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# ***The International Journal of Not-for-Profit Law***

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## ***Letter from the Editor***

As *The International Journal of Not-for-Profit Law* begins its tenth year, we devote our special section to The Shifting Landscape for American Not-for-Profit Organizations. **Kay Guinane**, Director of Nonprofit Speech Rights for OMB Watch, provides an overview of counterterrorism tactics that have affected American charities. **Thomas Silk**, senior counsel at the San Francisco law firm of Silk, Adler & Colvin, discusses proposed changes to IRS Form 990, which would encourage not-for-profit organizations to adopt good governance practices. In a sidebar, **Grant Williams** summarizes an October meeting on the topic between an IRS official and charity leaders. **Josh D. Friedman**, a former International Center for Not-for-Profit Law intern, proposes that not-for-profit organizations accused of being linked to terrorism be given the same due process rights as accused drug kingpins. *IJNL* student editor **Sarah R. Eremus** summarizes USAID's proposed Partner Vetting System and the NGO community's response to it.

This issue features three other articles as well. The protection that international treaties provide not-for-profit organizations is evaluated by **Luke Eric Peterson**, editor of *Investment Treaty News*, and **Nick Gallus**, a lecturer in international trade and investment law at Queen's University in Canada. **Marc Makary**, a member of the Beirut Bar and former Senior Research Fellow at ICNL, assesses the rules for incorporating associations in Lebanon and Jordan. Finally, **Benny D. Setianto**, a researcher and senior lecturer at Catholic University of Soegijapranata, Indonesia, considers civil society at the conceptual level, as a sector lying between the economy and the state.

We gratefully acknowledge our authors for sharing their expertise; student editor Sarah R. Eremus and faculty adviser Raquel Aldana of the Boyd School of Law at the University of Nevada, Las Vegas, for their assistance on this issue; and Rebecca See of ICNL for posting the issue online.

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**THE SHIFTING LANDSCAPE FOR  
AMERICAN NOT-FOR-PROFIT ORGANIZATIONS**

**U.S. Counterterrorism Developments  
Impacting Charities**

**Kay Guinane<sup>1</sup>**

Over the past year, the legal and regulatory environment impacting charities and their program operations has evolved in some troublesome ways, in all three branches of government. However, there appears to be growing acknowledgment of the unique impacts the "war on terror" has on charities, creating openings for the kind of oversight and evaluation that could lead to positive reforms. This article reviews the major events, and suggests that the charitable sector develop consensus around specific reform proposals that can protect both public safety and charitable programs.

**The Hill**

When it comes to terrorism-related issues, Congress has most often acted without adequate oversight that evaluates the effectiveness and impact of current counterterrorism laws. Where hearings have been held, they have been one sided, with government witnesses only. However, there are indications that Congress may begin paying more attention to issues relating to the financial war on terror as a whole, which hopefully will include the impact on charities.

Examples of missed opportunities to exercise oversight include the following:

- *Grantmakers Object to Senate Hearing Limited to Treasury Department Witness*

On May 10, Chip Poncy, the Director of Treasury's Office of Strategic Policy for Terrorist Financing and Financial Crimes, testified before the committee during a hearing on "Violent Islamist Extremism: Government Efforts to Defeat It." Poncy highlighted Treasury's revised Voluntary Anti-Terrorist Financing Guidelines, which he claimed are "based on extensive consultation between Treasury and the charitable and Muslim communities." This misled the committee, since a group of more than 40 U.S. charitable-sector organizations called for withdrawal of these guidelines in December 2006.

On June 20, Grantmakers Without Borders (Gw/oB), a philanthropic network of more than 150 organizations, wrote committee leadership objecting to this portrayal of the agency's relationship with the charitable sector. Gw/oB's letter noted that no representatives from the charitable and Muslim communities were called to testify at the congressional hearing, although this would have provided committee members with a more accurate, complete description of the impact Treasury's counter terrorism procedures have had on charitable programs and Treasury's lack of trust and credibility within the nonprofit sector on these issues.

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<sup>1</sup> Kay Guinane is Director of Nonprofit Speech Rights for OMB Watch, <http://www.ombwatch.org>

The letter states, "Ironically, Treasury's anti-terrorism policies often chill the valuable work of international grantmakers, including Gw/oB's member organizations. Thus, philanthropic money that funds, for example, farming projects or support for tsunami victims is too often delayed or discontinued."

- *Broadening Already Vague Definitions of Prohibited Activity*

In October, Congress approved S. 1612, the International Emergency Economic Powers Enhancement Act (IEEPA).<sup>2</sup> The bill expands penalties for violations of economic sanctions against countries such as Iran and designated terrorist organizations. But it also expands the scope of prohibited activity to include vaguely defined conspiracy and aiding and abetting language that could lead to unpredictable results for the unwary. The terms are undefined and could criminalize behavior far removed from the actual illegal act, such as charitable relief provided in disaster areas where terrorist groups operate or bankers playing an indirect role in a financial transaction.

The bill went through Congress relatively quickly, passing the Senate after a hearing that included only Bush administration officials, and with no hearing before the House Foreign Affairs Committee. Passage of the bill without review of the economic sanctions' effect on humanitarian aid, development, and human rights programs is unfortunate. OMB Watch wrote to the House Democratic leadership asking for a delay on the vote on the bill until the Foreign Affairs Committee could investigate how the IEEPA has affected the charitable sector. Although the bill passed, the call for oversight continues. Key questions for Congress include the following:

- How has Treasury treated charities under Bush's Patriot Act executive orders?
- Why does Treasury refuse to meet with charities about ways to release frozen funds for genuine charitable programs?
- Why is there no independent review of designation of charities?
- Why do charities get shut down, whereas companies such as Chiquita pay fines that are small relative to their assets?

Examples of growing Congressional awareness and interest include the following:

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<sup>2</sup> Charities and other entities are subject to asset seizure under Patriot Act amendments to IEEPA, which give the president discretion to declare an emergency for "any unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States." President Bush used these powers on Sept. 24, 2001, granting the Treasury Department (among other powers) the ability to freeze the assets of all persons the Secretary of the Treasury determined ". . . assist in, sponsor, or provide financial, material, or technological support for . . . such acts of (foreign) terrorism . . . or to be otherwise associated with those persons listed in the Annex to this order." (Executive Order 13224, 66 Fed. Reg. 49079 (2001), at Sec. 1(d)(i), (ii).) The threshold for asset seizure is low. Under the Patriot Act revisions to IEEPA, the Treasury Department can freeze an organization's assets pending an investigation into possible associations with a designated terrorist group.

- *Hearing Raises Questions on Extent of Charities' Role in Terrorist Financing*

The House Ways and Means Subcommittee on Oversight held a hearing July 24 on tax-exempt charitable organizations. The opening remarks of Rep. Bill Pascrell (D-NJ) challenged the Department of Treasury's assertion that charities are a "significant source of terrorist funding," observing that Treasury seems to be "painting the sector with a wide brush." During questioning, Pascrell asked Steve Gunderson, the President and CEO of the Council on Foundations, if he agrees with Treasury's claim. Gunderson responded that he does not and went on to explain the difficulties facing the sector as a whole. He also noted that not a single U.S. charity has been found to have redirected funds to a terrorist organization.

- *Senate Votes Down Expanded Definition of Material Support*

In March, one of many amendments proposed to the Senate bill designed to implement recommendations of the 9/11 Commission, S. 4, could have potentially weakened humanitarian work of U.S. charities overseas. The amendment, introduced by Sen. Jon Kyl (R-AZ), was defeated.

Kyl's amendment, SA 317, would have increased the maximum penalties for giving material support to suspected terrorists and broadened the definition of material support to anyone who "provides material support or resources to the perpetrator of an act of international terrorism, or to a *family member or other person associated with such perpetrator*, with the intent to facilitate, reward, or encourage that act or other acts of international terrorism" (emphasis added). The penalty for violating this provision would have been a fine, up to 25 years in prison, or both, or if death results, a prison term of any number of years to life. The terms "family member" or "person associated" were not defined in the amendment. This broad standard could have lead to discrimination in aid programs that would violate Red Cross and international standards.

- *House Financial Services Committee Moves to Implement GAO Recommendations*

On April 17, legislation was introduced in the House that would require the Departments of State and Treasury to adopt recommendations of an October 2005 Government Accountability Office (GAO) report, which addressed the effectiveness of the U.S. government's efforts to assist other countries in the war on terrorism. Among other things, the bill would require the Treasury Department to submit in an annual report to Congress more complete information on how the agency tracks and blocks terrorist assets. Although the bill does not include all the GAO recommendations, it opens the door to discussions on the effectiveness of Treasury's strategy, including how it deals with charities.

The major problems highlighted in the 2005 GAO report, "Terrorist Financing: Better Strategic Planning Needed to Coordinate U.S. Efforts to Deliver Counter-Terrorism Financing Training and Technical Assistance Abroad," reflect the overall flaws with anti-terrorism financing programs that also greatly impact charities. For example, since the assets of U.S.-based Muslim charities were frozen, no information has been provided about what Treasury plans to do with the money or even an exact amount of the

charitable aid lying dormant. In its 2006 Terrorist Assets Report to Congress, Treasury estimated that these designations have resulted in more than \$16.4 million in frozen assets. As the GAO report also notes, "The lack of accountability for Treasury's designations and asset blocking program creates uncertainty about the department's progress and achievements. U.S. officials with oversight responsibilities need meaningful and relevant information to ascertain the progress, achievements, and weaknesses of U.S. efforts to designate terrorists and dismantle their financial networks as well as hold managers accountable."

### **The Executive Branch**

Two new Executive Orders and action in three departments, Treasury, State and Justice, have implications for the nonprofit sector.

- *Executive Orders Broaden Activities That Can Lead to Designation, Shut Down*

Executive Orders extend criteria that can lead to designation and asset seizure in Iraq and Lebanon as a "threat to national security." The term is undefined, and there is concern that charities operating in these areas could be shut down for political reasons.

- *Treasury Department*
  - *Overbroad Claims of Charities Supporting Terrorism Continue*

On June 8, charities wrote to the Secretary of the Treasury, Henry Paulson, to express their concern about a May report from the Treasury Inspector General for Tax Administration (TIGTA) that claimed charities are a "significant source of alleged terrorist activities." The charities' letter<sup>3</sup> called upon Treasury to retract this claim, saying that "Treasury needs to recognize that charities are part of the solution and not part of the problem." The TIGTA statement was made in conjunction with a recommendation that the Internal Revenue Service (IRS) use the Terrorist Screening Center (TSC) watch list to check for connections between charities and terrorists.

The letter noted that Treasury never provided information to prove that a considerable portion of charitable funds are diverted to terrorist organizations. In fact, its own data shows that overall, charities account for only 8.75 percent of the individuals, companies, and organizations on Treasury's Specially Designated Nationals (SDN) list. In all, 45 charities appear on that list, only seven of which are based in the United States, so that U.S.-based charities account for just 1.25 percent of designations. The letter said this hardly justifies Treasury's broad claims about charities' role in supporting terrorism.

The letter also expressed concern about Treasury's overreliance on inaccurate watch lists, such as the SDN list. The TSC list is much larger, including the no-fly list and a variety of lists from different agencies using different standards. The letter said that the addition of yet another inaccurate watch list is not the most effective use of resources.

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<sup>3</sup> The letter was signed by the following organizations: American Civil Liberties Union, Fellowship of Reconciliation, Fund for Nonviolence, Global Fund for Women, Grantmakers Without Borders, Islamic Society of North America, Kinder USA, Life for Relief and Development, Moriah Fund, Muslim Advocates, Muslim Public Affairs Council, National Council of Nonprofit Associations, and OMB Watch.



- *Treasury's Voluntary Anti-Terrorist Financing Guidelines for U.S.-Based Charities*

The Guidelines remain in place, despite continued calls from the nonprofit sector for their withdrawal. Widespread sector criticism of the Guidelines led Treasury to revise them in 2006, but the changes were insufficient and the calls for withdrawal continue.

- *Treasury Posts Risk Matrix for Charities*

In March, without public announcement or comment, the Treasury's Office of Foreign Assets Control (OFAC) published a Risk Matrix for the Charitable Sector on its website. The Introduction of the publication says the matrix is meant to help charities comply with U.S. sanctions programs that prohibit transactions with designated terrorists or certain countries. In 2006, Treasury said it was working on a draft of the matrix, and in June 2006, a group of nonprofits wrote Treasury asking for a public comment period. Treasury did not respond, which is at odds with their claims of close cooperation with sector. The matrix has been criticized by groups such as Grantmakers Without Borders, which has called for it to be withdrawn, because it stigmatizes international grantmaking.

- *Frozen Funds:*

Treasury has not responded to a November 2006 letter from a group of 20 charities seeking a meeting to discuss ways to release frozen funds of charities Treasury has designated as supporters of terrorism to alternative charitable programs. As of this writing it appears Treasury is now willing to meet after intervention from a member of Congress. It remains to be seen whether this will be a good faith dialog or a token meeting to give appearance of cooperation where there is none.

- *State Department*

- *Guiding Principles on Non-Governmental Organizations*

In one of the few positive developments for nonprofits, in December 2006 the State Department published a set of principles<sup>4</sup> that recognize the essential role non-government organizations (NGOs) play in "ensuring accountable, democratic government." The preamble cites the United Nations Universal Declaration of Human Rights and other international standards that support "the right of freedom of expression, peaceful assembly and association." The ten standards include the following statement:

Criminal and civil legal actions brought by government against NGOs, like those brought against all individuals and organizations, should be based on tenets of due process and equality before the law.

The principles were published in response to repression of NGOs in such countries as Russia and Turkmenistan, but are equally needed in the United States. The lack of due process U.S. charities face when the Treasury Department shuts them down clearly violates these standards. This contradiction should call attention to the need to reform the process.

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<sup>4</sup> <http://www.state.gov/g/drl/rls/77771.htm>

- *Justice Department/FBI*
  - *Surveillance of U.S. organizations based on political beliefs and dissent*

Since 9/11 there have been disturbing revelations about use of anti-terrorism resources, including the Joint Terrorism Task Force (JTTF) and Department of Defense (DOD) databases, to track and sometimes interfere with groups that publicly and vocally dissent from administration policies. In this way lawful protest is mischaracterized as terrorist activity. Although since 9/11 antiwar groups have suffered from these abuses the most, it is not limited to them. Other instances have been exposed by the American Civil Liberties Union (ACLU) Spy Files project.

A report by the ACLU revealed that the Pentagon monitored at least 186 anti-military protests in the United States and collected more than 2,800 reports involving Americans in an anti-terrorist threat database.<sup>5</sup> For example, in 2005 DOD added the American Friends Service Committee, a 90-year-old pacifist Quaker organization and 1947 winner of the Nobel Peace Prize, to its database of suspected terrorist groups. The Threat and Local Observation Notice (TALON) database also “identified a 79-year-old Quaker grandmother attending an anti-war meeting at a Quaker meeting house in Florida as ‘potential terrorist activity.’”<sup>6</sup> The TALON database<sup>7</sup> has been discontinued as a result of public protest.

The American Civil Liberties union as used the Freedom of Information Act to obtain and expose FBI surveillance files on itself, peace groups including Code Pink and United for Peace and Justice, Greenpeace, People for the Ethical Treatment of Animals, the American-Arab Anti-Discrimination Committee and the Muslim Public Affairs Council.

- *Double Standard: Chiquita Banana Fined, Not Shut Down, for Transactions with Designated Terrorists*

In a March plea agreement with the U.S. Department of Justice (DOJ), Chiquita Brands International agreed to pay a \$25 million fine after admitting it had paid \$1.7 million to the United Self-Defense Forces of Colombia (AUC) and had also made payments to the leftist Revolutionary Armed Forces of Colombia (FARC), both of which are U.S.-designated terrorist organizations. The payments, made between 1997 and 2004, continued despite the company's knowledge of their illegality. The company was allowed to continue profitable production during the investigation. The Chiquita fine is unlikely to affect its operations, as the company has annual revenues of approximately \$4.5 billion.

DOJ's slap on the wrist exhibits unequal enforcement of anti-terrorist financing laws. In contrast to Chiquita's direct funding of AUC, no significant evidence points to terror financing by U.S.-based charities. Instead, questionable evidence was used to shut down the largest U.S.-based Muslim charities, including the Holy Land Foundation.

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<sup>5</sup> <http://www.aclu.org/safefree/spyfiles/28024prs20070117.html>

<sup>6</sup> Id.

<sup>7</sup> Chris Pifer, “Dissent is not Terrorism,” March 22, 2007, available at [http://www.tompaine.com/articles/2007/03/22/dissent\\_is\\_not\\_terrorism.php](http://www.tompaine.com/articles/2007/03/22/dissent_is_not_terrorism.php)

## **The Courts**

- *Court Upholds Islamic American Relief Agency Asset Freeze*

On February 13, the U.S. Court of Appeals for the District of Columbia upheld a lower court decision that allowed the Treasury Department's Office of Foreign Assets Control (OFAC) to freeze the assets of the Missouri-based Islamic American Relief Agency (IARA-USA). The court said the asset seizure was lawful because the court found the organization is affiliated with a Sudanese group that was designated as a terrorist organization in 2004, making this the first case to allow such designation based solely on an alleged branch relationship. There was no finding that the U.S. group used funds to support terrorist activities, and no criminal charges have been filed.

IARA-USA provided nearly \$23 million in such relief from 1992 to 2002. Founded by a Sudanese immigrant as the Islamic African Relief Agency USA in 1985, the organization changed its name to the Islamic American Relief Agency and established a separate board of directors and finances in 2000.

The IARA-USA case is significant, since the court states that a charity can be shut down even without any allegation of direct support of terrorism, if the organization is sufficiently linked to a group that is designated by OFAC through a relationship, history, or other ties. The opinion notes, "IARA-USA argues that OFAC cannot block an entity's assets unless it determines that the entity poses an 'unusual and extraordinary threat to national security.' The district court rejected this argument, holding that the threat need not be found with regard to each individual entity.... We agree."

## **Conclusions and Recommendations**

Both government and the charitable sector need to take steps to reform the current system, so that people in need receive help and civil society as a whole is not diminished by intrusive governmental controls. Such reforms require the following:

- Congress must provide more thorough oversight, including committee hearings that provide a complete picture of what is happening.
- A process for charitable use of frozen funds must be implemented.
  - Policymakers must assess current use of the designation/asset-blocking system in context of charities and counterterrorism programs.
- The charitable sector must develop common-sense alternatives to propose to lawmakers.

The problems are systemic. Although there are good arguments that the Bush administration has been overly draconian, matters will not improve significantly under the next administration without a new regulatory structure.

**THE SHIFTING LANDSCAPE FOR  
AMERICAN NOT-FOR-PROFIT ORGANIZATIONS**

**NGOs Respond to USAID's  
Proposed Anti-Terror Screening**

Sarah R. Eremus<sup>1</sup>

**I. Introduction**

The stated mission of the United States Agency for International Development (USAID) is to advance U.S. foreign policy objectives by supporting economic growth, agriculture, trade, global health, democracy, education, conflict prevention, and humanitarian assistance in more than 100 nations throughout Asia, Europe, Africa, and Latin America.<sup>2</sup> In 2006, USAID spent \$10.4 billion on its operations, with nearly 70 percent devoted to economic, social, and environmental issues, and the remainder devoted to democracy and human rights, regional stability, humanitarian responses, managerial and organizational excellence, counterterrorism, and international crime.<sup>3</sup> Close collaboration with nonprofit partners is fundamental to the successful achievement of USAID projects.<sup>4</sup> The agency works with international non-governmental organizations (NGOs) and U.S.-based private voluntary organizations (PVOs), among others.<sup>5</sup>

To receive a grant award, eligible nonprofits submit proposals, which are evaluated by the agency.<sup>6</sup> Currently, recipient organizations are required to screen their employees and provide USAID with certification that no employee is affiliated with any government-listed terrorist group.<sup>7</sup> Recently, USAID proposed new screening procedures that will be carried out by U.S. intelligence agencies and law enforcement.<sup>8</sup>

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<sup>1</sup> Sarah R. Eremus is a third-year student at the William S. Boyd School of Law at the University of Nevada, Las Vegas, and a student editor of the *International Journal of Not-for-Profit Law*.

<sup>2</sup> U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT, USAID PRIMER: WHAT WE DO AND HOW WE DO IT 1 (Jan. 2006), available at [http://www.usaid.gov/about\\_usaid/PDACG100.pdf](http://www.usaid.gov/about_usaid/PDACG100.pdf) (visited Nov. 13, 2007).

<sup>3</sup> See U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT, ANALYSIS OF USAID'S FINANCIAL STATEMENTS, chart 3, available at [http://www.usaid.gov/policy/par06/highlights\\_006.html](http://www.usaid.gov/policy/par06/highlights_006.html) (visited Nov. 24, 2007).

<sup>4</sup> USAID PRIMER, *supra* note 2, at 10.

<sup>5</sup> *Id.* at 24.

<sup>6</sup> *Id.* at 25.

