. 2010) (Twelve Nigerian plaintiffs are accusing three foreign oil companies—incorporated in the Netherlands, Britain, and Nigeria—affiliated with Shell—whose footprints are in the United States—of providing resources to the Nigerian government to torture, murder, and conduct other human rights violations); *see* Bobelian, *supra* note 7 (providing a historical background of Shell and its connection with Nigeria). This article explains that:

> Shell dug its first oil wells in Texas in 1953 and has extracted oil from the Gulf of Mexico for half a century. The company's American operations accounted for fifteen percent of its global oil and gas production last year. According to its 2011 [a]nnual [r]eport, the oil giant had 20,000 employees and generated $91 billion in revenue (nearly twenty percent of its global sales) in the United States; one-fifth of its assets were based in this country. This nation also saw the highest capital expenditures by Shell over the past three years and was the company's leading source of natural gas, followed by Malaysia and Nigeria. The connections between the United States and Nigerian oil were equally substantial. Nigeria was the fifth largest exporter of crude oil to the United States in 2011: fourth largest in 2010. And Shell brought a significant percentage of that Nigerian oil here. It's not difficult to figure out why: Nigeria represented Shell's largest source of crude oil and natural gas liquids production last year.

Id.

[10] Michael Bobelian, *Supreme Court Revisits Corporate Liability For Human Rights Violations*, FORBES (Sept. 28, 2012, 2:07 P.M.), http://www.forbes.com/sites/michaelbobelian/2012/09/28/supreme-court-revisits-corporate-liability-for-human-rights-violations/.

did not issue a ruling and asked the parties to analyze whether the ATS has extraterritorial application—in other words, "[s]hould the law apply to acts committed abroad, regardless of who committed them?"[11]

This comment analyzes the crux of *Kiobel*: (1) whether ATS applies to corporations and; (2) whether the ATS applies to human rights violations overseas.[12] This comment will focus on the ATS and corporate liability, specifically the reach of the ATS under *Kiobel* and whether corporations can be held accountable for human rights violations under the ATS. Part II traces the ATS's background by outlining its history, precedents, and evolution within the international context.[13] And, Part III considers aiding and abetting and corporate liability through the analysis of *Doe I. v. Unocal Corp.*, *Sosa v. Alvarez-Machain*, and the "law of nations."[14]

After providing a factual description of *Kiobel*, Part IV follows *Kiobel*'s historical and procedural background and analyzes the majority's opinion, specifically how the opinion's creation of a corporate exception is contrary to the purpose of the ATS and international law. Lastly, Part IV will focus on the policy concerning corporate liability under the ATS.[15] Then, Part V asserts that the Court has two options when faced with both the immediate and larger questions and outlines the reasons *Kiobel* should be overturned. Part V also recommends various tactics that foreign plaintiffs should use as an alternative in seeking remedy.[16] Finally, Part VI concludes that corporations should be found liable for violating human rights abroad, and that the Court should overturn *Kiobel*.[17]

II. Background

A. History of the Alien Tort Statute

Although Congress passed the ATS as part of the Judiciary Act of 1789, the ATS remained untouched for nearly two hundred years.[18] The ATS allows aliens to seek redress in United States courts for injuries caused by acts in violation of

---

[11] *Id.*

[12] Care2 Causes Editors, *Esther Kiobel Gets Her Day at the Supreme Court*, CARE2 (Oct. 13, 2012 1:00 P.M.), http://www.care2.com/causes/esther-kiobel-gets-her-day-at-the-supreme-court.html.

[13] *See infra* Part II (tracing the ATS's background—its history, precedents, and evolution—within the international scope).

[14] *See infra* Part III (discussing the considerations of aiding and abetting and corporate liability under *Unocal* and analyzing *Sosa* and the "law of nations").

[15] *See infra* Part IV (providing the factual, historical, and procedural background of *Kiobel*, analyzing its majority opinion and its shortcomings and flaws, bringing to light specific problems raised by the failure of the *Kiobel* reasoning and the allowance of ATS corporate cases, explaining how *Kiobel*'s majority opinion is contrary to the purposes of the ATS and international law—making it an outlier—and focusing on the policy concerning corporate liability under the ATS).

[16] *See infra* Part V (arguing that the Court has two options when faced with the immediate questions in *Kiobel*, arguing why the Court should overturn *Kiobel*, and looking forward in recommending useful tactics).

[17] *See infra* Part VI (concluding that the Court should overturn the *Kiobel* decision and find for corporate liability when violating human rights abroad).

[18] Ghatan, *supra* note 6, at 1275.

human rights outside the territory of the United Sates.[19] History shows that while foreign plaintiffs rarely invoked the ATS in the past, precedent demonstrates that in 1980, nearly two centuries after the ATS became law, the Second Circuit's influential decision in *Filartiga v. Peña-Irala*[20] revived the statute.[21] Subsequently, in *Doe I v. Unocal Corp.*,[22] the Ninth Circuit held that the foreign plaintiffs could bring claims of forced labor, rape, and murder under the ATS against the defendant, Unocal, thereby holding that a corporate defendant could be held liable for aiding and abetting under the ATS.[23] Although the Ninth Circuit granted *en banc* review, the *en banc* panel never heard the case because the parties agreed to settle, dismissing all claims.[24]

In 2010, the Second Circuit held in *Kiobel* that corporations—but, not individuals such as corporate employees, managers, officers, or directors—are exempt from liability under the ATS.[25] In holding that customary international law does not recognize corporate liability, the *Kiobel* decision has become an outlier in international law.[26]

United States courts generally allow foreign plaintiffs to bring only a limited number of claims under the ATS, resulting in the dismissal of most ATS complaints.[27] The claims that courts tend to allow under the ATS include genocide, torture, summary execution, disappearance, war crimes, crimes against humanity, slavery, arbitrary detention, and cruel, inhuman, or degrading treatment.[28] Because the ATS only reemerged in recent years, courts are slowly determining its modern meaning, while acknowledging that because every case brought under the ATS includes accusations against foreign corporations, individuals acting in another country, or foreign states themselves, they involve questions of foreign relations.[29] District courts face difficulties in assuming the role of arbitrators in

---

[19] Matthew E. Danforth, *Corporate Civil Liability Under the Alien Tort Statute: Exploring Its Possibility and Jurisdictional Limitations*, 44 CORNELL INT'L L.J. 660, 662-63 (2011).

[20] *Filartiga v. Pena-Irala*, 630 F.2d 876 (2d Cir. 1980).

[21] Danforth, *supra* note 19, at 663.

[22] *Doe I v. Unocal Corp.*, 395 F.3d 932 (9th Cir. 2002).

[23] Ghatan, *supra* note 6, at 1276.

[24] *Id.*; Anthony J. Sebok, *Unocal Announces It Will Settle A Human Rights Suit: What Is The Real Story Behind Its Decision?*, FINDLAW.COM (Jan. 10, 2005), http://writ.news.findlaw.com/sebok/20050110.html (stating that "[m]any commentators argued that the risks to Unocal of bad publicity arising from the testimony of the villagers were so high that a settlement made better sense from an economic point of view," but explaining this is not necessarily indicative of Unocal's guilt or who caved in settlement agreements first).