<sup>7</sup> USAID, CERTIFICATION REGARDING TERRORIST FINANCING, USAID ACQUISITION AND ASSISTANCE POLICY DIRECTIVE (AAPD) 02-19 (Dec. 31, 2002), available at [http://www.pngo.net/activities/cond\\_funding/Certification\\_Terrorist\\_Financing.pdf](http://www.pngo.net/activities/cond_funding/Certification_Terrorist_Financing.pdf) (visited Nov. 24, 2007).

<sup>8</sup> See discussion *infra*.

In this article, I provide an overview of USAID's proposed Partner Vetting System (PVS); the responses from prominent NGOs, categorized by the principal concerns expressed; and the current status of the proposed system.

## **II. The Proposed Partner Vetting System and Its Consequences**

On July 17, 2007, USAID announced that it would implement a new system of records, known as the PVS, pursuant to the Privacy Act of 1974, 5 U.S.C. 552a.<sup>9</sup> Under the PVS, an NGO would be required to disclose, for each officer, employee, or trustee, the full name (and any aliases), date and place of birth, government-issued identification numbers such as social security or passport numbers, current mailing address, telephone and fax numbers, email addresses, country of origin and nationality, citizenship, gender, and profession or other employment information. Disclosure of this information would be a prerequisite for receiving USAID grant funds and completing contracts, cooperative agreements, or registration as PVOs.<sup>10</sup> Some organizations construe the proposed rules as extending even to recipients of the NGO's assistance.<sup>11</sup> The information collected would be screened "to ensure that neither USAID funds nor USAID-funded activities inadvertently or otherwise provide support to entities or individuals associated with terrorism."<sup>12</sup>

On July 20, 2007, USAID published a second proposed rule in the Federal Register that would exempt the PVS from the Privacy Act of 1974 "because of criminal, civil, and administrative enforcement requirements."<sup>13</sup> This would allow USAID to withhold the screening results from the NGOs that turn over the data, because the findings would be based on classified and sensitive information.<sup>14</sup>

On July 23, 2007, USAID published a third notice in the Federal Register. This announcement revealed that the PVS could involve as many as 2,000 respondents.<sup>15</sup>

Since USAID proposed the PVS, the American Civil Liberties Union (ACLU) and NGOs have responded by sending letters to the Office of Security, the Privacy Office, and the Information and Records Division at USAID, protesting the proposed

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<sup>9</sup> Privacy Act System of Records Notice, 72 Fed. Reg. 39042 (proposed July 17, 2007) (original effective date of Aug. 27, 2007, postponed).

<sup>10</sup> *Id.*

<sup>11</sup> Ian Wilhelm, "Charities Protest Proposed Change in Federal Foreign-Aid Rules," THE CHRONICLE OF PHILANTHROPY (August 24, 2007), available at <http://philanthropy.com/news/updates/2910/charities-protest-proposed-change-in-federal-foreign-aid-rules> (visited Nov. 24, 2007); Steven R. Weisman, "Aid Groups Urge U.S. to Revise Plan to Screen Their Workers," NEW YORK TIMES (August 24, 2007).

<sup>12</sup> 72 Fed. Reg. 39042.

<sup>13</sup> Privacy Act of 1974, Implementation of Exemptions, 72 Fed. Reg. 39768 (proposed July 20, 2007).

<sup>14</sup> Walter Pincus, "Foreign Aid Groups Face Terror Screens," THE WASHINGTON POST (August 23, 2007), available at <http://www.washingtonpost.com/wp-dyn/content/article/2007/08/22/AR2007082202847.html> (visited Nov. 24, 2007).

<sup>15</sup> Notice of Public Information Collections Being Reviewed by the U.S. Agency for International Development; Comments Requested, 72 Fed. Reg. 40110 (proposed July 23, 2007).

system and demanding that it be withdrawn.<sup>16</sup> The organizations cite several factors: 1) lack of due process to challenge erroneous findings; 2) privacy concerns; 3) lack of necessity for the program; 4) lack of transparency; 5) lack of statutory authority; 6) risk of danger to NGO employees; and 7) administrative burden on NGOs.

## **1. Due Process**

NGOs worry that an employee could be falsely identified as “associated with” terrorism because the government watch lists are “riddled with error.”<sup>17</sup> Furthermore, the term “associated with” terrorism is vague.<sup>18</sup> OMB Watch points out that neither the regulations for the PVS system nor American law defines “associated with.”<sup>19</sup>

Once identified as “associated with” terrorist activities, an employee cannot adequately challenge the designation. In an August 27, 2007, letter, the ACLU points out that “the fact that USAID will not confirm to individuals or entities that its denial of funds or refusal to enter into a contract with those individuals or entities is a result of their having failed its undisclosed screening process, and the fact that there appears to be no effective means of challenging such denial or refusal, raises serious due process concerns.”<sup>20</sup> The International Center for Not-for-Profit Law (ICNL) describes a “Catch-22” scenario: in order to challenge an alleged positive finding, an individual must specify the data that need to be changed; however, because USAID would not disclose the findings, the individual would be unable to do so.<sup>21</sup>

## **2. Privacy**

Because of the highly personal nature of the information NGOs would have to disclose under the PVS, NGOs oppose the system based on privacy concerns. The ACLU writes that “[t]he creation of such a database by USAID and the fact that it, or portions of it, will be shared with other governmental entities raises privacy concerns that should be thought through more critically.”<sup>22</sup> ICNL states that the Privacy Act of 1974 was intended to bar just such forms of data-gathering, and that the Act “should be scrupulously followed to avoid unwarranted intrusions on civil liberties.”<sup>23</sup>

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<sup>16</sup> See discussion *infra*.

<sup>17</sup> Letter from Kay Guinane, Director of Nonprofit Speech Rights at OMB Watch, to Philip M. Heneghan, Chief Privacy Officer of USAID (Aug. 27, 2007), available at <http://www.ombwatch.org/npa/OMBWPVSCComments.pdf> (visited Nov. 24, 2007).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* While USAID bases its authority to implement the PVS in part on Executive Order 13224, the Order does not define the term “associated with.” See Executive Order 13224 of September 23, 2001, 66 Fed. Reg. 49079 (Sept. 25, 2001).

<sup>20</sup> Letter from Terence Dougherty, General Counsel, and Dorothy Ehrlich, Deputy Executive Director, ACLU, to Philip M. Heneghan, Chief Privacy Officer of USAID (Aug. 27, 2007), available at [http://www.aclu.org/pdfs/privacy/usaids\\_partnervetting\\_20070827.pdf](http://www.aclu.org/pdfs/privacy/usaids_partnervetting_20070827.pdf) (visited Nov. 24, 2007).

<sup>21</sup> Letter from Douglas Rutzen, President of ICNL, to Philip M. Heneghan, Chief Privacy Officer of USAID, available at [http://www.npaction.org/pdfs/pvs\\_icnl.pdf](http://www.npaction.org/pdfs/pvs_icnl.pdf) (visited Nov. 24, 2007).

<sup>22</sup> *Supra* note 20.

<sup>23</sup> *Supra* note 21.

NGOs express concerns not only about contravening privacy policies in the United States, but about violating privacy laws in foreign jurisdictions as well. In its letter, EngenderHealth states that “providing information on foreign nationals in the countries where EngenderHealth works may violate privacy laws and personal data directives and laws of these countries, and would place us in an untenable position of being forced to ignore host country laws.”<sup>24</sup>

### **3. Necessity**

The failure of USAID to demonstrate the necessity for such a system is another basis for NGO opposition. Samuel A. Worthington, President of InterAction, a coalition of charity organizations focusing on international humanitarian efforts, writes in a September 21, 2007, letter that USAID has failed to explain the need for the PVS, because it “has not conclusively demonstrated that its funds have been used for criminal activities associated with terrorism or wound up in the hands of individuals or organizations responsible for such criminal activities. Nor has USAID demonstrated that the PVS will be an effective means of ensuring its funds are not used for such purposes and do not wind up in such hands.”<sup>25</sup> According to USAID, the system is necessary because the organization operates in 90 percent of countries with active terrorists. “[E]xisting systems do not provide an appropriate level of due diligence,” according to USAID, which makes its staff members “potentially liable.”<sup>26</sup>

### **4. Lack of Transparency**

NGOs also complain of the lack of consultation concerning the PVS.<sup>27</sup> Furthermore, the fact the PVS was to take effect August 27, 2007, the same date as the deadline for responses and comments,<sup>28</sup> makes it appear that USAID had no interest in views expressed by the NGOs.<sup>29</sup> This deadline was not the only problem confronting NGOs that wished to comment on the proposal. According to InterAction, the lack of even basic information about the system and an explanation regarding its necessity leaves “the NGO community ... unable to provide meaningful comment.”<sup>30</sup> OMB Watch urges

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<sup>24</sup> ENGENDERHEALTH, “EngenderHealth Expresses Deep Concern over U.S. Proposal to Gather Private Information” (Aug. 24, 2007), *available at* <http://www.engenderhealth.org/news/newsreleases/070824-pvs.html> (visited Nov. 24, 2007).

<sup>25</sup> Letter from Samuel A. Worthington, President & CEO of InterAction, to USAID Officers (Sept. 21, 2007), *available at* [http://www.interaction.org/files.cgi/5976\\_InterAction\\_response\\_to\\_July\\_23\\_Federal\\_Register\\_Notice\\_\(PVS\).pdf](http://www.interaction.org/files.cgi/5976_InterAction_response_to_July_23_Federal_Register_Notice_(PVS).pdf) (visited Nov. 24, 2007). *See also* “Global Health Council Opposes Implementation of the Proposed Partner Vetting System” (Aug. 22, 2007), *available at* [http://www.globalhealth.org/images/pdf/usaaid\\_alert\\_082207.pdf](http://www.globalhealth.org/images/pdf/usaaid_alert_082207.pdf) (visited Nov. 20, 2007).

<sup>26</sup> Ian Wilhelm, “International Aid Groups Balk at Latest Federal Antiterror Screening Plan,” THE CHRONICLE OF PHILANTHROPY (August 31, 2007), *available at* <http://philanthropy.com/news/updates/2963/international-aid-groups-balk-at-latest-federal-antiterror-screening-plan> (visited Nov. 24, 2007).

<sup>27</sup> Global Health Council, *supra* note 25.

<sup>28</sup> 72 Fed. Reg. 39042. *See also* Pincus, *supra* note 14; ACLU, *supra* note 20.

<sup>29</sup> InterAction, *supra* note 25.

<sup>30</sup> *Id.*

USAID to withdraw the proposal and consult with NGOs to develop “mechanisms to protect USAID funds that would be both more effective and less subject to mistake and abuse.”<sup>31</sup>

EngenderHealth contends that “USAID has unilaterally initiated a questionable, counterproductive, and burdensome system without proactive consultation with the NGO community.”<sup>32</sup> After “repeated assurances” that the agency would consult with partners on significant matters, USAID’s failure to solicit NGO involvement here is “disrespectful” and “provocative.”<sup>33</sup>

### **5. Lack of Statutory Authority**

NGOs also point out that there is no statutory authority for PVS.<sup>34</sup> The ACLU notes questions about “whether the PVS may actually exceed the authority granted to USAID by Congress.”<sup>35</sup>

USAID bases its authority on the foreign operations appropriation bill, which requires the Secretary of State to “take all appropriate steps” to make certain that U.S. funds in the West Bank and Gaza do not reach any individual or group involved with terrorism.<sup>36</sup> However, as ICNL observes, 22 C.F.R. 226.4 specifies that “USAID shall not impose additional or inconsistent requirements except as provided in Sections 226.4 and 226.14, or unless specifically required by federal statute or executive order.” The PVS proposal does not fall under either section of the regulations, and no statute or executive order specifically requires it. Although Executive Order 13224 grants authority to the Secretary of State to identify Specially Designated Global Terrorists, it does not cover the PVS. If the order did require such a system, ICNL continues, the system would apply to all federal awards, and not just USAID ones.<sup>37</sup>

### **6. Risk of Danger to NGO Employees**

ICNL and other organizations are also concerned about the international ramifications and safety issues that may result. According to ICNL, there has already been a backlash against NGOs, and USAID should not give “precedential comfort” to countries that “seek to curtail civil society” by collecting such personal information on NGO employees.<sup>38</sup> If the collected data are misused, the Global Health Council notes, NGO employees and their relatives may be endangered.<sup>39</sup> InterAction voices a related concern: “If they are perceived to be extension of the U.S. intelligence community, terrorist attacks against them can only increase. Putting our employees in this position is

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<sup>31</sup> OMB Watch, *supra* note 17.

<sup>32</sup> ENGENDERHEALTH, *supra* note 24.

<sup>33</sup> *Id.*

<sup>34</sup> Global Health Council, *supra* note 25; ACLU, *supra* note 20.

<sup>35</sup> ACLU, *supra* note 20.

<sup>36</sup> 72 Fed. Reg. 39042.

<sup>37</sup> ICNL, *supra* note 21.

<sup>38</sup> *Id.*

<sup>39</sup> Global Health Council, *supra* note 25.



totally inconsistent with efforts USAID is making to help its implementing partners improve the security of staff members working in hazardous places."<sup>40</sup>

### **7. Administrative Burden**

Finally, NGOs oppose the PVS because of the administrative burden it will impose.<sup>41</sup> NGOs with thousands of employees all over the world are concerned about diverting time and resources from program work to PVS paperwork.<sup>42</sup>

### **III. Current Status of the PVS**

USAID is considering revising the system. The *International Herald Tribune* quotes James Kunder, acting deputy administrator of USAID, as saying, "We are trying to strike a reasonable balance here. We're trying not to make these requirements too onerous. But we have to have reasonable requirements to insure that aid money is not going to assist terrorists."<sup>43</sup> For now, the PVS will work only as a pilot program in Gaza and the West Bank. USAID will not expand the PVS until reviewing the pilot program and receiving comments from NGOs and other partners of USAID.<sup>44</sup> The responses from NGOs appear to have persuaded USAID to reconsider the PVS.

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<sup>40</sup> Letter from Samuel A. Worthington, President & CEO of InterAction, to Philip M. Heneghan, Chief Privacy Officer of USAID (Aug. 17, 2007), available at [www.interaction.org/files.cgi/5912\\_Partner\\_Vetting\\_System\\_081707.doc](http://www.interaction.org/files.cgi/5912_Partner_Vetting_System_081707.doc) (visited Nov. 24, 2007).

<sup>41</sup> Wilhelm, *supra* note 26.

<sup>42</sup> OMB Watch, *supra* note 17; Interaction, *supra* note 40.

<sup>43</sup> Steven R. Weisman, "Plan to screen aid groups for terror ties may be revised: Critics fear the U.S. Agency for International Development proposal would violate charities' privacy and drive away beneficiaries," INTERNATIONAL HERALD TRIBUNE (Aug. 24, 2007), available at <http://www.iht.com/articles/2007/08/24/america/charities.php> (visited Nov. 24, 2007).

<sup>44</sup> OMB WATCH, "USAID Temporarily Delays Implementation of Partner Vetting System," available at <http://www.ombwatch.org/article/articleview/3978/1/407?TopicID=1> (visited Nov. 24, 2007).

**THE SHIFTING LANDSCAPE FOR  
AMERICAN NOT-FOR-PROFIT ORGANIZATIONS**

**Solving the Necessity Conundrum:  
What the Drug War Can Teach Us About Due Process  
for U.S. Charities in the Fight Against  
International Terrorist Financing**

**Josh D. Friedman**<sup>1a</sup>

**Introduction**

Using new laws and novel tactics that permit the U.S. Government to freeze the domestic assets of organizations and individuals suspected of having associations with terrorists abroad, the Government has shut down seven domestic charitable organizations since the attacks of September 11, 2001. The Government's approach to combating terrorist financing, often testing the very limits of the Constitution, does not guarantee basic due process safeguards for targeted charities. What's more, this new legal regime lacks any provision for ensuring that frozen charitable funds are eventually used for charitable purposes.

Given how highly we as Americans esteem our Bill of Rights, we should be asking ourselves why we curtail the due process rights of U.S. charities suspected of having associations with terrorism. Aren't we, in the name of national defense, weakening the fundamental principles that make the defense of the nation worthwhile?

Some in favor of the current regulatory regime would argue, along a line that is by now a common refrain, that terrorism presents exigent circumstances requiring drastic measures to protect our national security. In the context of the non-traditional threats posed by terrorism, we must allow the President maximum flexibility to address terrorist threats and prevent terrorist acts. Given these circumstances, the current asset-freezing regime, entailing certain curtailments of due process, is a necessary and thus reasonable response to the threats posed by terrorism.

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<sup>1</sup> See, e.g., Bethany K. Hipp, Comment, *Defending Expanded Presidential Authority to Regulate Foreign Assets and Transactions*, 17 EMORY INT'L L. REV. 1311, 1314 (2003) (arguing that "Congress's grant of expanded authority to the President to regulate foreign transactions and take title to foreign assets was a reasonable and appropriate response to the threat the United States now confronts").

Of course, questioning targeted presidential authority to regulate the foreign transactions of U.S. charities in the face of terrorist threats is not a very fashionable stance. After all, if charities are being used as fronts for terrorist operations, we should act swiftly and decisively to confront this problem. But what if justice could be served without stripping individuals and organizations of their due process protections? Likewise, can't we find ways to protect public safety without denying assistance to people in need? The history of prosecutions of drug traffickers and organized crime syndicates teaches us that we can bring the guilty to justice without trashing the Bill of Rights or prohibiting aid to the poor.

This article compares the rights of drug traffickers and charities to defend themselves in situations where the Government seizes their assets, and finds that charities and the people who depend on their help have far fewer rights and less recourse to the courts than drug lords do. Arguing that equitable mechanisms for addressing this problem can be developed, this article looks toward civil asset forfeiture laws as one public policy approach that should stimulate ideas for reforming current law on charities.

### **The Day the World Changed for the Holy Land Foundation**

That the world changed on September 11, 2001, is by now a widely accepted notion.<sup>2</sup> For charitable organizations like the Holy Land Foundation for Relief and Development (HLF) caught up in the wake of our response to this changed world, the consequences have been stark.

On December 3, 2001, the U.S. Department of Treasury's Office of Foreign Assets Control (OFAC) decided to use the HLF to test-drive new powers recently conferred on the agency by President George W. Bush. Under provisions of the International Emergency and Economic Powers Act (IEEPA),<sup>3</sup> freshly amended<sup>5</sup> by the USA PATRIOT Act<sup>4</sup> and activated by the President's Executive Order 13,224,<sup>6</sup> OFAC designated the HLF as a specially designated global terrorist (SDGT)<sup>6</sup> and issued a "blocking notice"<sup>7</sup> that immediately froze all of the HLF's funds, accounts, and real property.<sup>8</sup> OFAC then seized all documents, computers, and furniture from the HLF's headquarters.

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<sup>2</sup> It's certainly a popular notion too: A Westlaw news search conducted on November 14, 2007, for the words "September 11," "world," and "changed" used in the same sentence anytime during the last three years returned over 863 references.

<sup>3</sup> International Emergency and Economic Powers Act (IEEPA), Pub. L. No. 95-223, tit. II, 91 Stat. 1625 (1977) (codified as amended at 50 U.S.C. §§ 1701-1707 (2006)).

<sup>4</sup> Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (USA PATRIOT Act) of 2001, Pub. L. No. 107-56, 115 Stat. 272 (codified as amended at various sections of 8, 15, 18, 22, 31, 42, 49, and 50 U.S.C. (2006)).

<sup>5</sup> Exec. Order No. 13,224, 66 FED. REG. 49079 (Sept. 23, 2001).

<sup>6</sup> Press Release, U.S. Dep't of Treas. Off. of Pub. Aff., Statement of Secretary Paul O'Neill on the Blocking of Hamas Financiers' Assets (Dec. 4, 2001), *available at* <http://www.ustreas.gov/press/releases/po837.htm>.

<sup>7</sup> U.S. Department of Treasury Designation & Blocking Mem. (Dec. 3, 2001), *available at* [http://nefafoundation.org/miscellaneous/FeaturedDocs/ofac\\_hlfblockingnotice.pdf](http://nefafoundation.org/miscellaneous/FeaturedDocs/ofac_hlfblockingnotice.pdf). See 50 USC 1702(a)(1)(B) (allowing the President to "investigate, block during the pendency of an investigation,

Accusing the HLF of masquerading as a charity while covertly aiming “to promote terror,” the Government claimed that the HLF had raised money for Hamas-run schools that “indoctrinate children to grow up into suicide bombers” and had provided millions of dollars in funding “to recruit suicide bombers and to support their families.”<sup>10</sup> Formidable charges indeed, but under the IEEPA and Executive Order 13,224, OFAC was entitled to use virtually any evidence, untested and unsubstantiated, in making its designation, including newspaper articles, raw intelligence data, unconfirmed hearsay declarations, and documents collected from trash bins.<sup>11</sup>

Before being shut down, the HLF had been the largest Islamic charity in the United States. A non-profit organization founded in 1989 and headquartered in Richardson, Texas, the HLF worked primarily with Palestinian refugees in Jordan,

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regulate, direct and compel, nullify, void, prevent or prohibit, any acquisition, holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest by any person, or with respect to any property, subject to the jurisdiction of the United States”).

<sup>8</sup> Before the Government may initiate a freeze of an entity’s assets under the IEEPA, two steps must be taken: First, to activate the executive powers granted to him by the IEEPA, the President must declare a national emergency. 50 U.S.C. § 1701(a) (defining “national emergency” as “any unusual or extraordinary threat, which has its source in whole or in part outside the United States, to the national security, foreign policy, or economy of the United States”). The President did so on September 23, 2001. *See* Exec. Order No. 13,224, 66 FED. REG. at 49079. Second, the President must designate the targeted entity as an SDGT. 50 U.S.C. § 1702(a)(1). Although section 1702(a)(1) of the IEEPA vests its authority in the President, 3 U.S.C. § 301 enables the President to delegate to “the head of any department or agency in the executive branch, or any official thereof . . . any function which is vested in the President by law,” including his section-1702(a) authorities. In 2001, President George W. Bush entrusted his IEEPA authority to the Treasury. *See* Exec. Order No. 13,224, § 7, 66 FED. REG. at 49081. Pursuant to the authority delegated to it, the Secretary of the Treasury may designate entities determined by it “to be owned or controlled by, or to act for or on behalf of . . . ; to assist in, sponsor, or provide financial, material, or technological support for,” or to be “otherwise associated with” already designated entities. *Id.* at 49079-80. “Terrorism” in this context means any activity that involves a violent act or an act dangerous to human life, property, or infrastructure; and appears to be intended to intimidate civilians, to influence governmental policy by intimidation or coercion, or to affect the conduct of the Government by mass destruction, assassination, kidnapping, or hostage-taking. *Id.* at 49080. After a federal court held the phrase “otherwise associated with” to be unconstitutionally vague, *Humanitarian Law Project v. U.S. Dep’t of Treas.*, 463 F. Supp. 2d 1049, 1064 (C.D. Cal. 2006), the Treasury redefined the term. *See* 31 C.F.R. § 594.316. The clarified phrase was upheld as valid. *See Humanitarian Law Project*, 463 F. Supp. 2d at 1105-07.

<sup>9</sup> Press Release, U.S. Dep’t of Treas. Off. of Pub. Aff., *supra* note 6.

<sup>10</sup> President George W. Bush, President Announces Progress on Financial Fight Against Terror, Remarks at the Rose Garden (Dec. 4, 2001) (transcript available at <http://www.whitehouse.gov/news/releases/2001/12/20011204-8.html>).

<sup>11</sup> *See* NAT’L COMM’N ON TERRORIST ATTACKS UPON THE U.S., MONOGRAPH ON TERRORIST FINANCING 11 (2004) [hereinafter NAT’L COMM’N ON 9-11, MONOGRAPH]. Despite the fact that almost all of this evidence would normally be inadmissible in any other civil trial context, courts have not yet blinked at OFAC’s the-sky’s-the-limit approach to using evidence. *See, e.g., United States v. Soussi*, 316 F.3d 1095, 1108-09 (10th Cir. 2002); *Holy Land Found. for Relief & Dev. v. Ashcroft*, 333 F.3d 156, 162 (D.C. Cir. 2003), *cert. denied*, 540 U.S. 1218 (2004); *Nat’l Council of Resistance of Iran v. Dep’t of State*, 251 F.3d 192, 196 (D.C. Cir. 2001).

Lebanon, and the occupied Palestinian territories.<sup>12</sup> Its stated mission was “to find and implement practical solutions for human suffering through humanitarian programs that impact the lives of the disadvantaged, disinherited, and displaced peoples suffering from man-made and natural disasters.”<sup>13</sup> Despite the accusations made by OFAC, even the Government admitted that the HLF’s funds went to building hospitals and feeding the poor.<sup>14</sup>

What recourse was available to the HLF or any similarly situated charity? The HLF could not have challenged the freeze beforehand, and its right to appeal after the fact is extremely limited. Generally, entities with a U.S. presence are entitled to due process, which, at a minimum, requires notice and an opportunity to be heard at a meaningful time and in a meaningful manner before being deprived of property.<sup>15</sup> For SDGTs, however, pre-freeze procedural safeguards are virtually nonexistent.<sup>16</sup> Where security concerns are present,<sup>17</sup> the Government can wait until after freezing a charity’s assets to provide notice.<sup>18</sup> Likewise, the Government is not required to afford a pre-freeze hearing before a judge.<sup>18</sup> The paltry OFAC administrative procedures available to a charity for contesting its designation are conducted solely on paper, impose the burden on the blocked charity of disproving its associations with terrorism, utilize secret evidence, don’t allow the charity to present witnesses or to cross-examine government witnesses, and generally are heavily skewed against the charity.<sup>19</sup>

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<sup>12</sup> Holy Land Foundation for Relief and Development Website, <http://www.hlf.org> (last updated Dec. 4, 2001) (archived at <http://wasearch.loc.gov/sep11/20011204221949/http://www.hlf.org/>).

<sup>13</sup> *Id.*

<sup>14</sup> See Leslie Eaton, *U.S. Prosecution of Muslim Group Ends in Mistrial*, N.Y. TIMES, Oct. 23, 2007, at A1.

<sup>15</sup> See *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976); *Nat’l Council*, 251 F.3d at 205; *Global Relief Found. v. O’Neill*, 207 F. Supp. 2d 779, 803 (N.D. Ill. 2002).

<sup>16</sup> Courts have recognized that the presence of exigent circumstances and a demonstrated governmental need for prompt action justifies the denial of pre-deprivation process. *United States v. James Daniel Good Prop.*, 510 U.S. 43, 56 (1993); *Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663, 679 (1974); *Global Relief Found.*, 207 F. Supp. 2d at 803. In such cases “where a State must act quickly, or where it would be impractical to provide predeprivation process, postdeprivation process satisfies the requirements of the Due Process Clause.” *Gilbert v. Homar*, 520 U.S. 924, 930 (1997). Under the IEEPA in particular, because of the Executive Branch’s need for prompt action in preventing the flight or destruction of assets and the exigencies of national security, pre-deprivation process has not historically been required. *Global Relief Found.*, 207 F. Supp. 2d at 803.

<sup>17</sup> See *Nat’l Council*, 251 F.3d at 208; *Milena Ship Mgmt. Co. v. Newcomb*, 995 F.2d 620, 624 (5th Cir. 1993); *Global Relief Found.*, 207 F. Supp. 2d at 803. When it eventually provides notice, the Government must disclose the charges against the entity, but executive privilege entitles it to withhold any classified information. See *Nat’l Council*, 251 F.3d at 208.

<sup>18</sup> See *Holy Land Found.*, 333 F.3d at 164 (in exigent circumstances, “we do not require an agency to provide procedures which approximate a judicial trial”); *Nat’l Council*, 251 F.3d at 209 (“We do not suggest ‘that a hearing closely approximating a judicial trial is necessary’”) (quoting *Mathews v. Eldridge*, 424 U.S. at 333). See also *Global Relief Found. v. O’Neill*, 315 F.3d 748, 754.

<sup>19</sup> OFAC need only provide an opportunity to present responsive evidence in writing. See *Nat’l Council*, 251 F.3d at 209; *Holy Land Found.*, 333 F.3d at 164 (the Secretary of Treasury complied with the hearing requirement of due process by providing the HLF with an opportunity for written response). While a designated entity may challenge its designation by seeking administrative reconsideration of its

Nor were the HLF's post-freeze prospects for a fair trial any more propitious.<sup>20</sup> The court was only entitled to review the case on the basis of the administrative record as presented by OFAC, including any normally inadmissible evidence.<sup>21</sup> On top of being compelled to privilege all OFAC decisions,<sup>22</sup> the judge was restricted to evaluating OFAC's compliance with the minimal procedures of the asset-freezing regime.<sup>23</sup>

Not surprisingly, the HLF has not been the only charity impacted by this new regime that seeks to hold charities responsible for providing humanitarian aid to groups that the Government has never itself said were off limits. On December 14, 2001, OFAC seized the funds, accounts, and business records of the Benevolence International Foundation and the Global Relief Foundation pending further investigation.<sup>24</sup> Then in

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designation, 31 C.F.R. § 501.807, the entity carries the burden of establishing that an "insufficient basis exists for the designation" or otherwise proposing "remedial steps on the person's part . . . which the person believes would negate the basis for designation." 31 C.F.R. § 501.807(a). The petitioner may submit "arguments or evidence" to satisfy its burden of proof. *Id.* However, the entity is only entitled to a review conducted solely on the basis of written submissions, without an opportunity to present witnesses or cross-examine USG witnesses. *Id.* (providing that the "submission must be made in writing"). Although designated entities "may request a meeting" with OFAC, "such meetings are not required, and the office may, at its discretion, decline to conduct such meetings." 31 C.F.R. § 501.807(b). Finally, the Treasury regulations do not establish deadlines for conducting the review.

<sup>20</sup> Under the IEEPA, an entity who is wrongly designated or whose assets are wrongly frozen by OFAC may seek relief pursuant to the Administrative Procedures Act (APA). 5 U.S.C. § 702. The APA provides that any federal court of competent jurisdiction may review agency actions that are final or made reviewable by statute. 5 U.S.C. §§ 703, 704.

<sup>21</sup> The APA narrowly limits the court's basis of review to the administrative record as presented by OFAC, including any normally inadmissible evidence. 5 U.S.C. § 706; *Holy Land Found. for Relief & Dev. v. Ashcroft*, 219 F. Supp. 2d 57, 67 (D.C. Cir. 2002) ("the Court does not undertake its own fact-finding" but "review[s] the administrative record assembled by the agency to determine whether its decision was supported by a rational basis"). As usual, OFAC may submit evidence *ex parte* and *in camera* for judicial review. 50 U.S.C. § 1702(c).

<sup>22</sup> Extraordinary judicial deference is given to OFAC actions. *See Global Relief Found.*, 207 F. Supp. 2d at 793 (in cases involving foreign policy and national security, courts are "particularly obliged to defer to the discretion of executive agencies interpreting their governing law and regulations" (quoting *Paradissiotis v. Rubin*, 171 F.3d 983, 988 (5th Cir. 1999))).

<sup>23</sup> Under the APA, the scope of the court's review is restricted to evaluating the procedural reasonableness of OFAC's actions, meaning whether such actions are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law"; "contrary to constitutional right, power, privilege, or immunity"; "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right"; "without observance of procedure required by law"; "unsupported by substantial evidence"; or "unwarranted by the facts." 5 U.S.C. § 706(2). *See Holy Land Found.*, 219 F. Supp. 2d at 66-67 ("In making this determination, the Court must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." (quoting *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 416 (1971))). What's more, determinations of national security have been held to be non-justiciable political questions. *See Regan v. Wald*, 468 U.S. 222 (1984) ("[m]atters related 'to the conduct of foreign relations . . . are so exclusively entrusted to the political branches of government as to be largely immune from judicial inquiry or interference.'" (quoting *Harisiades v. Shaughnessy*, 342 U.S. 580, 589 (1952))), *quoted in Global Relief Found.*, 207 F. Supp. 2d at 787-88.

<sup>24</sup> *See Benevolence Int'l Found., Inc. v. Ashcroft*, 200 F. Supp. 2d 935 (N.D. Ill. 2002); *Global Relief Found. v. O'Neill*, 205 F. Supp. 2d 885 (N.D. Ill. 2002). *See also* Press Release, U.S. Dep't of Treas. Off. of Pub. Aff., Treasury Designates Benevolence International Foundation and Related Entities as

September 2004, OFAC froze the assets of Al-Haramain USA.<sup>25</sup> The next month, the Islamic American Relief Agency was shut down as well.<sup>26</sup> Most recently, OFAC blocked KindHearts USA, in February 2006,<sup>27</sup> and the Goodwill Charitable Organization, in July 2007.<sup>28</sup>

### **Tumbling Down the Rabbit Hole: The Limbo of Frozen Funds**

Once OFAC had frozen the HLF's assets, all of the organization's charitable activities came to a dead halt. Its assets are frozen indefinitely,<sup>29</sup> and OFAC has denied the HLF's requests to transfer some of its funds to other charities.

In general, all frozen charitable funds are subject to rules that give OFAC unfettered discretion to decide when they will or will not release the funds. This includes discretion over the right to use funds to pay for legal counsel. Debiting a frozen account for any purpose at all requires a license, and the issuance of licenses and the application of conditions thereto are discretionary and carried out on an *ad hoc* basis.<sup>30</sup> OFAC has permitted some limited activities in the past, though few and far between.<sup>31</sup> But even if a charity is able to secure permission, OFAC can modify or revoke the license at any time

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Financiers of Terrorism (Nov. 19, 2002), available at <http://www.treas.gov/press/releases/po3632.htm> ; Press Release, U.S. Dep't of Treas. Off. of Pub. Aff., Treasury Department Statement Regarding the Designation of the Global Relief Foundation (Oct. 22, 2002), available at <http://www.treas.gov/press/releases/po3553.htm>.

<sup>25</sup> Press Release, U.S. Dep't of Treas. Off. of Pub. Aff., U.S.-Based Branch of Al Haramain Foundation Linked to Terror: Treasury Designates U.S. Branch, Director (Sept. 9, 2004), available at <http://www.treas.gov/press/releases/js1895.htm>.

<sup>26</sup> Press Release, U.S. Dep't of Treas. Off. of Pub. Aff., Treasury Designates Global Network, Senior Officials of IARA for Supporting bin Laden, Others (Oct. 13, 2004), available at <http://www.treasury.gov/press/releases/js2025.htm>. See also See Nate Carlisle & Mike Wells, *Federal Agents Raid Columbia, Mo.-based Islamic Charity*, COLUM. DAILY TRIB., Oct. 14, 2004 (pg. unavail.).

<sup>27</sup> Press Release, U.S. Dep't of Treas., Treasury Freezes Assets of Organization Tied to Hamas (Feb. 19, 2006), available at <http://www.ustreas.gov/press/releases/js4058.htm>.

<sup>28</sup> Press Release, U.S. Dep't of Treas. Off. of Pub. Aff., Twin Treasury Actions Take Aim at Hizballah's Support Network (July 24, 2007), available at <http://www.treas.gov/press/releases/hp503.htm>.

<sup>29</sup> See OMB WATCH, MUSLIM CHARITIES AND THE WAR ON TERROR 6 (2006) (available at [http://www.ombwatch.org/pdfs/muslim\\_charities.pdf](http://www.ombwatch.org/pdfs/muslim_charities.pdf)) [hereinafter OMB WATCH, MUSLIM CHARITIES].

<sup>30</sup> The IEEPA allows the President to regulate the use of frozen assets through the issuance of licenses. 50 U.S.C. § 1702(a)(1). In general, debiting a frozen account of blocked entities requires permission from OFAC in the form of a license. Pursuant to the authority delegated to it by the President, OFAC has promulgated regulations governing the issuance of general and specific licenses. See 31 C.F.R. § 501.801. Nevertheless, the issuance of licenses and the application of conditions thereto are discretionary and carried out on an *ad hoc* basis. See, e.g., 31 C.F.R. § 595.506 (providing that specific licenses for provision listed legal services to SDGTs "may be issued, on a case-by-case basis").

<sup>31</sup> For example, OFAC may issue licenses authorizing a designated entity to access frozen funds for paying attorneys' fees. 31 C.F.R. § 595.506. See *Global Relief Found.*, 207 F. Supp. 2d at 786. Alternatively, a blocked entity may pay attorneys' fees from extra-jurisdictional "fresh funds" – that is, funds drawn from unblocked foreign sources, such as foreign bank accounts held at non-U.S. financial institutions. See William B. Hoffman, *How to Approach a New Office of Foreign Assets Control Sanctions Program*, 27 STETSON L. REV. 1413, 1422-23 (1998).

it wishes.<sup>32</sup> For a variety of other activities, OFAC has categorically denied licenses, including for payment of operational expenses,<sup>33</sup> transfers of blocked assets to ostensibly legitimate charities,<sup>34</sup> receipt of blocked funds to satisfy court judgments,<sup>35</sup> retention of counsel on a contingency basis,<sup>36</sup> or appointment of a custodian to care for blocked assets.<sup>37</sup>

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<sup>32</sup> Even after issuance, licenses are modifiable and revocable at OFAC's discretion. 31 C.F.R. § 501.803.

<sup>33</sup> OFAC may issue licenses authorizing a blocked entity to access frozen funds to pay administrative overhead costs and to settle outstanding debts. 31 C.F.R. § 501.801 (authorizing specific licenses on a case-by-case basis). See Nicole Nice-Petersen, Note, *Justice for the "Designated": The Process That Is Due to Alleged U.S. Financiers of Terrorism*, 93 GEO. L.J. 1387, 1406, n.142 (2005). In terms of the operations of humanitarian relief organizations and grantmaking institutions, however, President George W. Bush specifically foreclosed the issuance of licenses for making donations "by, to, or for the benefit of" any blocked entity. See Exec. Order No. 13,438, 72 FED. REG. 39719, 39719 (July 17, 2007) (prohibiting donations of "funds, goods, or services"); Exec. Order No. 13,372, 70 FED. REG. 8499, 8499 (Feb. 16, 2005) (amending Executive Orders 13,224 and 12,947 to prohibit donations of "articles, such as food, clothing, and medicine, intended to be used to relieve human suffering"). The IEEPA expressly exempts donations of humanitarian relief aid from the President's regulatory authority unless "the President determines that such donations . . . would seriously impair his ability to deal with any national emergency . . . or . . . would endanger Armed Forces of the United States which are engaged in hostilities . . ." 50 U.S.C. § 1702(b)(2). Executive Orders 13,438 and 13,372 represent such a determination.

<sup>34</sup> In the past, OFAC has refused to grant licenses authorizing the transfer of blocked assets to seemingly legitimate charities due to concerns that such funds can be at least partially diverted to terrorist activities and that OFAC has limited ability to monitor the use of funds overseas. See NAT'L COMM'N ON 9-11, MONOGRAPH 101. In one highly publicized case, *Benevolence International Foundation, Inc. v. Ashcroft*, a blocked charity sought a license to transfer \$700,000 to \$800,000 of its blocked funds to overseas charitable causes, even offering to have Treasury officials escort the money to the intended recipient and monitor its eventual use. NAT'L COMM'N ON 9-11, MONOGRAPH 101. Predictably, OFAC denied the license. *Id.* The report by the National Commission on 9-11 recounts that the charities' legal bills ended up consuming the majority of the frozen funds, which infuriated donors who had donated the funds with the intentions that they be applied towards humanitarian relief aid. *Id.* See Gregory Vistica, *Frozen Assets Going to Legal Bills*, WASH. POST, Nov. 1, 2003, at A6.

<sup>35</sup> OFAC has also denied licenses to individuals wanting to receive blocked funds to satisfy judgments they have obtained against blocked entities. See *Sage Realty Corp. v. U.S. Dep't of Treas.*, No. 99 CIV. 3718(RJW), 2000 WL 272192, at \*6 (S.D.N.Y. Mar. 10, 2000) (holding that OFAC did not abuse its discretion in denying a license to plaintiff property-management company to levy against a blocked Yugoslav bank account in order to execute a court judgment obtained by the plaintiff against a blocked entity).

<sup>36</sup> OFAC may refuse to authorize the retention of counsel on a contingency basis that would entail payment of attorneys' fees by a blocked entity from any funds recovered by settlement or judgment. See *Beobanka d.d. Belgrade v. United States*, No. Nos. 95 Civ. 5138 (HB), 95 Civ. 5771 (HB), 1997 WL 23182, at \*1 (S.D.N.Y. Jan. 22, 1997) (upholding OFAC's denial of applications to retain counsel to be paid either on a contingency basis from blocked funds recovered by settlement or judgment). Restrictions on the method of payment of counsel have been found not to deprive a litigant of due process of law. See *id.* at \*1-2. Such restrictions are upheld against equal protection challenges if they are rationally related to the advancement of legitimate governmental purposes. *Heller v. Doe*, 509 U.S. 312, 319-20 (1993).

<sup>37</sup> In contrast to section 12 of the IEEPA's statutory predecessor, the Trading with the Enemy Act (TWEA), Pub. L. No. 65-91, ch. 106, 40 Stat. 411 (1917) (codified as amended at 50 App. U.S.C. §§ 1-44 (2006)), which explicitly authorized appointment of an "alien property custodian" to coordinate and administer the seizure and holding of property, the IEEPA is silent as to the Government's duty of



Rather than permitting a charity to transfer its donated assets to other charitable organizations, the Government is entitled to sit on the funds for an extended period of time or to use them for various instrumental policy purposes.<sup>38</sup> Although, presumably, an entity in this position would be able to challenge a long-standing freeze as an unconstitutional taking without just compensation, courts have thus far held that a temporary restriction on assets does not constitute an uncompensated taking.<sup>39</sup>

Even if a charity were successful in mounting a takings challenge to a prolonged freeze, nothing prohibits OFAC from simply releasing and simultaneously “re-freezing” the targeted property by publishing notice in the *Federal Register* and thereby reinitiating the entire process without ever returning the property to the organization. Alternatively, if freezing assets becomes too procedurally burdensome, OFAC can always forfeit title to the property without needing to comply with the normal<sup>40</sup> due process requirements afforded to property owners by federal forfeiture laws.