[25] Ghatan, *supra* note 6, at 1276.

[26] *See infra* Part IV.D (analyzing the shortcomings and flaws raised by the *Kiobel* reasoning, specifically explaining how *Kiobel*'s majority opinion is contrary to the purposes of the ATS and international law—making it an outlier).

[27] Ghatan, *supra* note 6, at 1277.

[28] *Id.*

[29] *Id.*

determining what constitutes a violation of the "law of nations"[30] and discerning modes of conduct that fall under the evolving concept of the "law of nations."[31]

B. ATS Precedents in Developing General Standards and the Evolution of the Evolution of the ATS in the International Context

While the district court in *Filartiga* initially dismissed the claims for a lack of subject matter jurisdiction, the Second Circuit reversed and held that individuals who committed tortious acts under official authority clearly constituted a violation of the laws of nations.[32] In its decision, the Second Circuit looked to sources from which customary international law is derived, specifically to the usage of nations, judicial opinions, and the work of jurists, allowing the Second Circuit to hold that the district court had subject matter jurisdiction under the ATS to hear the plaintiffs' action.[33]

Since *Filartiga*, the Supreme Court has only heard two cases implicating the ATS: *Sosa*[34] and *Kiobel*.[35] Until *Sosa* in 2004, neither the Court nor Congress provided useful guidance for the lower courts in regards to the application of the

---

[30] *Id.* at 1278; *see Sosa v. Alvarez-Machain*, 542 U.S. 692 (2004) (holding that the United States Drug Enforcement Agency (DEA) did not have authority to kidnap a Mexican national for a crime under the ATS because he fit the "foreign country" exception to waive the government's immunity). The case involved a Mexican national, allegedly murdering a DEA agent, who brought a claim against the DEA under the ATS for allegedly violating his civil rights by kidnapping him in Mexico and bringing him to trial in the United States for the murder of the DEA agent. *Id.*

[31] Ghatan, *supra* note 6, at 1278; *see* Danforth, *supra* note 19, at 663 (giving a "law of nations" definition). The law of nations is defined as:

> Historical sources, like Blackstone's Treatises, provide an insight as to what this term meant at the time of the First Judicial Act. Blackstone defines the law of nations as: 'a system of rules. . .established by universal consent among the civilized inhabitance of the world; in order to decide all disputes which. . .must frequently occur between two or more independent actions, and the individuals belonging to each.' For Blackstone, three primary offenses constitute violations of the law of nations: violation of safe conduct, interference with ambassadors, and piracy on the high seas.

Id.

[32] Danforth, *supra* note 19, at 664.

[33] *Id.*

[34] *See Sosa v. Alvarez-Machain*, 542 U.S. 692 (2004) (the first United States Supreme Court case involving the ATS where the court was tasked with deciding whether: 1) the [ATS] allows private individuals to bring suits against foreign citizens for cimmitting a crime abroad that violated the law of nations or trieaties of the United States; and 2) a private individual can bring suit under the Federal Tort Claims Act for an arbitrary arrest that was planned in the United Sates but implemented in a foreign country).

[35] *See* Danforth, *supra* note 19, at 664 (discussing the reasons why the singularity in *Sosa* makes it an important case). The "Standards" set by the Court are as follows:

> [*First*], the Supreme Court determined that the ATS was a jurisdictional grant and did not create a new cause of action. [*Second*], the Court applied the standard of 'specific, universal, and obligatory' in its consideration of alleged violations of the law of nations to limit jurisdiction to a narrow category. The Court held that the plaintiff's 'illegal detention of less than a day, followed by the transfer of custody to lawful authorities and a prompt arraignment, violate[d] no norm of customary international law so well defined as to support the creation of a federal remedy.' [*Finally*], the Supreme Court instructed lower courts to consider whether international law extends the scope of liability for a given norm to the perpetrator being sued, if the defendant is a private actor such as a corporation or individual.

Id.

ATS, leaving the ATS inaccessible, unused, and largely unknown.[36] But, since that decision, there has been an expansion in ATS cases.[37]

III. Discussion

A. A Consideration of Corporate Liability for Aiding and Abetting in *Doe I v. Unocal Corp.*

Following the standards established in *Sosa*, the Second Circuit determined that aiding and abetting human rights violations is a violation of the law of nations and an actor need not be the principal perpetrator to be liable under the ATS.[38] In *Kulumani v. Barclay Nat'l Bank Ltd.*, the Second Circuit considered state practice[39] in holding that individuals who aid and abet are in violation of international law.[40] The Second Circuit also looked to treaties and statutes that create international tribunals and found the concept of criminal aiding and abetting to be a customary and "well-established practice in international law."[41]

---

[36] *See* Kochan, *supra* note 5, at 105-6 (providing an anlysis of the evoluation of the ATS).

[37] *Id.* at 106, 110 (outlining an expansion in ATS cases). This expansion included:

> (1) [ATS's] disuse and dormancy; (2) acceptance of liability under the ATS for official state acts, including its recognition as a statute providing both jurisdiction and a cause of action and liability evidenced by noncompliance with customary international law outputs; (3) the movement toward an acceptance that quasi-state, and, indeed, private individuals, could be liable for violations of customary international law; (4) the ATS jurisdiction, involv[ing] suits against private individuals and corporations; and (5) the first guidance from the U.S. Supreme Court, [which makes] the idea of expansive evolution and predictions for the future of the ATS evolution remain a bit indeterminate.

Id. at 107. The article also outlines the evolution of the ATS litigation:

> [T]he evolution of ATS litigation began in 1980 when the ATS was raised from dormancy [with *Filartiga*], and a federal appeals court found that suits based on customary international law for human rights abuses could be entertained under the ATS.

Id. at 103. The cases expanded most notably again in 1995 [with the Kadic v. Karadzic, 70 F.3d 232 (2d. Cir. 1995) decision where the Second Circuit held that the ATS applies to actions by state actors or even private individuals that are in violation of the most egregious portions of law identified as customary international law. According to Kadic, state action is not necessary for a recognizable violation of the law of nations to exist. The court expanded upon the principles it enunciated in Filartiga, noting that international law is consistently evolving. *Id.* Also noting the expansion in litigation as having:

> [e]volved further in 1997 [with *Unocal*] when a federal district court held that a private corporation was subject to ATS jurisdiction for alleged human rights abuses abroad. Since then, dozens of lawsuits against private actors—principally corporations—have been filed. Since the U.S. Supreme Court finally addressed the ATS in part in 2004, the continued evolution and the form that the evolution will take is now in flux awaiting future applications in light of the Supreme Court's limited guidance provided by its interpretation of the ATS in *Sosa v. Alvarez-Machain*.

Id.

[38] Danforth, *supra* note 19, at 664-65.

[39] *See id.* (citing *Khulumani v. Barclay Nat'l Bank Ltd.*, 504 F.3d 254 (2d Cir. 2007)).

[40] *Id.*

[41] *Id.* (citing *Khulumani*, 504 F.3d at 277 (Katzmann, J., concurring)). This sets forth the standard:

> A defendant may be held liable under international law for aiding and abetting the violation of that law by another when the defendant (1) provides practical assistance to the principal which has a substantial effect on the perpetration of the crime, and (2) does so with the purpose of facilitating the commission of that crime.