While the HLF was left to grapple with this procedural morass, the U.S. Department of Justice was busy preparing an indictment of the charity on criminal charges,<sup>41</sup> and elsewhere federal judges were handing down decisions permitting the families of Hamas victims to raid hundreds of millions in compensatory damages from

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maintenance of and care for blocked assets. At least one court has held that Congress’s omission of a custodian provision indicates a lack of congressional intent to carry the custodian provision over from the TWEA and that, as such, the IEEPA imposes no obligation on OFAC to provide custodial agents for assets during seizure periods. See *Milena Ship Mgmt. Co.*, 995 F.2d at 625 (5th Cir. 1993) (holding that OFAC had no implied duty of maintenance and care with respect to vessels blocked under the former Republic of Yugoslavia embargo program). See also Rudolph Lehrer, Comment, *Unbalancing the Terrorists’ Checkbook: Analysis of U.S. Policy in its Economic War on International Terrorism*, 10 TUL. J. INT’L & COMP. L. 333, 343 (2002). As a corollary, OFAC likely has no duty to ensure the integrity of seized property under its control or to compensate third parties for incidental damages resulting from a freeze and could foreseeably return to the owner property that was blocked in error in a damaged condition. That the Government has no duty to compensate innocent third parties for incidental damage to their property caused by blocking orders is also clear. See *Rockefeller Ctr. Props. v. United States*, 32 Fed. Cl. 586, 591-94 (1995) (holding that a blocking order preventing a landlord from evicting his tenant and from drawing on a letter of credit did not constitute unconstitutional takings within the meaning of the Fifth Amendment, given the importance of the public interest served by presidential actions carried out under the IEEPA).

<sup>38</sup> These purposes include retaining a pool of blocked assets to use as leverage in negotiating the resolution of the broader defensive policy objective underlying the freezing regime or to settle claims of U.S. nationals against the target nation or entity. See Sokol Braha, *The Changing Nature of U.S. Sanctions Against Yugoslavia*, 8 MSU-DCL J. INT’L L. 273, 287 (1999).

<sup>39</sup> *Global Relief Found.*, 207 F. Supp. 2d at 802 (besides the fact that takings challenges may only be brought in the Federal Court of Federal Claims under the Tucker Act, a “temporary blocking of assets does not constitute a taking”); *DC Precision, Inc. v. U.S. Government*, 73 F. Supp. 2d 338, 343 n.1 (S.D.N.Y. 1999).

<sup>40</sup> When the USG is engaged in armed hostilities with a foreign country or foreign nationals, the President is empowered to forfeit “any property, subject to the jurisdiction of the United States, of any foreign person, foreign organization, or foreign country that he determines has planned, authorized, aided, or engaged in such hostilities or attacks against the United States.” 50 U.S.C. § 1702(a)(1)(C). Section 316(d) of the USA PATRIOT Act (amending 18 U.S.C. § 983(i)(2)(D)) explicitly exempts such forfeiture actions from the procedural safeguards of the federal civil forfeiture laws.

<sup>41</sup> See Indictment, *United States v. Holy Land Found. for Relief & Dev.*, 2005 WL 4902463 (N.D. Tex. 2004) (No. 3:04-CR-240-G).

the HLF's frozen accounts.<sup>42</sup> By the time the Government was finished with the charity, it practically existed only in name.

At the end of the day, however, it appears that the Government may have been overzealous in its drive to rout the HLF. In a recent turn of events in what was widely viewed as the Government's "flagship terror-financing case," a Texas jury was unable to reach a verdict in the criminal case against the HLF and its leaders, and on October 22, 2007, the judge declared a mistrial.<sup>43</sup> But even if the HLF is eventually acquitted or the charges dropped, its assets will remain frozen *ad infinitum*, with OFAC not being required to take the HLF off its list of designated organizations. That means that the intended beneficiaries of the HLF's relief-aid programs will remain without the help that the charity's donors meant for them to have.

### **A Twist of Irony: Protections for the Assets of Accused Drug Traffickers**

Our experience with prosecuting narcotics traffickers and shutting down organized crime syndicates teaches us that we can avoid these due process quandaries raised by the asset-freezing regime. In other words, it turns out that we can effectively protect due process rights *and* bring the guilty to justice at the same time. Take, for example, the ongoing case of the Black Mafia Family (BMF).

Until recently, the BMF, a nationwide street gang entrenched in several cities, including Atlanta, Detroit, Houston, and Los Angeles, operated a highly sophisticated drug-distribution network in a multi-state region that included California, Florida, Georgia, Kentucky, Michigan, Mississippi, and Texas.<sup>44</sup> The BMF trafficked multi-kilogram quantities of cocaine and marijuana from Mexico into the United States, then ran the proceeds of their drug-trafficking operations through various bank accounts and money-wiring services and acquired fleets of luxury vehicles, high-value real estate, and opulent jewelry as a way of concealing the illicit sources of their money.<sup>45</sup> During its fifteen years in operation,<sup>46</sup> the criminal enterprise had managed to launder more than \$270 million in drug money.<sup>46</sup> At the height of its infamy and as a testament to its nearly two-decade reign of terror and crime, the BMF had billboards towering over Atlanta that brazenly proclaimed, "The world is ours."<sup>47</sup>

In October 2005, the Government dealt a death blow to the once-flourishing drug empire when the U.S. Drug Enforcement Administration (DEA) raided the BMF,

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<sup>42</sup> See *Estates of Ungar ex rel. Strachman v. Palestinian Auth.*, 304 F. Supp. 2d 232, 241-43 (D.R.I. 2004); *Boim v. Quranic Literacy Inst.*, 127 F. Supp. 2d 1002, 1021 (N.D. Ill. 2001).

<sup>43</sup> Leslie Eaton, *U.S. Prosecution of Muslim Group Ends in Mistrial*, N.Y. TIMES, Oct. 23, 2007, at A1.

<sup>44</sup> See S.A. Reid, *Atlantans Charged in Cocain Ring: 'Black Mafia' Had Ties to Rap Music, Officials Say*, ATLANTA J. CONST., Oct. 30, 2005, at E4; Staff, *Cocaine Trafficking Ring Broken by Feds*, DAILY NEWS (L.A.), Oct. 29, 2005, at N6.

<sup>45</sup> See S.A. Reid, *supra* note 44, at E4.

<sup>46</sup> *Id.*

<sup>47</sup> Press Release, U.S. Dep't of Just., *Sixteen Members of Black Mafia Family Charged in Cocaine Distribution Conspiracy* (July 25, 2007), available at <http://www.usdoj.gov/usao/gan/press/2007/07-25-07.pdf>.

arresting some thirty members of the gang.<sup>48</sup> During the raids, the DEA seized over \$10 million in assets as well as 9.5 kilograms of cocaine.<sup>49</sup> Over the next two years, the Government issued a series of indictments against members of the gang, including conspiracy to distribute cocaine and conspiracy to launder illegally obtained funds.<sup>50</sup> As icing on the cake, the Government sought to forfeit millions worth of the gang's assets.<sup>51</sup> Spelling out the obituary of the BMF, U.S. Attorney David E. Nahmias declared, "A combined effort by federal, state, and local law enforcement has brought to an end an infamous chapter of drug dealing and gang violence that affected this country literally coast to coast."<sup>52</sup>

The prosecutions of the BMF were a triumph indeed. Despite the aggressive posturing, however, federal prosecutors were bound to afford these notorious criminals with due process, including during the Government's forfeiture actions. In fact, by most measures, the due process safeguards available to one of the most sinister criminal enterprises in recent U.S. history far outstrip the minimal procedural protections afforded to charities like the HLF under the current asset-freezing regime.

First off, in contrast to the IEEPA's permissiveness about providing an entity with notice of a freeze, the Civil Assets Forfeiture Reform Act (CAFRA)<sup>53</sup> (which, as the name implies, governs all federal civil forfeitures) imposes strict notice and filing requirements as a way of curbing prosecutorial abuse.<sup>54</sup> Under CAFRA, the Government has to comply with tight deadlines for filing civil judicial complaints and commencing civil or criminal actions once it seizes an entity's assets.<sup>55</sup> If the Government misses even

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<sup>48</sup> See Press Release, U.S. Drug Enforcement Admin., DEA Deals Motor City Mafia a Knock-out Blow: Detroit Drug Legends Facing Twenty Years to Life (Oct. 28, 2005), available at <http://www.usdoj.gov/dea/pubs/pressrel/pr102805.html>.

<sup>49</sup> *Id.*

<sup>50</sup> See Press Release, U.S. Drug Enforcement Admin., 16 Additional People Indicted in Large Scale Drug and Money Laundering Case (June 15, 2006), available at <http://www.usdoj.gov/dea/pubs/states/newsrel/detroit061506.html>.

<sup>51</sup> See *id.*; Press Release, U.S. Drug Enforcement Admin., Major Drug Trafficker Connected To Black Mafia Family (BMF) Gets Life Sentence (May 4, 2007), available at <http://www.usdoj.gov/dea/pubs/states/newsrel/atlanta050407.html>. See also *United States v. One 2003 Hummer H2, VIN: 5GRGN23U03H109783*, No. 06-11733, 2006 WL 3386565 (E.D. Mich. Nov. 21, 2006) (reviewing the Government's attempt to forfeit a Hummer belonging to Stanley Lackey, one member of the BMF).

<sup>52</sup> Press Release, U.S. Dep't of Just., *supra* note 47.

<sup>53</sup> Civil Asset Forfeiture Reform Act of 2000 (CAFRA), Pub. L. No. 106-185, 14 Stat. 202 (codified as amended at various sections of 8, 18, 21, 28, 31, and 42 U.S.C.).

<sup>54</sup> See Stefan D. Cassella, *The Civil Asset Forfeiture Reform Act of 2000: Expanded Government Forfeiture Authority and Strict Deadlines Imposed on All Parties*, 27 J. LEGIS. 97, 125 (2001) [hereinafter Cassella, *CAFRA 2000*] ("The enactment of CAFRA was, in part, a reaction to the perception that there was some inequity in imposing strict deadlines and sanctions on property owners contesting civil forfeiture actions, while not imposing similar deadlines and sanctions on the government. The logic was that if property owners were required to file claims within a fixed period of time, and were made to suffer consequences for failing to do so, the government should face deadlines and suffer consequences as well.").

<sup>55</sup> In general, the Government has sixty days from the date of the seizure of the property to send notice of the forfeiture action to all interested parties. 18 U.S.C. § 983(a)(1). Once the Government files a

one of its deadlines, it has to “promptly release the property pursuant to regulations promulgated by the Attorney General” and will be barred from taking “any further action to effect the civil forfeiture of such property in connection with the underlying offense.”<sup>56</sup>

What’s more, CAFRA entitles the average Mafioso to contest the pending forfeitures of his property in a federal court<sup>57</sup> – and not just by one, but by three, different remedies: by claiming that the pending forfeiture would cause hardship,<sup>58</sup> amount to disproportional punishment,<sup>59</sup> or deprive an innocent owner of his property.<sup>60</sup> Once at trial, instead of enjoying a presumption in favor of its allegations, the Government bears the burden<sup>61</sup> of proving the forfeitability of the targeted property by a preponderance of the evidence.<sup>62</sup> CAFRA also prevents the Government from admitting into court any hearsay or other evidence scavenged from news reports or dredged up from garbage bins in order to satisfy its evidentiary burden.

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civil judicial complaint, property owners have thirty days from the last date of publication to file a claim to the property and twenty days from the filing of the claim to file and answer. 18 U.S.C. § 983(a)(2); § 983(a)(4). If a claim is filed, the Government has ninety days either to commence either a civil or criminal forfeiture action in federal court or to return the property to the owner. 18 U.S.C. § 983(a)(3). However, if no one files a claim challenging the forfeiture within thirty days, the Government can declare the property forfeited by default. 19 U.S.C. § 1609.

<sup>56</sup> 18 U.S.C. § 983(a)(3)(B).

<sup>57</sup> A claim must be filed no later than thirty days either after the Government serves the complaint or after the date of final publication of the notice of the filing of the complaint. 18 U.S.C. § 983(a)(4)(A).

<sup>58</sup> Under the hardship remedy, a claimant may file a petition for the release of seized property with the seizing authority, asserting that the property should be released to the claimant pending trial to avoid hardship. 18 U.S.C. § 983(f). A claimant must show that, among other things, he has filed a claim to the property, he has a possessory interest in the property, and the Government’s continued possession will cause hardship outweighing the risk that the property will be made unavailable for forfeiture upon its return to the claimant. 18 U.S.C. § 983(f)(1). If the seizing agency fails to grant the petition within fifteen days, the claimant may file the petition in the federal court sitting in the district either where the property was seized or where the seizure warrant was issued. 18 U.S.C. § 983(f)(3).

<sup>59</sup> A claimant may challenge the forfeiture on the ground that it is grossly disproportionate to the gravity of the crime. 18 U.S.C. § 983(g). This provision essentially codifies the U.S. Supreme Court’s ruling in *United States v. Bajakajian*, 524 U.S. 321 (1998), which held that any forfeiture that is grossly disproportional to the gravity of the offense violates the Excessive Fines Clause of the Eighth Amendment. The claimant bears the burden of establishing the violation. 18 U.S.C. § 983(g)(3). Moreover, the determination is a matter of law to be decided by a court rather than by a jury. *Id.*

<sup>60</sup> Pursuant to the innocent owner defense, a person who held a property interest at the time of the alleged crime bears the burden of proving either that he was unaware that his property was being employed for an illegal purpose or that, upon learning of the illegal use, he “did all that reasonably could be expected under the circumstances to terminate such use of the property.” 18 U.S.C. § 983(d)(2).

<sup>61</sup> 18 U.S.C. § 983(c)(1). If the government’s theory of forfeiture is that the property was used to facilitate a criminal offense or was involved in such offense, the government must prove a “substantial connection between the property and the offense.” 18 U.S.C. § 983(c)(3).

<sup>62</sup> Although hearsay may be used to establish probable cause, it is not admissible for establishing the forfeitability of the property by a preponderance of the evidence. 18 U.S.C. § 983(c)(1). However, the government is explicitly permitted to use evidence “gathered after the filing of a complaint for forfeiture” to meet its burden of proof at trial. U.S.C. § 983(c)(2). Nevertheless, the Government must still have had enough evidence to establish probable cause at the time of filing or seizure. *See* 146 CONG. REC. H2040-01,

If the BMF were unable to pay for lawyers, CAFRA would guarantee that these drug lords are not deprived of their right to counsel.<sup>63</sup> Even though CAFRA prevents drug traffickers and other property claimants from using seized assets to pay for counsel,<sup>64</sup> the court can appoint attorneys to represent criminal defendants in their civil forfeiture proceedings.<sup>65</sup> When it comes to a gangster's multi-million-dollar mansions, the judge is required to afford a court-appointed attorney.<sup>66</sup> And if the trafficker eventually wins his case, CAFRA obligates the Government to pay his attorneys' fees and litigation costs.<sup>67</sup>

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at H2050 (daily ed. Apr. 11, 2001) (statement of Rep. Hyde); Cassella, *CAFRA 2000*, *supra* note 54, at 108-09.

<sup>63</sup> Criminal defendants have no constitutional due process right under the Sixth Amendment to legal fees from forfeited or forfeitable funds. *See Caplin & Drysdale, Chartered v. United States*, 491 U.S. 617, 622-23 (1989) (holding that the Sixth Amendment is not violated by preventing a criminal defendant from using forfeitable assets to pay attorneys' fees). *See also United States v. Payment Processing Ctr.*, 439 F. Supp. 2d 435, 441, n.3 (E.D. Pa. 2006) ("In a criminal case, of course, an indigent defendant would be eligible for court-appointed counsel. Thus, a criminal defendant's inability to access property subject to forfeiture does not deprive the defendant of his right to counsel."). However, restrictions on a defendant's right to retain counsel in civil cases, where defendants are not entitled to court-appointed counsel, may deny a defendant his or her right to due process and access to the courts. Indeed, without provision for counsel or entitlement to recovery of legal fees in civil forfeiture cases, overzealous prosecutors could choose "to pursue the forfeiture in a civil proceeding rather than as part of [a] criminal case in order to deprive the claimant of his right to counsel." 146 CONG. REC. S1753-02 (daily ed. Mar. 27, 2000) (statement of Sen. Leahy in support of the passage of CAFRA). By enacting CAFRA, Congress sought to plug this due process loophole. *See id.*

<sup>64</sup> *See United States v. Melrose E. Subdiv.*, 357 F.3d 493, 501, 508 (5th Cir. 2004) (denying claimant's motion to release restrained funds needed to retain an attorney in a related criminal case, upon finding that the government had met its burden of having to show probable cause at a post-restraint hearing to believe that the restrained assets were forfeitable).

<sup>65</sup> CAFRA permits courts to authorize judicially appointed counsel to represent indigent criminal defendants in related federal civil forfeiture proceedings. 18 U.S.C. § 983(b)(1). While the determination of whether to authorize representation is discretionary, *id.* (providing that "the court *may* authorize counsel" (emphasis added)), such a determination is made by an independent judge according to comprehensible criteria: Judges are directed to weigh both the claimant's standing to contest the forfeiture and whether the claim appears to be made in good faith. *Id.*

<sup>66</sup> When the Government seeks to forfeit an indigent claimant's primary residence, the court must afford the person with representation. 18 U.S.C. § 983(b)(2). In contrast to the discretionary nature of authorizations of counsel for criminal defendants in related civil cases, CAFRA provides that the court "shall insure that the person is represented by an attorney for the Legal Services Corporation" if "the property subject to forfeiture is real property that is being used by the person as a primary residence." *Id.* (emphasis added).

<sup>67</sup> CAFRA obligates the government to pay attorneys' fees and litigation costs in a civil forfeiture proceeding to all claimants, including those who are not provided with counsel, if the claimants "substantially prevail" on their claim. 28 U.S.C. § 2465(b)(1)(A). The government is not liable for attorneys' fees or litigation costs, however, if the claimant is convicted in a criminal case for which the interest of the claimant was subject to criminal forfeiture, 28 U.S.C. § 2465(b)(2)(B), or where multiple claims are filed and the government prevails on at least one claim while not contesting another. 28 U.S.C. § 2465(b)(2)(C). Similarly, if the government partially prevails in a civil proceeding, the court is required to reduce proportionally an award of attorneys' fees and costs. 28 U.S.C. § 2465(b)(2)(D). Moreover, where a reasonable cause for the seizure is apparent, the claimant is not entitled to attorneys' fees or costs. 28 U.S.C. § 2465(a)(2). Finally, some commentators have argued that the attorneys'-fee provision is

When all is said and done, what happens to the forfeited Mafia property? As an example of forward-thinking public policy, CAFRA makes sure that assets do not simply rot away in some government warehouse but instead get put to socially productive use. Both the Department of Treasury and the Department of Justice maintain accounts where forfeited funds are deposited and later used to pay for various law-enforcement activities.<sup>68</sup>

### **Frozen Charitable Funds, Revisited**

The happy ending to the BMF story is that the civil forfeiture regime worked. The bad guys got it, and we didn't have to sacrifice the Constitution in the process – all of which raises the question: Why can't we do the same when freezing the assets of charities accused of having links to terrorism?

Some may still maintain that the cases of charities like the HLF are different. After all, we're dealing with international terrorism rather than domestic organized crime. Still, we've successfully dismantled international drug-trafficking rings without throwing out the Bill of Rights. Remember José "Chepe" Santacruz Londoño, the number three leader and reputedly most violent member of the infamous Cali Cartel, a Colombia-based cocaine trafficking empire that had been responsible for eighty percent of the world's cocaine supply up until the mid-1990s?<sup>69</sup> Using the U.S. civil forfeiture laws, along with

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inapplicable in cases where the government declines to file a forfeiture complaint, given that such cases do not involve "litigation." See Cassella, *CAFRA 2000*, *supra* note 54, at 113, n.91. The legislative history appears to support this view. See, e.g., 146 CONG. REC. H2040-01 (daily ed. Apr. 11, 2001) (statement of Rep. Hyde) ("The bill provides that property owners who substantially prevail in court proceedings challenging the seizure of their property will receive reasonable attorneys fees."); 145 Cong. Rec. S14612-05 (daily ed. Nov. 16, 1999) (statement of Sen. Hatch) ("If the government decides to pursue a civil forfeiture action instead of the more difficult to prove criminal forfeiture action, it should be obligated to pay the attorney fees and costs of the property owner when the property owner prevails."); 145 CONG. REC. S14612-05 (daily ed. Nov. 16, 1999) (statement of Sen. Leahy) ("For claimants who were not appointed counsel by the court, the Hatch-Leahy bill allows for the recovery of reasonable attorney fees and costs if they substantially prevail in court."). However, this reading of the statute has as of yet only been borne out in one circuit. See *Synagogue v. United States*, 482 F.3d 1058, 1062 (9th Cir. 2007) (construing 28 U.S.C. § 2465(b) as operative only upon "the conclusion of a court proceeding").