Id. at 277 (Hall, J., concurring). In determining this standard, Judge Katzmann looked to international law to determine whether the scope of liability for a violation of international law should extend to aiders and abettors. *Id.* at 269. Also citing Judge Hall's concurrence, which noted that: "[I]nternational law does

While *Khulamani* recognized aiding and abetting as a liability-creating offense, *Unocal* is the landmark case for finding corporate liability.[42] In *Unocal*, the Ninth Circuit hesitated from directly holding Unocal liable due to a factual question, but it recognized the possibility that corporations could be held liable under the ATS.[43] The court reasoned that as long as the defendant Unocal met the Standards established in *Sosa* for aiding and abetting, this defendant may be liable under the ATS for aiding and abetting in international human rights violations.[44]

Following *Unocal*, claims against corporations substantially increased, but it was not until *Kiobel* that these claims received great attention.[45] *Presbyterian Church of Sudan v. Talisman Energy*, in preceding *Kiobel*, laid the foundation for corporate liability, but declined to rule on the issue.[46] The *Talisman* court laid the groundwork for the recognition of ATS corporate liability for the *Kiobel* appeal when it held that in order for a court to find a corporation liable of aiding and abetting under international law, the defendant must meet the necessary *mens* rea, requiring the defendant to act with purpose.[47] Other circuits, including the Ninth Circuit and the Eleventh Circuit—both popular venues for corporate ATS lawsuits—directly disagreed with the *Talisman* ruling but, concurred with the idea that courts can find aiding and abetting liability under international law where the defendants are aware that their conduct will facilitate a harm without a showing of purpose or intent.[48]

---

not specify the 'means of its domestic enforcement.'" *Id.* at 286 (Hall, J., concurring) (quoting the Brief for the International Law Scholars as Amici Curiae at 5-6). Also concluding that: "The combination of these two opinions—that liability should extend to aiding and abetting and that nations have the freedom to determine how to treat violators— intimates that corporate entities can violate the law of nations and be held liable under the ATS." Danforth, *supra* note 19, at 665.

42 Danforth, *supra* note 19, at 666; *see also Doe I v. Unocal Corp.*, 395 F.3d 932, 956 (9th Cir. 2002). The country of Burma was renamed Myanmar in 1989 after the military government took power and provided the Burmese government with funding for forced labor from which Unocal benefited. *Unocal*, 395 F.3d at 937. The renaming, however, remains a contested issue and those groups in opposition continue to use the name "Burma." While the U.S., Australia, Canada and the U.K. use "Burma," the United Nations uses "Myanmar" (quoting "One threshold question in *any* ATCA case is whether the alleged tort is a violation of the law of nations. We have recognized that torture, murder, and slavery are . . . violations of the law of nations."). *Unocal*, 395 F.3d at 945. The court also identified that forced labor was a modern day form of slavery. *Unocal*, 395 F.3d at 946. The Ninth Circuit reheard the case in 2003 and vacated its previous holding. *John Doe I v. Unocal Corp.*, 403 F.3d 708, 708 (9th Cir. 2005). Nevertheless, *Unocal* eventually decided to settle the case. *See Sebok*, *supra* note 24, at 2 (stating that "many commentators. . .argued that the risks to Unocal of bad publicity arising from the testimony of the villagers were so high that a settlement made better sense from an economic point of view," but explaining this is not necessarily indicative of Unocal's guilt or who caved in settlement agreements first).

43 Danforth, *supra* note 19, at 666.

44 *Id.* (quoting *Unocal*, 395 F.3d at 947).

45 *Id.*

46 *Id.*; *see also Presbyterian Church of Sudan v. Talisman Energy*, 582 F.3d 244, 247 (2d Cir. 2009) ("Sudanese plaintiffs alleged that a corporation, Talisman, assisted the government in aiding and abetting human rights abuses.").

47 *Id.*

48 *See* Drimmer, *supra* note 3, at 468-69 n. 76-77 (listing a few cases where the courts have concluded that corporate defendants in ATS cases cannot be liable under the aiding and abetting theory); *see also* Kochan, *supra* note 5, at 117 (listing cases involving aiding and abetting or vicarious liability theories).

B. *Sosa v. Alvarez-Machain* and the "Law of Nations"

In 2004, the Court heard *Sosa*, its first ATS case, and sought to set limits on the claims plaintiffs could bring under the ATS.[49] The Court interpreted the ATS in the context of the intent of the drafters and the claims recognized under it in 1789.[50] The Court found that, "[w]hen Congress passed the [ATS] it only had, at most, three specific violations of the law of nations in mind: offenses against ambassadors, violations of safe conduct, and piracy."[51] Next, the Court considered the modern usage of the ATS, leading the majority to give five arguments in favor of its conclusion that in determining what claims a plaintiff is able to bring under the ATS, district courts should act with caution:

> First, the Court stated that the prevailing interpretation of the common law changed since the enactment of the ATS. Second, *Erie Railroad Co. v. Tompkins*[52] and its progeny have greatly limited the scope of federal common law. Third, the Court argued, it is best to leave the creation of private rights of action to the legislature. Fourth, ATS litigation can possibly affect U.S. foreign relations. The Court stressed that lower courts should be 'particularly wary of impinging on the discretion of the Legislative and Executive Branches in managing foreign affairs.' Fifth, the courts lack a congressional mandate to define violations of the law of nations.[53]

Despite its explicit reasoning, the Court failed to provide clear guidance in regards to what claims a foreign plaintiff can bring under the ATS.[54] Specifi-

---

[49] *See* Ghatan, *supra* note 6, at 1278 (citing *Sosa v. Alvarez-Machain*, 542 U.S. 692, 725 (2004)); *see* Kochan, *supra* note 5, at 120-26 (further analyzing the *Sosa* decision); *see also* Drimmer, *supra* note 2, at 459. The courts:

> have construed the key relevant substantive term of the ATS—'violations of the law of nations'—to cover a limited class of alleged harms that are interpreted according to international law principles. Those principles include torture, extrajudicial killing, genocide, war crimes, crimes against humanity, forced labor, slave labor, child labor, human trafficking, forced disappearances, prolonged arbitrary detention or arrest, forced exile, rights of association (in the labor context), systematic racial discrimination and cruel, and inhuman or degrading treatment.

Id.

[50] Ghatan, *supra* note 6, at 1278 (citing Sosa v. Alvarez-Machain, 542 U.S. at 712-24).

[51] Sosa, 542 U.S. at 720.

[52] *Id.* (quoting Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938)) ("Erie. . .was the watershed in which we denied the existence of any federal 'general' common law, which largely withdrew to havens of specialty.")); see Ghatan, supra note 6, at 1278 (discussing the Court's analysis of the ATS in context by turning its focus to the modern use of the ATS).

[53] Ghatan, supra note 6, at 1278-79 (citing Sosa v. Alvarez-Machain, 542 U.S. at 720-29).

[54] *Id.* at 1279 (citing Sosa v. Alvarez-Machain, 542 U.S. at 725-29):

> On the one hand, it determined that 'judicial power should be exercised on the understanding that the door [of the ATS] is still ajar subject to vigilant doorkeeping, and thus open to a narrow class of international norms today.' The term 'narrow class' provides the impression that the Court did not want the ATS to be a basis for claims of violations of any and all customary international laws. District courts are to act as doorkeepers, ensuring that certain claims cannot be brought under the ATS. On the other hand, instead of defining exactly what claims a plaintiff can bring, the Court provided a vague standard for district courts to use in fulfilling their doorkeeping function: '[C]ourts should require any claim based on the present-day law of nations to rest on a norm of international character accepted by the civilized world and defined with a specificity comparable to the features of the 18th-century paradigms we have recognized.'

cally, the Court's reasoning was notably silent about how to compare the present-day law of nations to the paradigms existing when Congress passed the ATS in the eighteenth century.[55] In other words, while stating that foreign plaintiffs can only bring a limited number of claims for violations of customary international laws under the ATS, the Court did not specify which particular claims comprised this narrow class.[56]

IV. Analysis

A. Facts Giving Rise to Kiobel v. Royal Dutch Petroleum

The Niger Delta region of Nigeria has a history of being plagued by poverty, human rights violations, and environmental disaster.[57] In the 1990s, the defendants in *Kiobel* started drilling for oil in Niger Delta.[58] In opposition to the oil drilling, the Ogoni people started a resistance against what the Ogoni people saw to be a reckless oil development in the region, which the Nigeria's military dictatorship violently suppressed.[59]

In *Kiobel*, the plaintiffs accused oil companies Royal Dutch Petroleum ("Royal Dutch") and Shell Transport and Trading Company PLC ("Shell"), through a subsidiary, SPDC, of helping the former dictatorship in crimes against humanity—including arresting, torturing, and summarily executing twelve falsely charged members of the Ogoni tribe, as well as other innocent Ogoni residents.[60] These crimes were allegedly perpetrated by the Nigerian government with the active collaboration of Royal Dutch and Shell in retaliation against the Ogoni tribe members for their attempt to peacefully disrupt SPDC's operations in protest of the devastating health and environmental effects of the unregulated oil drillings.[61] Esther Kiobel brought her claims under the ATS on behalf of her late husband, Barinem Kiobel, one of the twelve-tribe members who were tortured.[62] Barinem Kiobel was executed following a sham trial in which, the plaintiffs believed, SPDC played a central role.[63]

Kiobel reached the Court after a federal appeals court ruled, for the first time, that the ATS could not hold corporations liable for violating human rights

---

Id.

[55] *Id.* (citing *Sosa v. Alvarez-Machain*, 542 U.S. at 720).

[56] *Id.* (citing *Sosa v, Alvarez-Machain*, 542 U.S. at 720).

[57] Vincent Warren, *Supreme Court holds U.S. Rights Legacy in the Balance*, CNN.COM (Sept. 27, 2012), http://www.cnn.com/2012/09/27/opinion/warren-supreme-court-alien-tort-law/index.html.

[58] *Id.*

[59] *Id.*

[60] *Id.*

[61] *Id.*; Peter Weiss, *The Question Before the US Supreme Court in Kiobel v Shell*, GUARDIAN.CO.UK (Feb. 28, 2012), http://www.guardian.co.uk/commentisfree/cifamerica/2012/feb/28/question-before-supreme-court-kiobel-v-shell; *see* Bobelian, *supra* note 7; *see* Danforth, *supra* note 19, at 660-61 (giving a detailed description and analysis of the facts and rulings of *Kiobel*).

[62] Warren, *supra* note 57; *see* Weiss, *supra* note 61 (providing a factual analysis of *Kiobel*).

[63] Warren, *supra* note 57.

abroad.[64] The Court did not initially rule on the issue, but instead ordered the case to be re-argued on the question, "whether and under what circumstances [the ATS] applies to any human rights violations, and by individuals, that take place outside the United States," and not just on the application of the ATS to corporations.[65]

Kiobel has attracted great interest in the legal community with over twenty *amicus curiae* briefs submitted for the plaintiffs, including briefs by many human rights organizations and the United States government, and almost as many *amicus curiae* briefs on behalf of the defendants by multi-national corporations, trade associations, and the governments of both the United Kingdom and the Netherlands.[66] The *amicus curiae* briefs for the defendants argued that there was a lack of precedent holding that corporations can be sued under international law, and this dearth of support is proof that an international principle on which to base ATS claims is lacking.[67] In response, the victims pointed to the fact that German companies were broken up and dissolved by the Allies after the Second World War for their use of slave labor and other crimes, as evidence illuminating an international principle on which to base ATS claims.[68]

B. *Kiobel*'s Historical and Procedural Background

The plaintiffs, former residents of the Ogoni Region of Nigeria, alleged that the corporate defendants—entities that are "juridical" persons rather than "natural persons"—aided and abetted the Nigerian government in committing human rights abuses.[69] The defendants, Royal Dutch and Shell, are both incorporated in the Netherlands and the United Kingdom, respectively, while SPDC is incorporated in Nigeria.[70]

In 1958, some residents of the Ogoni region organized a group called the "Movement for Survival of Ogoni People" (the "Movement") to protest the impact of SPDC's oil exploration and production in the Ogoni region of Nigeria.[71] The plaintiffs alleged that, in 1993, when the Movement stopped the oil production as a result of the Movement's protest of the environmental impact of the defendants' local oil exploration, the defendants responded by enlisting the aid of the Nigerian government to suppress the resistance.[72] Specifically, the plaintiffs further claimed that throughout 1993 and 1994, the Nigerian military forces beat, raped, arrested, and killed Ogoni residents and violently attacked and destroyed

---

[64] *Id.*; *see* Weiss, *supra* note 61 (discussing the question presented before the United States Supreme Court in *Kiobel*).

[65] Warren, *supra* note 57.

[66] *See* Weiss, *supra* note 61 (discussing the impact of *Kiobel* on the legal community).

[67] *Id.*

[68] *Id.*

[69] Danforth, *supra* note 19, at 666-67.

[70] *Id.* at 667.

[71] *Id.*

[72] *Id.*

Ogoni villages with the assistance of the corporate defendants.[73] These human rights violations perpetrated by the Nigerian government are commonly known as the "Ogoni Crisis."[74]

As a result of the defendants' alleged human rights violations, the plaintiffs brought an action against the defendants under the ATS for allegedly aiding and abetting the Nigerian government of (1) extrajudicial killing; (2) crimes against humanity; (3) torture or cruel, inhuman, and degrading treatment; (4) arbitrary arrest and detention; (5) violation of the rights to life, liberty, security, and association; (6) forced exile; and (7) property destruction.[75]

The district court reasoned that the defendants could not be held liable for counts one, five, six, and seven because international law did not sufficiently define those violations, and thus dismissed those claims.[76] However, the court denied the defendants' motion to dismiss the three remaining claims and elected to certify its entire order for interlocutory appeal, leading the Second Circuit to a review of all seven claims.[77]

C. *Kiobel*'s Majority Opinion

In 2010, the Second Circuit ruled on the *Kiobel* case, holding, for the first time,[78] that corporations are not proper defendants under the ATS and finding that customary international law does not recognize corporate liability.[79] In contrast to other circuit courts, the Second Circuit invoked *Sosa* and held that human rights violations committed by corporations abroad were not sufficiently explicit, defined, or expressed under international law to justify jurisdiction in United States courts.[80] The majority, however, found that the ruling does not eliminate a plaintiff's right to bring a suit against an individual, including a corporate employee, manager, officer, or director.[81] On October 17, 2011, the Supreme Court granted certiori in *Kiobel*.[82]

---

[73] *Id.*

[74] *Id.*

[75] *Id.*

[76] *Id.* at 667-68.