<sup>68</sup> Federal law authorizes the Department of Treasury to deposit assets seized and forfeited by the Treasury in a Treasury Forfeiture Fund (Treasury Fund). 31 U.S.C. § 9703(a) (2006). (The most recent audit report of the Treasury Fund can be accessed at <http://www.ustreas.gov/inspector-general/audit-reports/2006/oig06024.pdf>). The money in the Treasury Fund is available to the Secretary to fund various law-enforcement activities, including reimbursement of forfeiture-related expenses. 31 U.S.C. § 9703(a)(1). Federal law also permits assets forfeited or seized by the Department of Justice to be placed in a special Department of Justice Forfeiture Fund (DoJ Fund), from which the Attorney General can withdraw moneys for funding various law-enforcement activities. 28 U.S.C. § 524(c)(1). (The most recent financial statement of the DoJ Fund is available at <http://www.usdoj.gov/oig/reports/OBD/a0715.htm>). The Attorney General is required to deposit in the Department of the Treasury Forfeiture Fund "amounts appropriate to reflect the degree of participation of the Department of the Treasury" in Department of Justice forfeitures. 28 U.S.C. § 524(c)(10). However, when property is civilly or criminally forfeited in relation to a drug offense, federal law permits the Attorney General either to retain the property for official use, to transfer the property to another agency that participated in the seizure or forfeiture, to sell non-illicit or non-harmful property, to destroy the property, or to deliver the property to a state or federal agency for medical or scientific use. 21 U.S.C. § 881(e)(1).

<sup>69</sup> See Press Release, U.S. Drug Enforcement Admin., Arrest of Cali Mafia Leader Jose Santacruz-Londono (July 5, 1995), available at <http://justice.gov/dea/pubs/pressrel/pr950705.htm>.

all of their attendant due process safeguards, the U.S. Department of Justice assisted the Colombian Government in taking down the cartel by seizing and forfeiting the bank accounts that Santacruz Londoño used to launder his millions in illicit drug proceeds.<sup>70</sup> A similar fate befell international drug lord Gilberto “El Ajedrecista” Rodríguez Orejuela, founder of the Cali Cartel, when the U.S. Government forfeited approximately \$3 million in narcotics trafficking proceeds from his personal bank accounts.

This is not to say that fighting global terrorism is indistinguishable from the War on Drugs. Nor do I mean to blur the legal divide between civil asset forfeiture and asset freezing. But our victories in the War on Drugs have a lot to teach us.

We should start by trusting our court system’s remarkable ability to address the challenges posed by non-traditional threats, whether from international narcotics trafficking, money laundering, or terrorist financing. This means guaranteeing designated organizations and individuals the basic right to a fair hearing before a judge, where they are afforded a presumption of innocence and where they can confront their accusers and challenge all the evidence against them. This also means guaranteeing them legal representation, by permitting them to use seized assets to pay for legal expenses, providing them with court-appointed counsel, allowing them to retain counsel on a contingency basis, or employing some other reasonable method.

We might also listen to CAFRA’s lesson about putting forfeited assets to socially productive use. In the case of designated charities, donors have a justifiable interest in seeing their contributions put toward the charitable purposes for which they were originally donated.

The bottom line is that when the scores are tallied, the case for the asset-freezing regime’s exceptionalism looks pretty thin. Drastic limitations to the Bill of Rights are not necessary for successfully and decisively fighting terrorist financing. In other words, we can combat these threats to democracy without weakening the principles that make the defense of democracy a worthy cause.

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<sup>70</sup> See *United States v. All Funds on Deposit in Any Accounts Maintained in Names of Castro Meza or Rodriguez de Castro*, 856 F. Supp. 759 (E.D.N.Y. 1994).

<sup>71</sup> See *United States v. Banco Cafetero Pan.*, 797 F.2d 1154 (2d Cir. 1986).

**THE SHIFTING LANDSCAPE FOR  
AMERICAN NOT-FOR-PROFIT ORGANIZATIONS**

**Good Governance Practices  
for 501(c)(3) Organizations:  
Should the IRS Become Further Involved?**

**Thomas Silk<sup>1</sup>**

The board of directors in the United States is today composed of directors who are essentially part-time performers with other demanding responsibilities. So structured, the board is blind, except to the extent that the corporation's managers or independent gatekeepers advise it of impending problems.

--John C. Coffee Jr., *Gatekeepers: The Professions and Corporate Governance*, page 7 (2006)

**Introduction**

Should the IRS actively encourage good governance practices by exempt organizations?

The question is not entirely new. It was addressed directly some three years ago by former Commissioner Mark Everson, in his statement before the Senate Finance Committee on June 22, 2004.<sup>2</sup> Commissioner Everson stressed the need to improve coordination with the States, particularly with NASCO (the National Association of State Charity Officers), and requested expanded authority to share with state charity officials tax-exempt organization returns and related information. He recognized a “need to publicize practices that will help and encourage ... [exempt] organizations and their officers to prevent abuse,” and he announced the development by the IRS of a plain-language brochure that would “set-forth certain practices we believe will be useful in promoting good governance, ethics, and internal oversight.” The brochure was to be available in the fall of 2004.

Although the brochure seems to have gone missing, the governance project itself has recently shown signs of life. At a meeting of exempt organization councils, Marvin Friedlander, Manager, EO Technical Branch, mentioned the project which now had taken the form of “Good Governance Practices for 501(c) (3) Organizations” (GGP). On February 2, 2007, that document was published unofficially.<sup>3</sup>

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<sup>1</sup> Thomas Silk is senior counsel at Silk, Adler & Colvin, San Francisco. This article was originally published in the *Journal of Taxation*, Vol. 107, No. 1, p. 45 (July 2007).

<sup>2</sup> IR-2005-81.

<sup>3</sup> *EO Tax Journal* (vol. 12, no. 1, January/February 2007). (Hereinafter sometimes referred to as GGP.)



On April 27, Steven T. Miller, Commissioner, Tax Exempt and Governmental Entities, addressed the governance topic in his speech at the 24<sup>th</sup> Annual Conference on Representing and Managing Tax-Exempt Organizations, sponsored by Georgetown University. His reflective paper raised the question of “what the Service should do with governance practice.” He allowed that “it’s neither self-evident that we should get involved, nor obviously something we should avoid,” and he asked “whether it would benefit the public and the tax-exempt sector to require organizations to adopt and follow recognized principles of good governance.” “At a minimum,” he concluded, “we should educate on basic standards and practices of good governance and accountability. And we should strongly encourage the community in its efforts to formally elevate standards.... Someone needs to lead the sector on this issue. If not the IRS, then whom?”<sup>4</sup>

The debate in response to that question has been, and may continue to be, spirited. I have heard many practitioners argue that governance is the sole purview of state law, and that the IRS should stay away from the issue. My own view is that whether IRS guidance on charitable governance is or is not a good thing is beside the point. It is going to happen – either under this administration or the next.

It is not far-fetched to imagine a national scandal featuring a prominent charity in violation of standards of charitable governance, but incorporated in a state with inadequate charitable enforcement. In the congressional hearings that might follow, the IRS would surely be in a far more defensible position if it had already gone forward to educate the charitable sector about the importance of good governance practices than if it had not. Subsequent legislation introduced by a supportive Congress may easily resolve any jurisdictional ambiguities about governance of charitable organizations and enforcement.

That the IRS and Congress are marching in step on governance is suggested by recent events. In a letter dated May 29, 2007, from Senators Max Baucus and Chuck Grassley to Treasury Secretary Paulson, they note that “time and time again we have seen poor governance at the core of problems of charities.” They refer to a similar mention by Commissioner Everson in his letter to the Finance Committee in March, 2005, “Many of the situations in which we have found otherwise law-abiding organizations to be off-track stem from the failure of fiduciaries to appropriately manage the organization.” And the Senators conclude by noting that “Form 990 can serve a useful purpose of bringing a focus on governance issues both for the board and management of the charity as well as the public.”<sup>5</sup>

On June 14, the IRS released for public comment a discussion draft of a redesigned Form 990, containing, for the first time, extensive questions about governance. The core governance information portion of the draft of the redesigned Form 990 is found at Part III, page 4.

The same factors that are compelling state charity officials to expand their public education efforts, particularly through the medium of the Internet, are also at work within the IRS. The cost of enforcement of charitable and tax-related laws at the state and

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<sup>4</sup> *EO Tax Journal's Weekly Email Tax Service*, 05/01/2007, pp. 6-7.

<sup>5</sup> See Tax Analysts Doc. 2007-12969.

federal levels is substantial and is not declining. Widespread and effective educational efforts may significantly reduce enforcement needs. The Internet provides a low-cost, high-tech option for reaching a national audience,<sup>6</sup> and we are at the very early stages of discovering techniques that will further unleash the power of the Internet.

Although the IRS has available to it a broad variety of publication formats which it may use to educate about governance, including Form 990, Form 1023, and related instructions, none can match the taxpayer-friendly accessibility and immediacy of the Internet. The usefulness of the IRS website, [www.irs.gov/charities](http://www.irs.gov/charities), to exempt organization specialists continues to increase, particularly with the addition of the Internal Revenue Manual and articles from the Exempt Organization Continuing Professional Education Program. Informational features have recently been added, directed to members of the public who may want to learn about forming or operating a charity, including “Life of a Public Charity,” “Life of a Private Foundation,” and an online interactive workshop on exempt organizations ([www.stayexempt.org](http://www.stayexempt.org)) with, so far, five modules.

All this is irrelevant to the governance project, it may be objected, because the Commissioner has jurisdiction over federal tax-exempt organization matters but not over governance. It may be customary to think of the cluster of fiduciary duties as uniquely of state concern. But the truth is less narrow. Whether referred to as the duty of care or the duty of compliance, traditional fiduciary duty includes the duty to oversee and supervise compliance with federal tax laws as well as with state charitable and tax laws.

The purview of State Attorneys General and the IRS overlaps. The jurisdiction of State Attorneys General includes the prevention of waste of charitable assets, which may occur due to fines or penalties stemming from violations of federal tax laws as well as state laws. The jurisdiction of federal tax officials in enforcing federal tax-exempt organization laws extends to promoting compliance with those laws by directors and officers by providing guidance and information likely to enhance such compliance – including awareness of good governance practices.

It is surely in the public interest, and it may also be in the mutual interest of the IRS and NASCO, that good governance practices in the charitable sector, including high ethical standards and transparency, be encouraged. The solution may call for a joint effort. Perhaps IRS/EO and NASCO could join together and appoint a Task Force on Governance charged with producing *the Good Governance Guide for Charities*. Congress, in amending 6104 in 2006 to provide that the Service can disclose its audits to the Attorneys General, surely recognized this changing trend and the need for increased cooperation.

The complete text of the IRS's GGP draft follows, together with my comments on the GGP as well as on the governance provisions of the draft of the redesigned Form 990.

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<sup>6</sup> In its report on “High-Speed Services for Internet Access: Status as of June 30, 2006,” the FCC reported (pp. 1-4) that 65 million high-speed lines connect homes and businesses to the Internet, and in the prior 12-month period, high-speed lines had increased by 52%. Further, “more than 99% of the country’s population lives in the 99% of Zip Codes” where high-speed Internet services are available. [www.fcc.gov/web/stats](http://www.fcc.gov/web/stats).

### **Good Governance Practices for 501(c)(3) Organizations<sup>7</sup>**

The Internal Revenue Service believes that governing boards should be composed of persons who are informed and active in overseeing a charity's operations and finances. If a governing board tolerates a climate of secrecy or neglect, charitable assets are more likely to be used to advance an impermissible private interest. Successful governing boards include individuals not only knowledgeable and passionate about the organization's programs, but also those with expertise in critical areas involving accounting, finance, compensation, and ethics.

Organizations with very small or very large governing boards may be problematic: small boards generally do not represent a public interest and large boards may be less attentive to oversight duties. If an organization's governing board is very large, it may want to establish an executive committee with delegated responsibilities or establish advisory committees.

The Internal Revenue Service suggests that organizations review and consider the following to help ensure that directors understand their roles and responsibilities and actively promote good governance practices. While adopting a particular practice is not a requirement for exemption, we believe that an organization that adopts some or all of these practices is more likely to be successful in pursuing its exempt purposes and earning public support.

#### **Comment**

The first paragraph of GGP, on the composition of the governing body, contains sound advice – directors should exercise oversight in a manner that is informed and active; the board should avoid secrecy and neglect; and a governing body would be well-served by including one or more directors with expertise in the relevant areas of accounting, finance, compensation, and ethics.

The last clause, while well-intended, may produce unwanted results. An expertise qualification, while a realistic aim for boards of publicly traded companies, may be setting the bar too high for charitable organizations. The solution, I suggest, may be to broaden the qualification to “expertise, knowledge, or experience,” and to make plain that this is an ideal not always attainable in practice.

The second paragraph, addressing the structure of the governing body, warns against boards that are too large or too small. The cautionary note about large boards deserves at least another sentence to introduce the problem of trophy directors who fail to govern and to alert the more sophisticated reader to the interest taken by scholars in this problem and the solutions they propose.<sup>8</sup> The statement about small boards – “Small

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<sup>7</sup> Focus on IRS and Treasury, *EO Tax Journal* (vol. 12, no. 1, January/February 2007).

<sup>8</sup> Failure to Govern? The Disconnect Between Theory and Reality In Nonprofit Boards And How to Fix It, *Stanford Social Innovation Review* (Sept. 2005); Marion R. Fremont-Smith, *Governing Nonprofit Organizations: Federal and State Law and Regulations*, p. 433 (2004); Fishman and Schwarz, *Nonprofit Organizations: Cases and Materials*, p. 180 (2d Ed., 2002); American Law Institute, *Principles of the Law of Nonprofit Organizations*, p. 99-103 (Preliminary Draft 3, May 12, 2005).

boards generally do not represent a public interest” – is wrong and inappropriate. It should be deleted. The truth is that small boards come in many flavors, from the single trustee of a traditional charitable trust, to the few members on the board of a family foundation, to the start-up small charity that begins with a small board and seeks to grow, in time, with attentive and resourceful directors. It should also be noted that state laws authorize nonprofit boards with a single director.<sup>9</sup>

The third paragraph is important. While it contains the Service’s recommendation that directors actively promote good governance practices, it makes clear that “adopting a particular practice is not a requirement for exemption.”

Since all three paragraphs of this first topic concern the governing body, I recommend that this, the only untitled and un-numbered topic, be entitled “governing body,” and be given the first number.

The draft of the redesigned Form 990 asks the organization to provide the number of members of the governing body, the number of independent members, and whether it made any significant changes to its governing documents. It also asks whether the organization takes and maintains minutes of its governing body and related committees.

## **1. Mission Statement**

A clearly articulated mission statement that is adopted by an organization’s board of directors will explain and popularize the charity’s purpose and serve as a guide to the organization’s work. A well-written mission statement shows why the charity exists, what it hopes to accomplish, and what activities it will undertake, where, and for whom.

### **Comment**

Doubtless, most texts in Nonprofit Governance 101 recommend a mission statement. It does belong in a Guide to Good Governance.

By itself, the process of drafting and discussing such an aspirational statement can be stimulating and beneficial, but if the mission statement is to be more than that, if it is to serve as a core description of charitable identity and a map for the future, the charity needs to find a way to foster, among its directors, a continuing awareness of its goals and objectives.

This is often done by including the mission statement in the charity’s Code of Ethics and by requiring directors to sign an annual statement affirming that they have read, understood, and agree to comply with the Code of Ethics.

The GGP should warn against allowing the mission statement to migrate into the Articles of Incorporation or other organic documents. Traditionally, statements of purposes and powers in Articles of Incorporation were highly detailed. The modern practice in most states is to give the charity the greatest flexibility of operation by drafting purposes and powers clauses broadly, enabling the charity to be organized and operated for any of the purposes described in Section 501(c)(3), and permitting the charity to exercise powers as defined by comprehensive state-empowering statutes. An

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<sup>9</sup> See, e.g., Cal. Corp. Code §5120(a).

extreme example of the disabling impact of a restrictive purpose clause is a California case in which the Court ruled that the purpose clause of the Articles, which provided that the charity was to own and operate a hospital, prevented the charity from selling the hospital and operating medical clinics instead.<sup>10</sup>

Oddly enough, the governance provisions of the draft of the redesigned Form 990 do not ask whether the organization has a mission statement. I recommend that the Glossary in redesigned Form 990 contain this definition of a mission statement: “A statement explaining why the charity exists, what it hopes to accomplish, and what activities it will undertake, where, and for whom.” Further, the mission statement should be added to the list of documents contained on line 11 of Part III, page 4, of the redesigned Form.

## **2. Code of Ethics and Whistleblower Policies**

The public expects a charity to abide by ethical standards that promote the public good. The board of directors bears the ultimate responsibility for setting ethical standards and ensuring they permeate the organization and inform its practices. To that end, the board should consider adopting and regularly evaluating a code of ethics that describes behavior it wants to encourage and behavior it wants to discourage. The code of ethics should be a principal means of communicating to all personnel a strong culture of legal compliance and ethical integrity.

The board of directors should adopt an effective policy for handling employee complaints and establish procedures for employees to report in confidence suspected financial impropriety or misuse of the charity’s resources. Such policies are sometimes referred to as *whistleblower* policies.

### **Comment**

If the Board intends to make plain to everyone involved with the charity that the Board expects them to adhere to the highest ethical standards – and that following minimum legal requirements are not enough – the Code of Ethics should reflect that intent. Here is one version of a suitable provision for the Code of Ethics.

#### *Law and Ethics*

Charity shall comply with all applicable federal, state, and local laws and regulations and shall seek the advice of counsel when necessary or appropriate. Compliance with the law, however, is the minimum standard of expected behavior. Charity shall also adhere to the highest ethical standards. All resolutions and other legal actions by the Board of Directors and all actions by directors, officers, and employees shall satisfy two requirements: (1) they shall be legally permissible, and (2) they shall also reflect the highest ethical standards as determined by the person involved within such person’s best judgment.

It has become a best practice for nonprofit organizations to adopt a whistleblower policy that goes far beyond the criminal prohibitions imposed by law. The charity should

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<sup>10</sup> *Queen of Angels Hospital v. Younger*, 66 Cal. App. 3d 359 (1977).

be alerted, however, that laws of many states add whistleblower provisions, including required postings in the workplace. Those provisions should be integrated into any whistleblower policy the charity adopts.

Whistleblower policies tend to contain the following elements: (1) they encourage employees to be vigilant about possible illegal or unethical conduct at the state or federal level and to report that information; (2) they allow the report to be made anonymously; and (3) they assure employees that no retaliation, demotion, or other adverse action will be taken against any person who reports a good-faith concern and warn employees that they may not participate in retaliatory action.

Whether a whistleblower policy is expressed as part of the Code of Ethics or as a separate document is a matter of individual style. My preference is to include it in the Code of Ethics for the practical reason that the requirement of annual affirmation of the Code by each director may bring the whistleblower policy to the attention of those directors without the need to remember to affirm yet another document.

It is one thing to adopt appropriate policies, but it is equally, if not more important, to make sure that all board members are aware of the policies and that the policies are followed. Many of the for-profit corporations that have found themselves in the public spotlight during the past ten years had solid conflicts of interest and ethics policies in place, but they neglected to remember to actually follow them.

The draft of the redesigned Form 990 asks whether the organization has a written whistleblower policy, but it is silent as to a Code of Ethics. I recommend that line 11 of Part III be amended to include a Code of Ethics in the list of documents listed, and I recommend that the Glossary contain the following definition of a Code of Ethics: “A policy that expresses a commitment to ethical standards and may address matters such as transparency, accountability, diversity, and governance.”

### **3. Due Diligence**

The directors of a charity must exercise due diligence consistent with a duty of care that requires a director to act:

- In good faith;
- With the care an ordinarily prudent person in a like position would exercise under similar circumstances;
- In a manner the director reasonably believes to be in the charity’s best interests.

Directors should see to it that policies and procedures are in place to help them meet their duty of care. Such policies and procedures should ensure that each director:

- Is familiar with the charity’s activities and knows whether those activities promote the charity’s mission and achieve its goals;
- Is fully informed about the charity’s financial status; and
- Has full and accurate information to make informed decisions.

## **Comment**

There is a glaring omission from this general description of the duty of care in the GGP, and that is the complete absence of any mention of reliance provisions. Common law, nonprofit corporation statutes in most states, and the standards of conduct for directors in the Revised Model Nonprofit Corporation Act (1987) and the Proposed Model Nonprofit Corporation Act (Third Edition, 2006), permit a director to avoid duty of care liability if the director acts in reliance on individuals or committees under certain circumstances.<sup>11</sup>

Because fiduciary duties are interpreted frequently at the state rather than at the federal level, this topic would benefit by adding the views of NASCO representatives or appointees to those of IRS representatives or appointees.

The draft of the redesigned Form 990 makes no direct statement about the duty of care. Fiduciary duty is tested in another way, however, by determining how the organization responds to questions about conflict of interest policies and practices, compensation review, financial review, and other related detailed inquiries.