[77] *Id.* at 668.

[78] *See* Ghatan, *supra* note 6, at 1277-78 ("[N]o other circuits have ruled that customary international law does not recognize corporate liability.").

[79] Susan Farbstein, et al, *The Alien Tort Statute and Corporate Liability*, 160 U. PA. L. REV. 99, 99 (2011); *see also* Ghatan, *supra* note 6, at 1276 (analyzing the Second Circuit's majority opinion in *Kiobel*); Danforth, *supra* note 19, at 668-71 (giving a more in depth analysis and description of the majority opinion).

[80] *See* Farbstein et al., *supra* note 79, at 99 (summarizing the Second Circuit's majority opinion in *Kiobel*).

[81] *See* Ghatan, *supra* note 6, at 1276 ("[B]ecause the majority based its opinion on the norms of customary international law, which are subject to adaptation, it is possible that in a future case the Second Circuit will determine that corporate liability has become a norm under customary international law.").

[82] *See* Farbstein et al., *supra* note 79, at 99 (providing a chronological timeline for *Kiobel*).

D. Shortcomings and Flaws Raised by the *Kiobel* Reasoning

In its ruling on *Kiobel*, the Supreme Court will decide whether the lower court's decision is, as Judge Richard Posner put it, an "outlier" in more than fifteen years of corporate ATS litigation.[83] In finding that corporations cannot be liable under the ATS, the Second Circuit's decision in *Kiobel* marked an important departure from the idea of *Filartiga* and from ATS cases dating from the mid-1990s, which all ruled against corporations and for the allowance of the use of the ATS as a significant tool for foreign survivors of violent human rights abuse to seek redress for their harms.[84] It follows that if the Court affirms the Second Circuit's ruling, *Kiobel* will become the outlier in ATS litigation.[85]

Before *Kiobel*, courts dissected ATS cases by focusing on establishing appropriate standards for aiding and abetting liability, among other contested issues, but did not question the fundamental issues on whether corporations were to be exempted from liability under the ATS for committing human rights violations abroad.[86] As such, it may be that the drafters of the ATS never perceived the possibility of a corporate carve-out, as courts before *Kiobel* rightly understood that if a non-state actor can be held liable for violations of international law, then that actor can either be a private individual or a corporation.[87] Therefore, the history, purpose and language of the text of the ATS all demonstrate that the decision reached in *Kiobel* is deeply inconsistent with previous ATS rulings.[88]

Additionally, *Kiobel*'s numerous dissents echo Judge Posner's position on the Second Circuit's ruling.[89] Specifically, Judge Leval's dissent in the opinion pointed out the flaws of the majority approach and its broad implications: "By

---

[83] *Id.* at 100.

[84] *Id.* at 101; *see also* Brief for Petitioners at 19, *Kiobel v. Royal Dutch Petroleum Co.*, 10-14919 (Dec. 14, 2011) 2011 WL 6396550 ("Excluding corporations from the universe of permissible ATS defendants would have the perverse effect of sending alien tort plaintiffs to state courts, precisely the opposite of the drafters' intent.").

[85] *Id.* at 100.

[86] *See id.* at 108.

[87] *Id.* ("As Judge Richard Posner from the Seventh Circuit noted, '[A]ll but one of the cases at our level hold or assume (mainly the latter) that corporations can be liable.'") (quoting *Flomo v. Firestone Natural Rubber Co.*, 643 F.3d 1013, 1017 (7th Cir. 2011)).

[88] *Id.* at 108-09. The statute, which was enacted in 1789, was:

> [a] significant component of the Founders' efforts to ensure that the young United States would comply with its obligation to uphold, respect, and enforce the law of nations. The Framers sought a federal forum to discharge this duty because states— and state courts in particular—had proven ineffective. Through the statute, the drafters intended to create a meaningful civil remedy ("tort only") for aliens harmed by violations of the law of nations. The statute extends this remedy to "all causes," confirming congressional intent to provide plaintiffs with broad remedies. Tellingly, the text of the ATS restricts the identity of the plaintiff but places no limit on the type of defendant subject to suit. To now read such a corporate exception into the statute runs counter to both the Framers' broad remedial intent and the statute's plain text.

Id. at 112 (quoting *Kiobel v. Royal Dutch Petroleum*, 621 F.3d 111, 196 (2d Cir. 2010) (Leval, J., concurring) ("I cannot, however, join the majority's creation of an unprecedented concept of international law that exempts juridical persons from compliance with its rules. The majority's rule conflicts with two centuries of federal precedent on the ATS, and deals a blow to the efforts of international law to protect human rights."). *Id.*

[89] *Id.*

adopting the corporate form, such an enterprise could have hired itself out to corporate Nazi extermination camps or the torture chambers of Argentina's dirty war, immune from civil liability to its victims."[90] Furthermore, Judge Leval noted that the majority undermined a central purpose of international law expressed in *Filartiga*: in protecting corporate profits earned through abuse of human rights, the Second Circuit's reasoning is in opposition to the international law objective of protecting against human rights violations.[91] Subsequently, in his dissent, Judge Katzmann pointed out that the Second Circuit's denial to rehear the case *en banc* deviated from the principle that corporations and natural persons alike may be liable for violations of the law of nations under the ATS.[92]

Moreover, the ATS decisions issued by federal district courts and the Seventh Circuit firmly rejected the Second Circuit's logic in *Kiobel* by pointing out the flaws in the court's reasoning.[93] Three flaws in particular stand out from these decisions: (1) *Kiobel* misinterpreted the structure of international law; (2) the historical proposition in regards to the criminal trials at Nuremberg underlying *Kiobel* is incorrect and;[94] (3) the *Kiobel* majority opinion's outcome falls short of upholding the purpose of the ATS.[95]

The majority decision in *Kiobel* is troubling because it stems from the Circuit where the modern era of the ATS cases began, in a country that has a history of respecting human rights and has a system that allows victims a means of redress

---

[90] *Id.* at 101 (quoting *Kiobel*, 621 F.3d at 150 (Leval, J., concurring)).

[91] *Id.*

[92] *See id.* at 101-02 (quoting *Kiobel*, 642 F.3d at 381 (Katzmann, J., dissenting from denial of rehearing)).

[93] *See id.* at 102 (discussing subsequent ATS decisions rejecting *Kiobel*'s logic).

[94] *See* Danforth, *supra* note 19, at 671-75 (providing a more in depth description of the possibility of corporate liability under the ATS while using Nuremberg as an example). A further analysis is given of the Nuremberg trials, a series of military tribunals by the Allied forces of World War II, most notable for the prosecution of members of major political, military, and economic leadership of the Nazi Germany, indicted for aggressive war, war crimes, and crimes against humanity, who were brought to trial before the International Military Tribunal in the city of Nuremberg, Bavaria, Germany, in 1945 and 1946, at the Palace of Justice. *Id.* at 669. This analysis indicates that:

> [w]hile individual liability for crimes committed in violation of the law of nations during wartime had arisen to a small degree after World War I, it was not until after World War II that such liability was greatly considered. In the wake of the Holocaust, the United States, Great Britain, France, Soviet Union, and twenty-one other states signed the London Charter, which established the IMT to try German war criminals who allegedly orchestrated war crimes, crimes against humanity, and crimes against peace. As mentioned above, the Nazi defendants contended that they could not be guilty of war crimes because international law had never provided punishment for individuals. Despite the lack of precedent for individual liability, the IMT held that 'individuals could be punished for violations of international law.' However, when the issue of corporate liability arose with respect to I.G. Farben (a German corporation that manufactured Zyklon B, the killing chemical in the gas chambers), the IMT refused to consider imposing criminal liability for the corporation. Despite the focus of the IMT in expanding international crimes to encompass individuals, the majority treated the failure of the IMT to criminally prosecute the 'most nefarious corporate enterprise known to the civilized world' as clear evidence that corporate liability was not recognized as a norm of customary international law.

Id.

[95] *See* Farbstein et al., *supra* note 79, at 102-03 (citing in part *Kiobel*, 621 F.3d 111, 150 (2d Cir. 2010) (Leval, J., concurring)).

against those who have committed human rights violations.[96] The District Court for the Southern District of New York, the Seventh Circuit, and the Ninth Circuit have all noted that because the purpose of the ATS is to continuously allow victims to pursue corporate and individual accountability for violent human rights crimes, it would come as no surprise if the Court follows the spirit of *Filartiga* and rejects the Second Circuit's decision, making *Kiobel* a temporary outlier.[97]

Moreover, contrary to the reasoning of the majority in *Kiobel*, Nuremberg shows that even with a lack of precedent for corporate liability, corporations can be held liable for aiding and abetting human rights violations, and that corporate liability under the ATS is consistent with international law.[98] According to Danforth, in preventing corporate ATS liability, various problems could arise:[99]

> (1) [I]nternational forum shopping and congestion of United States courts;[100] (2) absence of notice for the defendant;[101] (3) procedural inefficiency due to the availability and location of evidence;[102] (4) undue influence on extraterritorial legal systems, markets, and commerce (territoriality);[103] (5) international political backlash/under influence on

---

[96] *Id.* at 103.

[97] *Id.*

[98] *See* Danforth, *supra* note 19, at 680 (discussing the problems raised by the failure of the *Kiobel* reasoning and the allowance of the ATS corporate cases).

[99] *Id.* at 680-82.

[100] *Id.* at 681 (noting that "in *Kiobel*, the Alien Tort Statute is a jurisdictional provision unlike any other in American law, and of a kind apparently unknown to any other legal system in the world in that it is a statutory grant of universal jurisdiction."). Additionally noting that, "[a] new capacity to sue corporations combined with no ceiling on recovery would likely further incentivize plaintiffs to bring suits in the United States when some should be properly brought elsewhere. Because the number of ATS claims would likely increase, a risk of court congestion would arise." *Id.*

[101] *Id.* ("Because the Dutch, Nigerian, and British defendants in Kiobel operated in Nigeria, they likely presumed Nigerian law would govern their actions. To hold similarly situated defendants liable for a crime yet to be recognized by international law as applicable to corporations would raise due process issues of notice.").

[102] *Id.* (discussing that "[t]he majority of the evidence presented and of the witnesses in Kiobel were located outside of the United States."). Further giving the example that:

> [w]hile some eyewitnesses have been exiled to the United States, others, including Nigerian soldiers or defense witnesses, likely remain in Nigeria. Similarly, corporate records of communication with the Nigerian government will likely be found either in Nigeria or the place of incorporation of the defendant. Therefore, in Kiobel-like cases, the U.S. legal system will often be no better than the third-best option from a procedural efficiency standpoint.

Id.

[103] *Id.* (explaining that "[e]ven though U.S. courts would act under the ATS, the principles of sovereignty underlying international law do not disappear in cases of universal jurisdiction."). Further explaining that:

> [h]olding Dutch and British corporations (enterprises in third-states) liable for an offense with no connection to the U.S. could directly affect labor markets, international trade, and stock value without the United States having a substantial connection to the controversy. In addition, while regulation could raise corporations' standard of care, it may also deflect foreign direct investment by making corporations more reluctant to invest in developing countries with possible human rights problems.

Id.

> foreign relations;[104] (6) reciprocal effect—foreign courts holding United States Corporations liable for violations occurring outside the territory of the foreign sovereignty.[105]

The first three issues concern the "smooth functioning of the [United States] legal system and procedural fairness," while the last three issues concern "foreign relations and comity."[106]

V. Proposal

Although the immediate questions before the Court concern the reach of the ATS and whether it will continue to allow foreign plaintiffs, like those in *Filartiga* and *Kiobel*, to pursue and hold accountable those who were responsible for the perpetration of heinous acts against their suffering, and whether corporations can be held accountable for such acts, the larger question is whether the United States wants "to be a leader or a laggard in upholding international rights."[107] In regards to the latter, others will recognize the narrowing of the ATS as the United States would be separating itself from its history of leading support for human rights.[108] In regards to the former, if the Court reverses the *Kiobel* decision, it will maintain consistency with its history and demonstrate to the people of United States—and the world at large—that United States citizens and foreign citizens are entitled to certain fundamental rights, which the United States will help enforce against any person—human or corporate.[109]

According to *Bobelian*, in deciding *Kiobel*, conservatives have two options that would be favorable to the business community but, at the same time, disagreeable with the history and purpose of the ATS and with the history of the United States in its fights against human rights violations.[110] The first option is to rule that corporations are not liable under international human rights laws.[111] This option is problematic because although shielding corporations from liability

---

[104] *Id.* at 681-82. Stating that:

> Despite the universality of the norms allegedly violated by the defendant corporations, the states where the defendants are incorporated may view an ATS claim as infringing on their territorial sovereignty. This view could cause negative feelings towards the United States and thus hamstring the U.S. executive branch in negotiating with the Dutch and British governments in areas of foreign relations. Similarly, such litigation could also unduly influence Dutch and British foreign policy with Nigeria.

Id.

[105] *Id.* at 682 ("Because U.S. courts would hold foreign corporations liable for violating the law of nations, other countries may uphold jurisdiction when plaintiffs in those states bring suits against United States corporations. This is especially undesirable when the forum state has no connection with the U.S. corporation or its conduct.").

[106] *Id.*

[107] *See* Warren, *supra* note 57 (discusisng the legacy of the United States as a result of the Supreme Court's ruling in *Kiobel*).

[108] *Id.*

[109] *Id.*

[110] *See* Bobelian, *supra* note 10 (discussing the two opportunities the Court in *Kiobel* has in order to make a favorable ruling for the business community).