### **4. Duty of Loyalty**

The directors of a charity owe it a duty of loyalty. The duty of loyalty requires a director to act in the interest of the charity rather than in the personal interest of the director or some other person or organization. In particular, the duty of loyalty requires a director to avoid conflicts of interest that are detrimental to the charity. To that end, the board of directors should adopt and regularly evaluate an effective conflict of interest policy that:

- Requires directors and staff to act solely in the interests of the charity without regard for personal interests;
- Includes written procedures for determining whether a relationship, financial interest, or business affiliation results in conflict of interest; and
- Prescribes a certain course of action in the event a conflict of interest is identified. Directors and staff should be required to disclose annually in writing any known financial interest that the individual, or a member of the individual's family, has in any business entity that transacts business with the charity. Instructions to Form 1023 contain a sample conflict of interest policy.

## **Comment**

Adoption of conflict of interest policies by charitable organizations is encouraged today by a many sources. The Sarbanes-Oxley Act requires listed companies to adopt a conflicts policy, and the influence of that Act on nonprofit organizations has been substantial, particularly on large educational institutions and hospital foundations. Best practice codes recommend that charities adopt a conflicts policy.

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<sup>11</sup> See, e.g., Cal. Corp. Code §5231(b).

The content of conflicts policies is also changing. The traditional conflict of interest policy, emerging from corporate law, focused on validation, the procedures a Board must follow to permit a conflict of interest to exist. The modern conflicts policy requires disclosure of conflicts as a separate matter, entirely apart from validation. It contains remedies for failing to disclose conflicts. In the charitable sector, the concept of conflicts of interest is being transformed to reflect, as well, emerging ethical concerns. This is best illustrated by the treatment of conflicts of interest in the American Law Institute's project, *Principles of the Law of Nonprofit Organizations*, where a single-page conflict of interest text is followed by 50 pages of commentary and where conflicts policies reach beyond financial conflicts and include non-pecuniary conflicts as well.<sup>12</sup> Finally, the modern conflicts policy applies to directors, officers and employees, while the traditional policy applies only to directors.

The sample conflicts policy recommended by the IRS should be reviewed and revised to include non-pecuniary conflicts, to reach officers and employees as well as directors, and to contain an annual statement affirming that they have read, understood, and agree to comply with the conflict of interest policy.

The draft of the redesigned Form 990 asks whether the organization has a written conflict of interest policy, and how many transactions the organization reviewed under this policy during the year (lines 3a and 3b, Part III, page 4). The definition of conflict of interest policy in the glossary does not cover most employees but limits the policy to officers, directors, and managers. However, the definition of a conflict is broad, extending beyond financial benefits (a conflict exists whenever a covered person "may benefit personally from a decision he or she could make").

## **5. Transparency**

By making full and accurate information about its mission, activities, and finances publicly available, a charity demonstrates transparency. The board of directors should adopt and monitor procedures to ensure that the charity's Form 990, annual reports, and financial statements are complete and accurate, are posted on the organization's public website, and are made available to the public upon request.

### **Comment**

Comprehensive website disclosure – whereby nonprofit organizations strive toward maximum transparency of operations to the widest possible audience with a minimum of expenditure – has quickly become a best practice of nonprofit governance. Website disclosure may result from legal requirements. For example, the IRS requirement of tax-return disclosure for charities gives the taxpayer the choice of making its annual Form 990 or 990 PF available to anyone who requests it or, alternatively, posting it on the charity's website. California has also adopted the website-posting option for public disclosure of audited financial statements required by the Nonprofit Integrity Act of 2004.

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<sup>12</sup> Discussion Draft, April 6, 2006 (Disclosure: I am an adviser to that ALI Project.)



A charitable organization may benefit if it maximizes use of its website as a channel of information accessible to all who desire to be informed about the charity and its operations.<sup>13</sup>

I recommend that the following transparency policy be included in a Code of Ethics, adopted and enforced by the Board of Directors, and posted on the charity's website:

### *Transparency*

Charity shall provide comprehensive and timely information to the public, the media, and all stakeholders and shall be responsive to reasonable requests for information. All information about charity shall fully and honestly reflect its policies and practices. All financial and program reports shall be complete and accurate in all material aspects.

Basic financial and organizational information about charity, including the current Form 990 and the current audited financial statement, shall be posted on charity's website, along with this Code of Ethics, the Conflict of Interest Policy, the Articles of Incorporation (or other organizing document), and Bylaws.

The draft of the redesigned Form 990 addresses the transparency issue indirectly. It does not require outright that the organization make information available to the public. Instead, Part III, line 11, asks whether the organization makes available to the public its governing documents, conflict of interest policy, Form 990, Form 990-T, financial statements, audit report. The organization may check one of five boxes: not applicable, website, other website, office, or other.<sup>14</sup>

## **6. Fundraising Policy**

Charitable fundraising is an important source of financial support for many charities. Success at fundraising requires care and honesty. The board of directors should adopt and monitor policies to ensure that fundraising solicitations meet federal and state law requirements and solicitation materials are accurate, truthful, and candid. Charities should keep their fundraising costs reasonable. In

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<sup>13</sup> Taxpayers are also becoming aware that other websites can be used for marketing purposes. For example, Guidestar maintains a comprehensive database of tax returns of 501(c)(3) organizations, provided by the IRS ([www.guidestar.org](http://www.guidestar.org)). Sophisticated donors are turning to Guidestar's database for information about possible grantees. In turn, sophisticated donees, in recognition that the audience for the tax returns is not only the IRS but also possible donors, are expanding the description of their purposes and activities as described in Form 990, transforming it into a marketing publication for donors as well as an information return for the IRS; for an example, see Memorial Sloan-Kettering Cancer Center's Form 990 for 2004 at [www.guidestar.org](http://www.guidestar.org).

<sup>14</sup> Questions about written policies are not limited to Part III in the redesigned Form 990. For example, Part VII, lines 11 and 12, asks whether the organization has a written policy to review investments or participation in affiliates and whether it has a written policy requiring it to protect its exempt status as to transactions with affiliates.

selecting paid fundraisers, a charity should use those that are registered with the state and that can provide good references. Performance of professional fundraisers should be continuously monitored.

### **Comment**

This is a topic that could benefit from the help of NASCO. Other points might be made here, such as a reminder of the need to register in each state where the charity solicits funds.

The draft of the redesigned Form 990 contains a new Schedule G applicable to fundraising activities. The Schedule addresses fundraising activities generally, events, and gaming, requiring detailed financial information about each type of activity.

### **7. Financial Audits**

Directors must be good stewards of a charity's financial resources. A charity should operate in accordance with an annual budget approved by the board of directors. The board should ensure that financial resources are used to further charitable purposes by regularly receiving and reading up-to-date financial statements including Form 990, auditor's letters, and finance and audit committee reports.

If the charity has substantial assets or annual revenue, its board of directors should ensure that an independent auditor conduct an annual audit. The board can establish an independent audit committee to select and oversee the independent auditor. The auditing firm should be changed periodically (*e.g.*, every five years) to ensure a fresh look at the financial statements.

For a charity with lesser assets or annual revenue, the board should ensure that an independent certified public accountant conduct an annual audit.

Substitute practices for very small organizations would include volunteers who would review financial information and practices. Trading volunteers between similarly situated organizations who would perform these tasks would also help maintain financial integrity without being too costly.

### **Comment**

Only a few states currently require annual financial audits of nonprofit corporations, although that is changing.<sup>15</sup> Independent financial audits have become such a fundamental and essential test of the financial soundness of any corporate enterprise that all best practice codes of nonprofit governance require that every nonprofit corporation with substantial assets or annual revenue should be audited annually by an independent auditing firm.

Along with a mandatory audit requirement for nonprofit organizations of significant size, core best practices require that the board of directors appoint an audit

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<sup>15</sup> California, for example, did not mandate charitable audits until it enacted the Nonprofit Integrity Act of 2004, requiring financial audits of charities with annual gross revenues of \$2 million or more. [www.caag.state.ca.us/charities](http://www.caag.state.ca.us/charities)

committee. GGP should be revised to address the notion of an audit committee. The audit committee should be composed of one or more directors. All of the directors must be independent, in the sense that they may not be paid for services by the nonprofit corporation, aside from a reasonable honorarium. While audit committee members need not meet the SEC definition of an “audit committee financial expert,” it is desirable that at least one member should be knowledgeable, generally, about organizational financial matters.

The audit committee must have received delegated authority from the board to function effectively and independently of management.

Two provisions in the GGP warrant further discussion. The notion of changing the auditing firm every five years is a legacy from Sarbanes-Oxley. Like the requirement of including an expert on the board, this requirement to change auditing firms is neither practical nor appropriate for nonprofit organizations generally. The availability of auditing firms with the expertise to audit charities and the willingness to do so for a reduced fee is limited. Moreover, the costs to an accounting firm of creating a financial baseline for a new client are not insignificant. Many accounting firms spread those fees over a number of years. But if the expected life of a charitable client is to be limited to five years, the universe of available auditing firms may diminish even further.

Another solution should be sought so that the charity may benefit by a fresh auditing perspective. Changing the auditing partner but not the auditing firm may be worth considering. This may be an area where the insights of NASCO could be helpful. NASCO’s view might also be useful in evaluating the practicality of advising small charities to use volunteers to review financial information and to trade volunteers with similar organizations.

The draft of the redesigned Form 990 asks three questions about financial review: whether the organization has an audit committee, whether the financial statements are prepared by an insider or by an independent accountant, whether they take the form of a (checkoff) compilation, review, or audit, and whether the governing body reviews the Form 990 before filing (lines 8, 9, 10, Part III, page 4).

## **8. Compensation Practices**

A successful charity pays no more than reasonable compensation for services rendered. Charities should generally not compensate persons for service on the board of directors except to reimburse direct expenses of such service. Director compensation should be allowed only when determined appropriate by a committee composed of persons who are not compensated by the charity and have no financial interest in the determination.

Charities may pay reasonable compensation for services provided by officers and staff. In determining reasonable compensation, a charity may wish to rely on the rebuttable presumption test of section 4958 of the Internal Revenue Code and Treasury Regulation section 53.4958-6.

## **Comment**

This is one area where the charitable sector is far ahead of the for-profit sector. Most restrictions on the payment of compensation to corporate officials in the for-profit

sector are imposed by new corporate governance rules adopted by the New York Stock Exchange and other stock exchanges. The Sarbanes-Oxley limitations on compensation are modest and require the CEO and CFO to pay back bonuses or other incentive or equity-based compensation paid during the 12 months after financial statements are restated under certain circumstances.

In the charitable sector, by contrast, restrictions on the payment of excessive benefits, including unreasonable compensation, are imposed by federal tax law. To benefit from a presumption of reasonableness for insider compensation decisions, charities must base compensation decisions for chief executive officers, chief operating officers and chief financial officers on objective, documented comparable information. It is becoming a best practice for charities to rely on that type of information in determining the compensation paid to anyone if it is substantial, whether or not they happen to be a senior officer or other insider.

The draft of the redesigned Form 990 devotes two pages to detailed questions about compensation paid to insiders and to independent contractors (Part II, pages 2-3). This is a substantial change from the meager information requested on compensation by the current Form 990. This detailed information will give the IRS as well as state charity officials new tools to enforce existing prohibitions on excess compensation, and the disclosures (or lack thereof) may lead to new legislation or regulations.

## **9. Document Retention Policy**

An effective charity will adopt a written policy establishing standards for document integrity, retention, and destruction. The document retention policy should include guidelines for handling electronic files. The policy should cover backup procedures, archiving of documents, and regular check-ups of the reliability of the system. For more information see IRS Publication 4221, *Compliance Guide for 501(c)(3) Tax-Exempt Organizations*, available on the IRS website.

### **Comment**

This is a topic on which the input of NASCO would be particularly helpful. For example, the reference to IRS Publication 4221 tends to reinforce the notion that records need be kept only for three or four years, standard periods of limitation for federal income tax and employment tax records. But state laws differ widely. In California, for example, the limitation period applicable to actions by the Attorney General for violations of the charitable self-dealing statute is 10 years.<sup>16</sup> Relevant corporate records, including minutes and accounting records, should be kept for at least that long.

Document destruction policies can be a trap for the unwary. At the least, a reader should be advised that all document destruction should be halted the moment the charity knows it is being investigated by a federal or state law enforcement agency, and routine destruction should not be resumed without the written approval of legal counsel or the chief executive officer.

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<sup>16</sup> Cal. Corp. Code §5233(e).

The draft of the redesigned Form 990 asks whether the organization has a written document retention and destruction policy (line 5, Part III, page 4)

### **Conclusion**

The Service's interest in good governance practices of exempt organizations is expressed by statements of IRS officials, in the draft of Good Governance Practices, and in the draft of the redesigned Form 990, which adds, for the first time, questions about governance practices.

The governance questions on the draft form are not to be taken lightly. They are not asked as part of a benign poll of charitable organizations. They are backed with the full enforcement power of the federal government. Form 990 must be signed under penalties of perjury, requiring that the information be complete and truthful, to the best of the knowledge and belief of the signing officer. An incomplete or false statement made knowingly on Form 990 may be punishable as a civil matter (IRC § 6721), as a misdemeanor (IRC § 7207), or as a felony (IRC § 7206).

Practitioners would be well advised to counsel their exempt organization clients on the wisdom of (1) adopting good governance policies, (2) following them in practice, and (3) responding in a complete and truthful manner to the governance and other questions on the redesigned Form 990.

**THE SHIFTING LANDSCAPE FOR  
AMERICAN NOT-FOR-PROFIT ORGANIZATIONS**

**Governance Is Key Issue in Regulating Charities,  
IRS Official Tells State Leaders**

**Grant Williams<sup>1</sup>**

A top official of the Internal Revenue Service says the tax agency is sticking with its plan to ask charities a series of questions about their management and governance policies and practices on the IRS's new version of its Form 990 informational tax return, the primary tax document charities file each year.

"Some folks would argue that we have gone beyond where we should be going" with such questions, Lois G. Lerner, director of the Exempt Organizations Division of the IRS, told the annual meeting in Denver of the National Association of State Charity Officials on October 15.

"We disagree; we think that governance is a very big part of accountability," said Ms. Lerner. "There is some argument that this is only the purview of the states. The IRS believes it is your purview but it is also of interest to us."

The Internal Revenue Service in June released a new draft version of its Form 990 and is attempting to finish its overhaul of the form by the end of the year so that a final version can be used by charities by the beginning of 2009.

In Part III of the draft form, the IRS asks such new questions as:

- "Does the organization have a written conflict of interest policy? If Yes, how many transactions did the organization review under this policy and related procedures during the year?"
- "Does the organization have a written whistleblower policy?"
- "Does the organization have an audit committee?"

Ms. Lerner said governance policies are one factor that figure into "risk models" that the IRS uses to help decide "which organizations we should use our scarce resources on" when selecting charities for review.

"The IRS has been involved in governance for a long time," Ms. Lerner said. "When you talk about charities operating in a charitable manner, you are talking about governance."

**How Is Compensation Set?**

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<sup>1</sup> From *The Chronicle of Philanthropy*, <http://philanthropy.com>, October 16, 2007. Reprinted with permission.

Ms. Lerner referred to a law enacted in 1996, in Section 4958 of the Internal Revenue Code that gives the IRS the authority to fine charity officials for receiving salaries and other benefits that are deemed excessive, as well as to penalize trustees who approve the compensation. The law is known as the intermediate-sanctions statute because it gives the government an alternative to revoking a charity's tax-exempt status.

"When you talk about 4958 sanctions, you are talking about governance: How are people setting compensation, who is involved, are there conflicts going on?" said Ms. Lerner. "That is governance."

To the regulators, Ms. Lerner added: "We just want to use governance as one piece of a larger picture of what we do when we are looking at organizations. We understand that the main purview of the states is the actual day-to-day governance of the organizations. We aren't trying to take over your job, we've got a big enough one ourselves."

Ms. Lerner said the governance part of the final version of the new Form 990 would "clarify whether the requested information pertains to policies that are legally required" or are simply "good practices" of well-run organizations.

### **Meaningful Questions**

But taking such an approach will not be easy, said other people at the meeting. Jack B. Siegel, a Chicago lawyer who was the keynote speaker at the conference of state regulators, said he believes "there are problems with formulating meaningful questions" about governance on the Form 990.

"I'm not necessarily opposed to having governance questions on the form," he said. "As someone who looks at charities, that's useful information."

But Mr. Siegel said the IRS's question about whether a charity has a conflict-of-interest policy "carries the implicit judgment that Yes is the right answer and you are bad if you answer No."

Said Mr. Siegel: "There are going to be some organizations out there that are smart and say Yeah, we better answer Yes to that. So what are they going to do? They are going to on the Internet and grab one and throw it in the drawer and never look at it — but now they have one."

Mr. Siegel said "at one point there was a suggestion that these questions were aspirational or educational" on the part of the IRS. "And I know you folks get into that business, too, and that's fine," he told the state regulators. "But you have to then decide what you are going to tell your auditors if you are the IRS and your staff regulators when they review these forms, so that what becomes an aspirational or an educational question does not become a rule of law."

### **Accounting and Legal Expenses**

Ms. Lerner said that the IRS has been informed by lawyers for some nonprofit organizations that filling out the new form and its attachments "is going to cause a significant increase in the accounting fees — the preparation — depending upon the organization. Some are estimating a 50- to 200-percent increase."

“I can’t speak to that,” Ms. Lerner continued. “I’ve heard that; I don’t know. But we do think about those things as we go through this, because remember one of our guiding principles in this form was reducing or at least keeping the burden the same.” Ms. Lerner said IRS officials “still believe that most organizations” will not face new steep costs.

In the end, Ms. Lerner said, the new Form 990 will be “much easier” for the IRS to change and update in future years than the current form has been.

“We do not believe that the form that is going to come out at the end of 2008 for the 2009 filing will be the form for the next 30 years,” she said. “We think it is a continuing, evolving form. So there will be some things that you will be unhappy with, there will be some things you will really like, there will be some things that we will learn don’t really work. We will be able to adjust it because we have designed it in a way that the cost factor will not be so great if we need to make incremental changes. And that’s a good thing because we’ve never been able to do that before, which is why [the current form] is such a mess.”

The new flexible form will allow the IRS to adjust quickly to any “flavor-of-the-month abuse that we will not have thought about” that some nonprofit organizations may engage in, said Ms. Lerner. “We want to be able to change the 990 quickly so that we can deal with that.”



**ARTICLE**

## **International Investment Treaty Protection of Not-for-Profit Organizations**

**Luke Eric Peterson and Nick Gallus<sup>1</sup>**

### **EXECUTIVE SUMMARY**

The International Center for Not-for-Profit Law (“ICNL”) has identified a “growing regulatory backlash against civil society organizations in many parts of the world.” ICNL notes that, particularly in the Middle East, the former Soviet Union, Asia and Africa, not-for-profit organizations have encountered a range of obstacles including the outright seizure of assets and facilities, dissolution, de-licensing, restrictions or bans on the use of foreign funding and intimidation.

While affected organizations may have recourse to remedies under local law or international human rights agreements, such remedies can be of limited utility. For example, local courts are sometimes reluctant to rule against the state and not all human rights treaties are enforceable. At times, not-for-profit organizations appear to conclude purpose-built investment contracts or host government agreements to protect their overseas activities.

A less-explored avenue for not-for-profit organizations is the existing international regime governing economic activities, specifically the vast and still-growing network of international treaties for the protection of foreign investments, commonly referred to as bilateral investment treaties (“BITs”).

While not conceived primarily as instruments for protecting not-for-profit actors many investment treaties potentially afford significant protection to not-for-profit actors’ investments. Not-for-profit organizations may be able to rely on such treaties to bring a claim for direct expropriation where a state seizes assets. Organizations may also be able to claim for breaches of treaty obligations requiring the free transfer of capital, fair and equitable treatment, full protection and security and national treatment where states interfere with the transfer of funds, discriminate between organizations, deny re-registration on arbitrary grounds or contrary to prior representations, or intimidate, or fail to prevent non-state actors from intimidating, not-for-profit organizations.

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<sup>1</sup> Luke Eric Peterson is a free-lance writer and analyst focusing on the international regime protecting foreign investments. He edits a popular newsletter in the field, *Investment Treaty News*, and has written or consulted for a number of international organizations and publications. Nick Gallus is a lecturer in international trade and investment law at Queen’s University in Canada and an Associate at Appleton & Associates, which specializes in investment treaty arbitration. He has been counsel in a number of investment treaty arbitrations and publishes widely in the area. The views expressed herein are those of the authors personally and not necessarily those of any institution or entity with which they work.

## **I. Introduction**

One of the defining features of the current phase of globalization has been the astonishing proliferation of civil society organizations, and the increasing influence and reach of such actors on the global stage. At the same time as there has been a sustained boom in international trade and investment activity, not-for-profit activity has also enjoyed healthy growth on the international stage. However, unlike commercial activity – which is governed by a dense universe of purpose-built trade and investment agreements – not-for-profit activities have been more neglected by the architects of global governance. At first glance, the international legal regime governing not-for-profit organizations is far more skeletal than the regimes governing commercial for-profit activities.