[111] *Id.*

could be an abuse of the law, it *is* inconsistent with granting them protections (*e.g.*, limited liability for shareholders) and constitutional rights if they are not being held accountable for the same responsibilities and standards as human beings.[112] The second, more extreme, option is for the Court to strike down the use of the ATS for human rights violations committed abroad for both corporations and human beings.[113]

Consequently, the Court should of overturned *Kiobel*.[114] On Monday, October 7, 2011, the Court granted certiorari and there were many indications, specifically two main reasons, to support the Court's reversal of *Kiobel*.[115] The first main reason being that the Second Circuit's decision misinterpreted the Supreme Court ruling in *Sosa*, where the Supreme Court presented the standard for determining whether a violation of a recognized norm of customary international law that could be construed as a tort is in violation of the law of nations for ATS purposes.[116] The Second Circuit also misinterpreted the *Sosa* footnote in determining whether a norm is sufficiently definite to support a cause of action, which states, "[r]elated consideration is whether international law extends the scope of liability for a violation of a given norm to the perpetrator being sued, if the defendant is a private actor such as a corporation or individual."[117] The Second Circuit misunderstood this footnote to indicate that international law provides a standard form of liability for different types of juridical persons claiming that the language of the footnote requires courts to look to international law to determine their jurisdiction over ATS claims against a particular class of defendants, ostensibly including corporations.[118] Contrary to the Second Circuit's understanding, in reading the footnote it becomes clear that the *Sosa* Court was not suggesting that an international law standard regarding the differentiation of individuals from corporations existed, but rather was suggesting that a standard about whether private actors as opposed to state actors can be held liable under the ATS.[119] Further, the *amicus curiae* briefs of International Law Scholars, which supported the granting of certiorari, argued that in accordance with text and terms of the ATS, the language of the footnote demonstrates that the *Sosa* Court was referring to a single class of non-state actors (natural and juristic individuals), not

---

[112] *Id.*

[113] *Id.*

[114] *See* Farbstein et al., *supra* note 79, at 104 (arguing that the Supreme Court should overturn *Kiobel*).

[115] *Id.*

[116] *Id*. (citing *Sosa v. Alvarez-Machain*, 542 U.S. 692, 698-99 (2004) (quoting 28 U.S.C. § 1350)).

[117] *Id.* (citing *Sosa*, 542 U.S. at 732 n.20).

[118] *Id.* (citing *Kiobel v. Royal Dutch Petroleum Co.*, 621 F.3d 111 (2d Cir. 2010)).

[119] *Id.* at 105. Explaining that:

> [t]he footnote continues on to compare Judge Edwards's concurrence in *Tel-Oren v. Libyan Arab Republic*, 726 F.2d 774, 791-95 (D.C. Cir. 1984), which detailed an insufficient consensus on whether torture by private actors violates international law, with *Kadic v. Karadzic*, 70 F.3d 232, 239-41 (2d Cir. 1995), which found a sufficient consensus that genocide by private actors violates international law.

Id.

two different classes, as was hastily presumed by the *Kiobel* Second Circuit majority.[120]

The second reason the Supreme Court should of overturned the Second Circuit decision is the substantial historical evidence—specifically, the Nuremberg trials and subsequent courts' reliance on the outcome,[121] which proposes that international law identifies that juridical persons, such as corporation, can be found in violation of international law, proving that international law has recognized that actors other than natural persons can commit international law violations.[122] Several federal courts have relied on the Nuremberg trials to support notion of civil corporate liability for international law violations.[123] For example, in *In re Agent Orange*, the district court acknowledged that in the Nuremberg trials, especially in the proceedings against German corporate executives, the culpable parties were the "corporations through which the individuals acted."[124] The *In re Agent Orange* court further explained that, "[l]imiting civil liability to individuals while exonerating the corporate directing the individual's action. . .makes little sense in today's world."[125] Thus, a review of that case, and those other cases similarly relying on the Nuremberg trials, demonstrate the degree to which United States courts are citing to Nuremberg as precedent for corporate liability in the context of violations of the law of nations.[126]

Both the district court and the Seventh Circuit in *Kiobel* highlighted the point that it is irrelevant whether there is an international law "standard" for civil liability for violations of international law as these violations can be punished in domestic courts through the remedy provided by a civil suit left to individual states.[127] For these reasons, the Court should have overturned *Kiobel* and re-

---

[120] *Id.* ("Indeed, as the International Law Scholars point out, the Supreme Court has previously noted that the 'Alien Tort Statute by its terms does not distinguish among classes of defendants.'" (citing Brief for International Law Scholars as Amici Curiae Supporting Petitioners, for Writ of Certiorari, *Kiobel v. Royal Dutch Petroleum Co.*, 10-14919 (Dec. 14, 2011) 2011 WL 6396550) *(*quoting *Argentine Republic v. Amerada Hess Shipping Corp.*, 488 U.S. 428, 438 (1989).)

[121] *See Id.* at 102-03 (for an in-depth analysis of Nuremberg, which indicates that international law has acknowledged that actors other than natural persons can violate international law). *See generally* Brief of Amici Curiae International Law Scholars in Support of Petitioners at 6, *Kiobel v. Royal Dutch Petroleum*, 10-14919 (Dec. 14, 2011) 2011 WL 6396550.

[122] *Id.*

[123] *Id.*

[124] *In re Agent Orange Prod. Liab. Litigation (In re Agent Orange)*, 373 F. Supp. 2d 7, 57 (E.D.N.Y. 2005). In the case, several Vietnamese nations sued the manufacturers and distributors of Agent Orange, a herbicide used during the Vietnam War, arguing that the use of chemicals was in violation of the law of nations. *Id.* at 15. It should be noted however, that the case was dismissed on the grounds that use of such chemicals was not a violation of customary international law at the time. *Id.* at 145.

[125] *Id.* at 58-9.

[126] *See Presbyterian Church of Sudan v. Talisman Energy, Inc. (Presbyterian Church I)*, 244 F. Supp. 2d 289 (S.D.N.Y. 2003); *reaffirmed in Presbyterian Church of Sudan v. Talisman Energy, Inc. (Presbyterian Church II)*, 374 F. Supp. 2d 331, 333-34 (S.D.N.Y. 2005) (citing Nuremberg trials in reaffirming previous holding of corporate liability). *See also Bowoto v. Chevron Corp,* 2006 WL 2455752, at *9 (N.D. Cal. 2006).

[127] *See* Farbstein et al., *supra* note 79, at 106 (arguing for the irrelevance of an international "standard").

jected the Second Circuit's majority reasoning that there is no civil liability under the ATS for corporations that violate the laws of nations.[128]

Additionally, plaintiffs, like Kiobel, could benefit from following in the footsteps of the plaintiffs in *Talisman*[129]—a case that ended up being dismissed after a corporate defendant prevailed in court for a decade.[130] The court's dismissal in *Talisman* was presumably the result of the array of tactics used by the Presbyterian Church of Sudan, which included: protests, a stock divestment campaign targeting institutional investors, political pressures in the United States and Canada coordinated by multiple NGOs, and the employment of effective media tactics.[131] The impact of these tactics was evidenced by the falling of the defendant's, Talisman, stock price, despite the success of its oil operations in Sudan, and was acknowledged by Talisman when, instead of choosing to continue its operation, it succumbed to the multi-faceted pressures by selling its interest to an Indian state-controlled oil and gas company, which lacked the same commitment to local development and peace efforts.[132] *Talisman* demonstrates the effectiveness of these tactics that are increasingly frequent in transactional tort cases.[133]

Further, on a legislative basis, pursuant to the district court's approach in *In re Sinaltrainal*, courts should impose a heightened pleading standard in transactional tort cases, including ATS cases, when considering the inherent difficulties and expenses associated with litigation.[134] Finding that the ATS requires plaintiffs to establish that a tort was committed in violation of international law, the court noted that the complaint must identify the specific international law that the defendant allegedly violated—a higher standard of pleading than is traditionally required under the Federal Rules of Civil Procedure.[135] The court also noted that it would be appropriate to require a heightened pleading standard in determining whether the facts pled in the complaints sufficiently showed that the defendants violated the law of nations.[136] It further explained that a higher pleading standard would help to ensure courts proceed cautiously in recognizing new theories under the ATS, as instructed in *Sosa*,[137] and that a higher standard may be justi-

---

[128] *Id.*

[129] Drimmer, *supra* note 2, at 521.

[130] *See generally Presbyterian Church of Sudan v. Talisman Energy*, 582 F.3d 244 (2d Cir. 2009).

[131] *Id.*

[132] *Id.*

[133] *Id.*

[134] *See* Drimmer, *supra* note 2, at 525 (referencing *In re Sinaltrainal*, 474 F. Supp. 2d 1273, 1275 (S.D. Fla. 2006), *aff'd in part vacated in part*, *Sinaltrainal v. Coca-Cola Co.*, 578 F.3d 1252 (11th Cir. 2009)). In this case, the corporate entities were accused of being vicariously liable, through theories of conspiracy, aiding and abetting, or joint action, for the violent actions of paramilitary members—whose actions were regarded as an attempt to intimidate union members and squelch union activity. *Id.*

[135] *Id.*

[136] *See* Drimmer, *supra* note 2, at 525 (quoting *In re Sinaltrainal Litig.*, 474 F. Supp. 2d 1273, 1275 (S.D. Fla. 2006)).

[137] *See Sosa v. Alvarez-Machain*, 542 U.S. 692, 725 (2004) (discussing in further details the higher pleading standard).

fied when considering the risk that vague, conclusory, and weakened allegations may allow individuals to unjustifiably accuse corporate entities and abuse the judicial process in pursuing political agendas.[138]

VI. Conclusion

The ATS and the use of international law in litigation have rapidly increased in recent years. The ATS's swift evolution increasingly remains the center of a debate concerning whether or not corporations should be held liable under the ATS for human rights violations committed abroad. The Second Circuit's majority reasoning in *Kiobel* is contrary to the basic purposes of the ATS and international law—if corporations are shielded from liability for human rights violations under the ATS, then the ATS cannot achieve its purpose in redressing genocide or crimes against humanity perpetrated by corporations in violation of international law. As suggested by a diverse range of sources, corporate liability under the ATS is, in fact, consistent with international law. Although the ATS is now widely known, its future still remains uncertain. Lawyers and academics alike hope that the Supreme Court's decision in *Kiobel* will provide more concrete guidance and truly define the ATS's future.

VII. Afterward

The Court issued a decision on *Kiobel v. Royal Dutch Petroleum* on April 17, 2013.[139] The decision was unanimous in the holding that Royal Dutch was not liable under the ATS, but split 5-4 on its rationale, resulting in dismissal.[140] Justice Roberts wrote in the majority opinion that the decision was governed by "the presumption against extraterritoriality,"[141] meaning that, "Congress is presumed not to intend its statutes to apply outside the United States unless it provides a 'clear indication' otherwise."[142]

Specifically, the Court stated that, in 1789, Congress intended for the ATS "to provide foreign ambassadors the ability to seek redress in the federal courts if they were attacked while in the United States."[143] The Court also noted that, for American courts to assert jurisdiction over human rights violations committed abroad, may have negative foreign policy ramifications for the United States, and in the case that it would, any decision to permit such suits should be made by Congress exclusively, not by the courts.[144]

Nevertheless, the Court's recognition of the presumption against extraterritorial application of the ATS still left hope for the future of tort suits under the ATS by recognizing that ATS cases in which a portion of the conduct occurred over-

138 *See* Drimmer, *supra* note 2, at 525 (citing *In re Sinaltrainal*, 474 F. Supp. 2d at 1275).

139 *Kiobel v. Royal Dutch Petroleum*, No. 10-1491, slip op. at 1 (U.S. April 17, 2013).

140 *Id.* at 14.

141 *Id.* at 6.

142 *Id.* at 6-7.

143 *Id.* at 9.

144 *Id.* at 13.

seas may still be sustainable, so long as at least some portion of "the relevant conduct" occurred within the United States.[145] Although the Court also stated that mere corporate presence in the United States is insufficient to qualify as the requisite conduct to bring a corporation under the ATS, it never spelled out just what conduct would qualify.[146]

Further still, the concurring opinions acknowledged the possibility for plaintiffs to raise claims arising out of a corporation's operations in a country where alleged human rights abuses occurred.[147] Specifically, Justice Kennedy's concurring opinion gives Kiobel-like plaintiffs hope:

> Other cases may arise with allegations of serious violations of international law principles protecting persons, cases covered neither by the [Torture Victim Protection Act] nor by the reasoning and holding of today's case; and in those disputes the proper implementation of the presumption against extraterritorial application may require some further elaboration and explanation.[148]

Another alternative exists. Some commentators believe that plaintiffs may be able to assert their allegations of overseas human rights abuses as common law tort actions alleging violations of state law.[149] Because "states are largely free to craft their tort law without interference from the federal government, [. . .] plaintiff's lawyers barred from raising overseas human rights claims in federal court under the ATS may well decide to file their lawsuits in state courts instead."[150]

Although the *Kiobel* Court decision made it more difficult for human rights activists to sue United States corporations for human rights violations overseas, it left enough room for activists to sue corporations, in the foreseeable future, for their overseas activities.[151] At least for the time being, United States-based corporations continue to have many of the same rights as individuals,[152] without the same responsibilities. In the wake of *Kiobel* therefore, these corporations will continue to have their cake and eat it too while doing business abroad.

---

[145] *Id.* at 14.

[146] *Id.*

[147] *Kiobel*, No. 10-1491, slip op. (Kennedy, J., concurring).

[148] *Id.*

[149] Rich Samp, *Supreme Court Observations: Kiobel v. Royal Dutch Petroleum & the Future of Alien Tort Litigation*, FORBES (Apr. 18, 2013, 10:52 A.M.), http://www.forbes.com/sites/wlf/2013/04/18/supreme-court-observations-kiobel-v-royal-dutch-petroleum-the-future-of-a-tort-litigation/.

[150] *Id.*

[151] *Id.*

[152] *See Citizens United v. Federal Election Com'n*, 588 U.S. 310, 342 (2010) (finding that corporations have the same right to freedom of speech under the First Amendment as do individuals).