In cases where not-for-profit organizations encounter turbulence in their foreign operations, some limited forms of international legal recourse may be available. Not-for-profit organizations might look to regional instruments such as the European Convention on the Recognition of the Legal Personality of International Non-Governmental Organizations – an agreement which obliges signatories to grant non-governmental organizations the equivalent status and protection afforded in their home territories. However, this Convention is poorly adhered to, with only ten ratifications to date.

Not-for-profit organizations often turn to international human rights law for recourse in cases of interference or abuse at the hands of host governments. Indeed, in late 2006, the European Court of Human Rights issued the latest in a line of ringing endorsements for the right of not-for-profit organizations to associate freely.<sup>2</sup> However, the leading international human rights regimes in Europe and the Americas are limited in their geographical coverage, and, hence, in their capacity to remedy wrongs suffered by not-for-profit organizations operating internationally.<sup>3</sup>

International treaties for the protection of foreign investments, commonly referred to as bilateral investment treaties (“BITs”), present another option. An earlier article by the present authors has highlighted how such agreements might provide jurisdiction for not-for-profit organizations to arbitrate against a host government pursuant to international law.<sup>4</sup> These treaties provide a slate of binding legal protections for those entities fitting underneath the agreements’ protection umbrella. These protections include compensation in case of expropriation of assets; non-discriminatory treatment; the right to transfer funds into and out of a host country; due process; physical protection (including basic police protection); and so-called “fair and equitable treatment”.

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<sup>2</sup> See *Moscow Branch of the Salvation Army v Russia*, Application No. 72881/01, 5 October 2006.

<sup>3</sup> See discussion in Nick Gallus and Luke Eric Peterson, “International Investment Treaty Protection of NGOs,” 22(4) *Arbitration International* 527 (2006) at pages 531-2.

<sup>4</sup> *Ibid.* See also earlier work by Timothy Evered and Gregory W. MacKenzie, which had raised the possibility of investment arbitration as a legal recourse for not-for-profit actors: Timothy Evered, “Foreign Investment Issues for International Non-Governmental Organizations,” 3 *Buffalo Journal of International Law* 153 (Summer 1996) and Gregory W. Mackenzie, “ICSID Arbitration as a Strategy for Leveling the Playing Field Between International Non-Governmental Organizations and Host States,” 19 *Syracuse Journal of International Law and Commerce* 215 (Spring 1993).

The purpose of the present paper is two-fold: to profile the features of these international investment treaties, and to offer a preliminary assessment of how – and to what extent – the protections of these agreements might be relevant to not-for-profit organizations who have suffered deprivations, interferences, and various forms of abuse at the hands of host governments. While these investment treaties were not conceived primarily as instruments for protecting not-for-profit actors, many such agreements do afford potentially significant international law protection to such actors. In so doing, they represent a useful supplement to the patchy framework of international human rights law and international not-for-profit law.

## **II. Problems faced by not-for-profit organizations in foreign countries**

The organizations which are the subject of this paper are those which do not distribute profits to directors or other owners. Such not-for-profit organizations may pursue widely varying goals, be they private or public benefit. Particular attention is given in the following discussions, however, to those not-for-profit organizations which pursue some form of public good or benefit for civil society.

In recent years, there appears to have been an upsurge in harassment and obstruction of not-for-profit organizations. The International Center for Not-for-Profit Law (“ICNL”) has identified a “growing regulatory backlash against civil society organizations in many parts of the world.”<sup>5</sup> ICNL notes that restrictive laws, regulations and policies have been most common in the Middle East, the former Soviet Union, Asia and Africa.<sup>6</sup>

These restrictions come in a variety of forms.

Countries often take measures targeted at the right of not-for-profit organizations to form. Some repressive countries place severe limits on the creation of such organizations. Conversely, the right to establish a not-for-profit organization may be granted, but severely circumscribed in practice. For instance, several countries have introduced onerous registration requirements which oblige all organizations to register with the government so that their activities may be monitored.<sup>7</sup> At the same time, government agencies may exercise arbitrary sway over the registration process, with applications delayed for long periods or rejected summarily without explanation.

Another problem arises where countries apply restrictions on foreign funding of not-for-profit organizations. Such measures may ban foreign funding; require that all foreign funds be channeled through or approved by government agencies; or place onerous taxes or limits on any foreign funding.<sup>8</sup> The professed intention of such measures

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<sup>5</sup> International Center for Not-for-Profit Law, *Constraints on Civil Society*, Draft of January 15, 2006, pages 1-2, on file with authors.

<sup>6</sup> *Ibid.*

<sup>7</sup> *Ibid.*, at pages 3-4.

<sup>8</sup> *Ibid.*, at pages 4-5. See also Article 9 of the *Indian Foreign Contribution (Regulation) Bill*, 2006, which empowers the Indian government to “prohibit any person or organization ... from accepting any foreign contribution” for a broad range of reasons including the “public interest.” CIVICUS, the World Alliance for Citizen Participation, says the Bill “gives civil servants the power to interfere with civil society

is often to limit foreign “meddling” in domestic political affairs, however, such measures may grant governments wide discretion to hamper the activities of not-for-profit organizations. In Uzbekistan, foreign funds intended for local non-governmental organizations must be channeled through select government banks, which enjoy broad discretion whether and when to pass those funds onwards to local actors. A local chapter of the Open Society Institute was de-registered by the Uzbek Government in 2004 and forced to cease its activities in that country. Prior to being de-registered, the Institute decried the onerous new requirements to channel grants through state hands, lamenting that this had effectively halted international support to many local grantees in areas such as health, education, legal reform and economic and small business support.<sup>9</sup>

A further tool which is often used to harass not-for-profit organizations is the threat of arbitrary termination or dissolution. ICNL warns that laws introduced in Belarus and Egypt grant broad discretion to shut down any organizations for vague violations of national security, public order or morals.<sup>10</sup> In a related vein, authorities may seize the assets or offices of not-for-profit organizations, making it difficult or impossible for them to carry out their work. For example, one not-for-profit organization was allegedly forced to abandon construction of a camp for children in Africa, and the money incurred in constructing the camp, when the African government arbitrarily halted construction.<sup>11</sup> Another problem may be the denial or revocation of permits which had been issued or promised.

Even where arbitrary termination or dissolution is not employed, governments may enjoy wide latitude to monitor and interfere in the activities of not-for-profit organizations. For example, a recently enacted law in Russia provides government officials with a right to attend any meetings and events of a not-for-profit organization, raising the specter of state-meddling in internal staff meetings, strategy sessions, and program development meetings.<sup>12</sup> A particular concern has been that reporting requirements are sometimes introduced which would require that any program activities (an undefined and potentially open-ended term) be reported to government officials on an ongoing basis. ICNL reports that, in some instances, government officials may harass not-for-profit organizations to such an extent that their ability to carry out program

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activity” (CIVICUS, “Indian Government Bill Threatens Civil Society,” 9 March 2007, available on-line at: <http://www.civicus.org/csw/CIVICUS-press-release-IndiaFCRB-9.3.07.htm>).

<sup>9</sup> Open Society Institute, “Uzbek government forces closure of local Soros Foundation”, Open Society Institute Press Release, April 18, 2004, available on-line at: [http://www.soros.org/newsroom/news/uzbekistan\\_20040418](http://www.soros.org/newsroom/news/uzbekistan_20040418).

<sup>10</sup> ICNL, *supra* n. 4 at page 6.

<sup>11</sup> Confidential information provided to one of the authors on 2 February 2006 by a Canadian-based not-for-profit organization undertaking charitable activities in various developing countries.

<sup>12</sup> Article 38, Russian Federal Law on Non-commercial Organizations: “Supervision over the observance of laws by public associations shall be exercised by the Procurator’s Office of the Russian Federation. A body rendering decisions on the state registration of public associations shall exercise control over the compliance of their activities with their statutory goals. The said body shall have the right to exercise the following: 1) summon documents containing resolutions by a public association’s governing bodies; 2) send over its representatives to participate in events held by public associations.”

activities is compromised.<sup>13</sup> Recently, a group of major international not-for-profit organizations, including Amnesty International, Human Rights Watch and Transparency International, wrote to Russian President Vladimir Putin to warn that the reporting requirements of his government have the potential “to present serious obstacles to the functioning of these organizations, including through burdensome and unreasonable demands and arbitrary decisions by officials.”<sup>14</sup>

Not-for-profit organizations are sometimes the victim of more generalized harassment. For example, in a recent report on Zimbabwe, Human Rights Watch has chronicled a pattern of “sustained harassment and intimidation of human rights activists.”<sup>15</sup> The report notes that human rights organizations are a particular target of the government which has accused them of supporting the political opposition and of using Western funds to “destabilize the country.” Human Rights Watch notes that repression and intimidation are used to such an extent that they inhibit the course of the daily work by human rights organizations:

These threats take many forms including attacks in the state media by state officials, public statements by ministers, and threatening phone calls involving death threats by unknown persons purporting to speak on behalf of the government. Some human rights organizations report that their offices are sometimes subjected to random checks without warrant by police under the pretext of looking for incriminating material or evidence of criminal activities. Other activists report that police and intelligence officers often follow, harass and intimidate them.<sup>16</sup>

In addition to harassing not-for-profit organizations, governments have also reneged on commitments. Some private foundations or organizations engaged in development or relief activities may conclude legal agreements with their host countries so as to clarify the terms upon which they may enter and operate. For example, CARE International has entered into host government agreements with Tunisia and Mozambique in relation to water improvement projects and food relief activities, respectively.<sup>17</sup> Such agreements might clarify whether personnel of the foreign organization will pay income taxes; whether the organization itself will pay Value-Added Taxes or import duties on goods brought into the country; and what sort of contributions the host state may make (for example, provision of free or subsidized office space or utilities).<sup>18</sup> Governments

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<sup>13</sup> ICNL, *supra* n. 4 at page 7.

<sup>14</sup> Letter to President Vladimir Putin, January 2007, at page 2, available on-line at: <http://www.civicus.org/new/media/Global-civil-society-letter-to-PresidentPutin-february-2007.pdf>.

<sup>15</sup> Human Rights Watch, “You Will be Thoroughly Beaten: The Brutal Suppression of Dissent in Zimbabwe,” 18(10A) *Human Rights Watch Country Reports* (November 2006).

<sup>16</sup> *Ibid.* at page 25.

<sup>17</sup> Mackenzie, *supra* n. 3. See also the reference to ICRC Host Government Agreement with Russia in *Protecting Eurasia’s Dispossessed: a Practical Guide*, Open Society Institute, Forced Migration Project, 1996, Chapter 2, available on-line at: [http://www2.soros.org/fmp2/html/chapter\\_2\\_ngo.html](http://www2.soros.org/fmp2/html/chapter_2_ngo.html).

<sup>18</sup> See the extensive discussion in Evered, *supra* n. 3.

reneging on commitments to not-for-profit organizations after they are relied on could cause severe financial difficulties.<sup>19</sup>

### **III. BIT protection of not-for-profit organizations**

Not-for-profit organizations seeking to claim that some of the actions described above breach an investment treaty must be able to establish, first, that an arbitration tribunal convened has jurisdiction to hear the claim and, second, that the treatment is inconsistent with treaty obligations.

This section addresses each of these requirements.

#### **A. Jurisdiction**

A not-for-profit organization claiming a breach of a BIT faces two main jurisdictional hurdles: first, to establish that it qualifies as an “investor” or “company” under a particular treaty, and, second, to establish that it has made “investments” that fall under the same treaty.

##### *i. Is the not-for-profit organization a protected “investor” or “company”?*

Investment treaties differ as to whether they expressly include not-for-profit entities as “investors” or “companies” protected under the agreement. Some treaties, such as the US treaties with Kazakhstan and Kyrgyzstan expressly define companies so as to include organizations that may not be “organized for pecuniary gain.”<sup>20</sup> Indeed, the letters of transmittal submitted by the White House to the US Senate make clear that these treaties are drafted so as to cover “charitable and non-profit entities.”<sup>21</sup>

However, some investment agreements leave open the question as to whether they extend their protections to not-for-profit entities. For example, United Kingdom treaties with Azerbaijan, Kyrgyzstan, Turkmenistan, Kazakhstan, and Uzbekistan all define companies simply as “corporations, firms and associations incorporated or constituted under the law in force in any part of the United Kingdom.”<sup>22</sup> In the absence of any express requirement for such companies to be profit-seeking, it might be argued that a not-for-profit association constituted according to UK law falls within the cover of the treaty.<sup>23</sup>

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<sup>19</sup> Evered, *supra* n. 3 at page 165.

<sup>20</sup> US-Kyrgyz Bilateral Investment Treaty, Article 1(b); US-Kazakh Bilateral Investment Treaty, Article 1(b). See also Article 1(2) of the China – Germany BIT: “the term ‘investor’ means ... any juridical person as well as any commercial or other company or association with or without legal personality having its seat in the territory of the Federal Republic of Germany, irrespective of whether or not its activities are directed at profit.”

<sup>21</sup> Letters of Transmittal available on-line at the US State Department website: <http://www.state.gov/documents/organization/43566.pdf> and <http://www.state.gov/documents/organization/43567.pdf>.

<sup>22</sup> See Article 1(d) of the relevant treaties. Treaty texts available on-line at the UK Foreign Office website: <http://www.fco.gov.uk/servlet/Front?pagename=OpenMarket/Xcelerate/ShowPage&c=Page&cid=1045739996216>.

<sup>23</sup> It is worth noting that UK treaties do not impose any nationality requirement beyond mere incorporation in the designated home country (see, for example Article 1(d) of the UK-Turkmenistan

ii. *Does the not-for-profit organization have a protected investment?*

Assuming that a not-for-profit entity falls within the definition of “investor” or “company” as set out in a relevant investment treaty, it still remains to be determined whether such an entity has made an “investment” as defined under that same treaty.

Every treaty defines what qualifies as an “investment” – even if some do so in the circular fashion of the US-Kyrgyzstan treaty which indicates that “‘investment’ means every kind of investment ... .”<sup>24</sup> It might be inferred from such an open-ended definition that assets not intended to be used for commercial or profit-seeking purposes might still constitute “investments” covered by the US-Kyrgyzstan treaty. In other cases, this may be made explicit, as, for example, in the North American Free Trade Agreement (“NAFTA”), whose definition of investment includes “enterprises,” which are elsewhere defined as entities constituted either for profit or not-for-profit.<sup>25</sup>

The plain-face of the treaty text does not provide the final word on the matter. Where a definition does not expressly encompass assets deployed for non-profit-seeking ends, arbitral tribunals have taken different approaches in defining what constitutes an investment. In some cases, arbitrators have gone beyond the text of the relevant treaty, in arguing for certain inherent or objective characteristics of “investments.”<sup>26</sup> In at least two instances, arbitrators have read-in a requirement for investments to be commercially oriented or intended to generate an economic return or profit.<sup>27</sup>

In addition to meeting the definition of investment set out in a given investment treaty, claimants may also need to satisfy a further definition of investment, depending on the means through which the investor chooses to resolve the dispute. Typically, when an investor has a dispute with a host state, that investor can choose from one of several different sets of arbitration rules identified in the dispute settlement provisions of a given investment treaty. Investors can, typically, choose between:

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investment treaty, available on-line at: [http://www.fco.gov.uk/Files/kfile/CM6021IPPA\\_Turkmenistan.pdf](http://www.fco.gov.uk/Files/kfile/CM6021IPPA_Turkmenistan.pdf)). By contrast, US treaties set a higher standard insofar as they require that US “companies” must have substantial business activities in the US. This requirement ensures that mere shell companies incorporated in the US (and used to make onward investments) would not enjoy the coverage of the treaty. Conversely, because the UK’s treaties impose no similar requirement, they might easily be used by non-nationals of the United Kingdom merely by virtue of incorporation of a legal entity in the UK. Indeed, arbitration tribunals have confirmed that certain investment treaties operate as “portals” – through which investments emanating from a multitude of different countries might transfer while en route to a final destination in some third country (see Luke Eric Peterson, “Tribunal Split in Bechtel-Bolivia case over corporate nationality of investor,” *Investment Treaty News*, Dec.20, 2005, available at: [http://www.iisd.org/pdf/2005/itm\\_dec20\\_2005.pdf](http://www.iisd.org/pdf/2005/itm_dec20_2005.pdf)).

<sup>24</sup> US-Kyrgyzstan BIT, Article 1(a).

<sup>25</sup> Article 201(1) of the NAFTA reads: “enterprise means any entity constituted or organized under applicable law, whether or not for profit ...”

<sup>26</sup> Gallus and Peterson, *supra* n. 2 at pages 537-8.

<sup>27</sup> *CME Czech Republic BV (The Netherlands) v. Czech Republic*, Ian Brownlie’s separate opinion, Final Award, 14 March 2003 at para. 34; *Franz Sedelmeyer v. Russian Federation*, Award, July 7, 1998 at page 65.

- a. the rules of the World Bank's International Centre for Settlement of Investment Disputes ("ICSID"), if both parties to the BIT have signed the ICSID's foundational Washington (or ICSID) Convention;
- b. the ICSID's "Additional Facility" Rules, if only one of the parties to the BIT has signed the ICSID Convention; and
- c. the rules of the United Nations Commission on International Trade Law (UNCITRAL).

Investors choosing the UNCITRAL rules or the ICSID's "Additional Facility" Rules need not satisfy any definition of investment beyond that in the BIT.<sup>28</sup> Conversely, investors choosing to resolve their dispute under the ICSID rules might also need to satisfy an implicit definition of investment within the ICSID Convention.

The ICSID Convention does not offer any *explicit* definition of the types of investments which are eligible for arbitration. Some arbitrators have inferred from this that parties enjoy broad discretion to determine what constitutes a foreign investment – for example through definition in a given investment treaty – and that arbitration under the ICSID rules should be open to all such investments.<sup>29</sup> Conversely, some arbitrators have taken the view that arbitration under the ICSID rules may impose more stringent hurdles than a given investment treaty. Specifically, some arbitrators have taken the view that there is an implicit or objective definition of investment under the ICSID Convention, consisting of four chief characteristics:

- a. contribution of resources;
- b. a certain duration of performance;
- c. risk; and
- d. contribution to the economic development of the host state.<sup>30</sup>

Some tribunals have cited a fifth characteristic—the expectation of profit or return.<sup>31</sup>

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<sup>28</sup> The UNCITRAL rules are more commonly used for arbitration of non-investment disputes (for example commercial contract or trade disputes) and are accordingly indifferent as to what constitutes an investment. Article 2 of the ICSID Additional Facility Rules provides: "The Secretariat of the Centre is hereby authorized to administer ... arbitration proceedings for the settlement of legal disputes which are not within the jurisdiction of the Centre because they do not arise directly out of an investment ..."

<sup>29</sup> See, for example, *Tokios Tokeles v. Ukraine*, Decision on Jurisdiction, 29 April 2004 at para. 73; *Fedax N.V. v. Republic of Venezuela*, ICSID Case No. ARB/96/3, Decision on Objections to Jurisdiction, July 11, 1997 at para. 31; *M.E. Cement Shipping & Handling Co., SA v. Arab Republic of Egypt*, ICSID Case No. ARB/99/6, Award, 12 April 2002 at para 136 and the discussion of those cases in Gallus and Peterson, *supra* n. 2 at pages 539-40.

<sup>30</sup> See, for example, *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 16 July 2001 at para. 52; *AES v. Argentina*, ICSID Case No. ARB/02/17, Decision on Jurisdiction, 26 April 2005 at para. 88; *Jan de Nul and Dredging International v. Egypt*, ICSID Case No. ARB/04/13, Decision on Jurisdiction, 16 June 2006 at para. 91, discussed in Gallus and Peterson, *supra* n. 2 at pages 540-1.

<sup>31</sup> See, for example, *Fedax NV v. Republic of Venezuela*, ICSID Case No. ARB/96/3, Decision on Objections to Jurisdiction, July 11, 1997 at para. 43; *Joy Mining Machinery Limited v. Arab Republic of*



One practical import of this divergence of approaches is that there is a great deal of uncertainty as to how this jurisdictional question will be handled by tribunals. Potential claimants will need to take specific legal advice so as to understand how the selection of arbitrators might have pivotal implications for the prospects of their claim against a host state. Where arbitrators take a restrictive approach – arguing that investments must meet four criteria to fall within the ICSID Convention – it will be necessary to examine whether commitments of capital for non-profit ends satisfy these characteristics. Clearly, many activities of not-for-profit organizations should meet the first two criteria: contribution of resources and duration of performance. Non-profit organizations often establish offices or other facilities and devote significant financial resources to programs. Likewise, many of these organizations are engaged in long-term projects or undertakings in their host state.

Not-for-profit organizations should also be able to satisfy the third criterion. A recent tribunal identified this criterion as “an economic risk entailed, in the sense of an uncertainty regarding its successful outcome.”<sup>32</sup> Another tribunal enumerated various risks assumed by a foreign investor, including the possibility that the state might cancel its contract; potential increases in the cost of labor and inputs during the life of the investment; and any unforeseeable incidents which might affect the investment.<sup>33</sup> It seems inarguable that non-profit organizations engaged in program activity or even the production of goods or services on a non-profit basis might be understood to take on similar risks. For example, so-called social enterprises routinely commit capital to so-called “earned income strategies” which are designed to generate revenue (but not profits or dividends).<sup>34</sup> There is an ongoing debate as to whether such activities are a recipe for success – suggesting that non-profit organizations take on sizable risks in pursuing such “earned income strategies.”<sup>35</sup> Likewise, even where non-profit actors are not engaged in income or revenue generating activities, their programmatic activities might engage numerous risks due to the challenges and uncertainty of operating in alien and sometimes hostile climates. Indeed, some observers have remarked upon the close similarities

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*Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction at para. 53, discussed in Gallus and Peterson, *supra* n. 2 at page 542. In the view of the authors, reading in a requirement of paying out a profit to directors or shareholders is incoherent when one considers that non-distribution of profits would preclude otherwise identical types of private sector activity (for example, provision of water services or administration of health clinics) from being considered “investments” for purpose of the given treaty. Indeed, given that contribution to the economic development of the host state has been identified as another important criterion by some tribunals, it seems incoherent to include only those investments which are profit-distributive (and indeed likely to take some funds out of the host country, rather than leaving more in the host country).

<sup>32</sup> Gallus and Peterson, *supra* n. 2 at page 542; *Patrick Mitchell v. The Democratic Republic of Congo*, ICSID Case No. ARB/99/1, Decision on Annulment, 1 November 2006 at para. 27.

<sup>33</sup> *Salini v. Morocco*, ICSID *supra* n. 29 at para 55.

<sup>34</sup> Gabriel Berger, “NGOs and Socially Inclusive Businesses: Within the Market, for the Mission,” *Revista: The Harvard Review of Latin America Magazine* (Fall 2006) at pages 47-48.

<sup>35</sup> William Foster and Jeffrey Bradach, “Should Nonprofits Seek Profits,” 83(2) *Harvard Business Review* (February 2005).

between certain activities of not-for-profit and for-profit investors in foreign environments. For example, Timothy Evered noted that “[b]oth types of investors confront common infrastructural or logistical problems, similar cost and administrative concerns, and the potential for host country discrimination against foreign investors.”<sup>36</sup>

Finally, many non-profit activities should easily meet the final criterion of a contribution to economic development in the host state. Indeed, in contrast with many for-profit investments, a contribution to local economic development is very often the *raison d'être* for non-profit activities.<sup>37</sup>

## **B. BIT Protections**

Not-for-profit organizations seeking to claim under a BIT must not only demonstrate that an arbitration tribunal convened has jurisdiction to hear the claim but also must demonstrate that the treatment is inconsistent with a treaty obligation.

### *i. Description of protections*

Most BITs contain eight provisions representing the core investment protections. These are the provisions on:

- a. fair and equitable treatment;
- b. full protection and security;
- c. arbitrary impairment;
- d. national treatment;
- e. expropriation;
- f. observance of obligations;
- g. free transfers; and
- h. establishing investments.

This section broadly explains these eight provisions.

Before examining these provisions, it is important to note three general points. First, while many BITs contain these core provisions, they are not included in every BIT. Furthermore, the precise wording of the core provisions often differs. Differently worded provisions could create different protections to those described in this section.

Second, many provisions only impose obligations on the state in regard to *investments*. Consequently, a state may interfere with a not-for-profit organization but if it does not interfere with a protected investment then the state may not breach the treaty.

Finally, it is important to note that even tribunals considering exactly the same provision do not always agree on its meaning. Different arbitrators hear different BIT disputes and often take advantage of the fact that there is no binding doctrine of precedent which would oblige them to hew to an interpretation adopted in an earlier case.

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<sup>36</sup> Evered, *supra* n. 3 at page 158.

<sup>37</sup> See Berger, *supra* n. 33, for a discussion of non-profit activities contributing to local economic development.

Moreover, there is no appellate body to ensure consistency of reasoning in investment treaty awards. While consensus sometimes emerges after a few decisions addressing the meaning of a particular provision, the area of law is new and consensus is yet to emerge over all aspects of the protections BITs offer foreign investors. As a consequence, both would-be claimants and respondents may be faced with uncertainty when it comes to the concrete meaning of investment treaty commitments and the implications flowing from these obligations.

a. Fair and equitable treatment

Almost every BIT requires the host state to provide “fair and equitable treatment.”<sup>38</sup> The precise scope of this standard of treatment is unclear. At least two tribunals have interpreted the standard literally, simply deciding whether the state’s conduct was “fair and equitable.”<sup>39</sup> Some countries have rejected this standard as too high.<sup>40</sup> Furthermore, it is unclear whether the standard is uniform across countries or depends on the country’s level of development.<sup>41</sup>

While the precise scope of the standard is unclear, it is possible to identify elements of the standard on which many tribunals have agreed. All tribunals agree that the fair and equitable treatment standard protects against “denial of justice.” A state denying a foreign investor access to the justice system or administering that justice system unfairly can commit a denial of justice.<sup>42</sup>

Some tribunals agree that the fair and equitable treatment obligation protects the investor’s legitimate expectations.<sup>43</sup> Tribunals have found that states failed to protect the investor’s legitimate expectations and, therefore, failed to provide fair and equitable treatment by:

- failing to fulfill representations to the investor that an investment permit would be renewed;<sup>44</sup>

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<sup>38</sup> Article II(2)(a) of the Kazakhstan-US BIT, for example, provides: “Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law.”

<sup>39</sup> *Azurix Corp. v Argentina*, ICSID Case No. ARB/01/12, Award, 14 July 2006 at para 360; *Siemens A.G. v Argentine Republic*, ICSID Case No. ARB/02/8, Award, 6 February 2007 at para. 290.

<sup>40</sup> The three parties to the NAFTA have said that the “fair and equitable treatment” obligation within the NAFTA refers only to the lower customary international law standard of treatment that has evolved over the past hundred or so years: NAFTA Free Trade Commission Note of Interpretation, July 31, 2001.

<sup>41</sup> Nick Gallus, “The influence of the host state’s level of development on international investment treaty standards of protection,” 6(5) *Journal of World Investment and Trade* 711 (October, 2005).

<sup>42</sup> The leading text on the issue says “denial of justice occurs when the instrumentalities of a state purport to administer justice to aliens in a fundamentally unfair manner.” Jan Paulsson, *Denial of Justice* (Cambridge University Press, 2005) at page 62. Note that an investor must give local courts an opportunity to remedy their unfair treatment before the investor can successfully claim for a denial of justice (Jan Paulsson, *Denial of Justice* at pages 100-130). This is known as ‘exhausting local remedies’.

<sup>43</sup> *Azurix v Argentina*, *supra* n. 38 at para 372, *Técnicas Medioambientales, TECMED S.A. v Mexico*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003 at para .154.

<sup>44</sup> *Tecmed v Mexico*, *ibid.* at para. 154 and 174.

- issuing an investment permit for an urban renewal project that was inconsistent with local planning laws<sup>45</sup>; and
- reneging on a commitment to sell shares to an investor.<sup>46</sup>

Among those tribunals that agree the fair and equitable treatment standard requires the state to protect the investor's legitimate expectations, there is little consensus on what, precisely, investors legitimately ought to expect. Some tribunals have said that foreign investors expect a stable legal and business environment.<sup>47</sup> These same tribunals have found that by failing to provide that environment, the state failed to provide fair and equitable treatment. For example, one tribunal found that Argentina breached the standard by reneging on a commitment to allow US investors to charge local Argentine customers in US dollars for the transport and distribution of gas.<sup>48</sup>

Where tribunals have not equated a state's obligation to provide fair and equitable treatment with an obligation to protect the investor's legitimate expectations, tribunals have found the state breached its obligation by, for example:

- permitting money to be transferred from an investor's bank account without consulting the investor on the terms of that transfer;<sup>49</sup> and
- imposing excessive and harassing administrative burdens on the investor.<sup>50</sup>

Tribunals have rejected several claims that states breached their obligation to provide fair and equitable treatment. For example, a tribunal rejected a claim that Estonia's revocation of the investor's license to operate a bank breached the obligation, where the revocation was "contrary to generally accepted banking and regulatory practice" but "justified" having "regard to the totality of the evidence."<sup>51</sup>

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<sup>45</sup> *MTD Equity Sdn. Bhd. And MTD Chile S.A. v. Republic of Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004 at para. 188.

<sup>46</sup> *Eureko B.V. v Republic of Poland*, Partial Award, 19 August 2005 at para. 233.

<sup>47</sup> See *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award, 25 April 2005 at para. 274; *LG&E Energy Corp, LG&E Capital Corp and LG&E International Inc v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at para. 124; *Occidental Exploration and Production Company v The Republic of Ecuador*, Award, 1 July 2004 at para. 183; *Metalclad Corporation v Mexico*, Award, 30 August 2000 at para. 99.

<sup>48</sup> *CMS v Argentina*, *supra* n. 46 at paras. 275-281.

<sup>49</sup> *Emilio Agustín Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7, Award, 13 November 2000, at para. 83.

<sup>50</sup> *Pope & Talbot Inc v. Canada*, Award on the Merits of Phase 2, 10 April 2001 at para. 181. See also *Saluka Investments BV v Czech Republic*, Partial Award, 17 March 2006 at para. 308, noting that "it transpires from arbitral practice that, according to the 'fair and equitable treatment' standard, the host State ... must grant the investor freedom from coercion or harassment by its own regulatory authorities."

<sup>51</sup> *Alex Genin, Eastern Credit Limited, Inc and A.S. Baltoil v The Republic of Estonia*, ICSID Case No. ARB/99/2 at para. 364 and 371. For a general discussion of the obligation to provide fair and equitable treatment, see Christoph Schreuer, "Fair and Equitable Treatment in Arbitral Practice," 6 *Journal of World Investment and Trade* 357 (2005) and Stephan Schill, "Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law," IILJ Working Paper 2006/6 (Global Administrative Law Series), available at <http://www.iilj.org/20066SchillGAL.htm>.

b. Full protection and security

In many cases, BIT provisions requiring fair and equitable treatment also make reference to the obligation to provide “full protection and security.”<sup>52</sup> This obligation potentially provides broader protection than provided by the non-binding standards found in international human rights agreements, such as the United Nations Declaration on Human Rights Defenders.<sup>53</sup>

At a minimum, the obligation to provide “full protection and security” requires the state to protect the investment’s *physical* security. For example, a tribunal found Sri Lanka failed to provide full protection and security when its army destroyed the investor’s shrimp farm as part of a military operation against Tamil Tiger rebels.<sup>54</sup> Similarly, another tribunal found Zaire failed to provide full protection and security when its army looted the investor’s battery factory.<sup>55</sup>

Both these cases concerned states that injured an investment through their own actions. However, the state’s obligation to provide full protection and security is even broader, requiring the state to protect investment against injury by private parties. An ICSID Tribunal, for example, found Egypt failed to provide full protection and security when it failed to prevent private parties taking over the investor’s hotel and failed to subsequently prosecute those parties.<sup>56</sup>

Some tribunals have endorsed an even broader interpretation of the full protection and security provision by applying the provision to protect the investment’s *legal* security, as well as its physical security.<sup>57</sup> One tribunal, for example, found that

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<sup>52</sup> Article II(2)(a) of the Kazakhstan-US BIT, for example, says: “Investment shall at all times be accorded fair and equitable treatment, *shall enjoy full protection and security* and shall in no case be accorded treatment less than that required by international law [emphasis added].”

<sup>53</sup> Article 12.2 of the United Nations Declaration on the Right and Responsibility of Individuals, Groups and Organs of Society to Promote and Protect Universally Recognized Human Rights and Fundamental Freedoms (A/RES/53/144, March 8, 1999) provides: “The State shall take all necessary measures to ensure the protection by the competent authorities of everyone, individually and in association with others, against any violence, threats, retaliation, de facto or *de jure* adverse discrimination, pressure or any other arbitrary action as a consequence of his or her legitimate exercise of the rights referred to in the present Declaration.” For a general discussion of the obligation to provide full protection and security, see Helge Elisabeth Zeitler, “The Guarantee of ‘Full Protection and Security’ in Investment Treaties Regarding Harm Caused by Private Actors,” 3 *Stockholm International Arbitration Review* 1 (2005).

<sup>54</sup> *Asian Agricultural Products Limited v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Award, June 27, 1990.

<sup>55</sup> *American Manufacturing & Trading v. Republic of Zaire*, ICSID Case No. ARB/93/1, Award, 21 February 1997.

<sup>56</sup> *Wena Hotels Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Award, 8 December 2000 at paras 84-95.

<sup>57</sup> See, for example, *CME Czech Republic B.V. (The Netherlands) v. The Czech Republic*, Partial Award, September 13, 2001 at para. 613: “The host State is obligated to ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor’s investment withdrawn or devalued.” See also *Azurix v. Argentine Republic supra* n. 38 at para. 408: “The cases referred to above show that full protection and security was understood to go beyond protection and security ensured by the police. It is not only a matter of physical security; the stability afforded by a secure investment environment is as important from an investor’s point of view;”

Argentina failed to provide full protection and security by failing to provide a secure investment framework.<sup>58</sup>

Not all investors have succeeded in their claims that states breached their obligation to provide full protection and security. The International Court of Justice, for example, found that failing to prevent local workers from occupying a factory was not sufficient to amount to a failure to provide full protection and security, where there was no evidence the workers damaged the plant and some level of production was maintained.<sup>59</sup> A BIT tribunal later partly relied on the International Court of Justice's decision in rejecting a claim that Romania's reaction to labor unrest breached the State's obligation to provide full protection and security.<sup>60</sup>

c. Arbitrary impairment

A state's earlier-discussed obligation to provide fair and equitable treatment may also oblige the state not to treat the investor in an arbitrary fashion.<sup>61</sup> Nevertheless, several BITs include a separate explicit provision protecting investors against arbitrary impairment of their operations.<sup>62</sup> Tribunals have said a measure is arbitrary if it is "founded on prejudice or preference rather than on reason or fact"<sup>63</sup> or is a "willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety."<sup>64</sup> A tribunal has applied this latter definition to find that a government acted arbitrarily, in breach of its BIT obligations, by:

- interfering with the investor's ability to collect payment from consumers for water services;
- preventing the investor from increasing tariffs in accordance with the concession agreement; and
- penalizing the investor and then denying the investor access to the documents on the basis of which it was penalized.<sup>65</sup>

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and *Occidental Exploration and Production Company v. The Republic of Ecuador*, Award, July 1, 2004 at para. 187, finding that Ecuador's amendment of its tax laws breached Ecuador's obligation to provide full protection and security.

<sup>58</sup> *Azurix v. Argentine Republic*, *supra* n. 38 at para. 408.

<sup>59</sup> *Case concerning Elettronica Sicula S.p.A. (ELSI) (US v Italy)*, 20 July 1989, ICJ Reports [1989] 15 at para. 108.

<sup>60</sup> *Noble Ventures v. Romania*, ICSID Case No. ARB/01/11, Award of October 12, 2005, at paras 164-166.

<sup>61</sup> See, for example, *Waste Management, Inc v Mexico*, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004 at para. 98.

<sup>62</sup> Article II(2)(b) of the Kazakhstan-US BIT, for example, reads: "Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments."

<sup>63</sup> *Lauder v. Czech Republic*, Final Award, 3 September 2001 at paras. 221 and 232; *Occidental v. Ecuador*, *supra* n. 46 at paras. 162-163.

<sup>64</sup> *ELSI*, *supra* n. 58 at para 128, quoted with approval in *Azurix v. Argentine Republic*, *supra* n. 38 at para. 392.

<sup>65</sup> *Azurix v. Argentina*, *supra* n. 38 at para. 393.

Conversely, another tribunal rejected a claim of “arbitrary treatment” where a state’s conduct merely arose from administrative confusion.<sup>66</sup>

d. National treatment

The national treatment obligation prevents states from treating foreign investors “less favorably” than local investors in “like situations” or “like circumstances.”<sup>67</sup> The precise scope of the provision is unclear. Indeed, a recent survey of investment treaty disputes cautions that the national treatment obligation, as interpreted by arbitral tribunals, “remains open to further refinement.”<sup>68</sup> Tribunals chiefly disagree on the meaning of the two key phrases, “less favorably” and “like situations (or circumstances).”

A state clearly treats a foreign investor “less favorably” than local investors when the state *intentionally* discriminates against a foreign investor because of the investor’s nationality.<sup>69</sup> It is less clear whether a state breaches the provision by effectively treating a foreign investor less favorably while pursuing a legitimate policy objective.<sup>70</sup>

Which local investors are in “like situation” or “like circumstances” with foreign investors is also unclear. One NAFTA tribunal supported a narrow interpretation of “like,” comparing the treatment of the foreign investor with the treatment of the local investor producing the same product.<sup>71</sup> Another NAFTA tribunal supported a broader interpretation, examining the treatment of all local investors operating in the same economic sector.<sup>72</sup> Another tribunal went even further, comparing the foreign investor with all local investors that exported other types of products. That tribunal found that Ecuador failed to provide national treatment by refunding value-added tax to a local flower exporting company and not to the foreign investor exporting oil.<sup>73</sup>

It is also unclear whether the “situation” or “circumstances” includes the policy goals of the impugned measure. One tribunal said the “assessment of ‘like circumstances’ must also take into account circumstances that would justify governmental regulations

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<sup>66</sup> *Occidental v. Ecuador*, *supra* n. 46 at para. 163.

<sup>67</sup> Article II(1) of the Kazakhstan-US BIT, for example, reads: “Each Party shall permit and treat investment, and activities associated therewith, on a basis no less favorable than that accorded in like situations to investment or associated activities of its own nationals or companies. ...”

<sup>68</sup> UNCTAD, *Investor State Disputes arising from Investment Treaties: a Review*, (United Nations: New York and Geneva, 2005) at page 34.

<sup>69</sup> See, for example, Mexico’s submission to the *Methanex* Tribunal: *Methanex Corporation v. United States of America*, Final Award, 3 August 2005 at para. 32 of Chapter C of Part II.

<sup>70</sup> The *S.D. Myers*, *Feldman* and *Pope & Talbot* Tribunals said a state cannot breach the obligation if the measure pursues a legitimate public policy objective in certain circumstances: *S.D. Myers*, Partial Award, 12 November 2000 at para. 250; *Pope & Talbot*, Award on Merits Phase 2 at para. 79; *Feldman v. Mexico* at para. 170. For example, the *S.D. Myers* Tribunal found Canada breached the obligation by preventing US waste processing companies from exporting waste to the US to process. The Tribunal acknowledged that Canada’s goal of ensuring the strength of the Canadian waste processing industry was laudable but found Canada overlooked other, less restrictive means of doing so: *S.D. Myers*, Partial Award, 12 November 2000 at para. 255.

<sup>71</sup> *Methanex v US*, *supra* n. 68 at para 19 of Chapter B of Part IV.

<sup>72</sup> *S.D. Myers*, *supra* n. 69 at para. 250.

<sup>73</sup> *Occidental v Ecuador*, *supra* n. 46 at para. 179.

that treat [foreign investors] differently in order to protect the public interest.”<sup>74</sup> Conversely, another tribunal conspicuously did not consider the legitimate policy goals of the impugned measure when determining if the foreign and local investors were in like circumstances.<sup>75</sup> Nevertheless, that latter tribunal went on to reject a claim that a Californian law proscribing the use of an ingredient in a gasoline additive breached the US’ obligation to provide national treatment because, regardless of the law’s legitimate goals, US companies producing the ingredient were harmed in the same way as the Canadian claimant.<sup>76</sup>

#### e. Expropriation

Almost every BIT requires states to pay compensation when they expropriate foreign investments.<sup>77</sup> The precise protection provided by such provisions depends on the meaning of the two key words, “investment” and “expropriation.”

Every BIT includes a definition of investment. This definition will invariably include tangible property, such as land and buildings, thereby protecting such property against expropriations.

In addition to defining investments so as to include tangible property, almost every BIT also defines investment to include intangible property, such as contractual rights and intellectual property. BIT tribunals have found states breached BITs by failing to pay compensation for expropriating intangible property rights. Egypt, for example, breached the Greece-Egypt BIT by expropriating the investor’s license right to import cement;<sup>78</sup> Egypt had passed legislation proscribing cement imports three years before the investor’s license was due to expire.

The protection provided by expropriation provisions is also, not surprisingly, largely determined by the meaning of the term “expropriation.” The term expropriation typically covers both *direct* and *indirect* expropriations. States can directly take tangible property rights. One tribunal, for example, found that Russia expropriated a German investor’s property through a Presidential Decree confiscating the property.<sup>79</sup> States can also directly take intangible property rights; in a 2006 case, another tribunal found Hungary had directly taken the investor’s contractual right to manage an airport by passing legislation extinguishing the right.<sup>80</sup>

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<sup>74</sup> *S.D. Myers v. Canada*, *supra* n. 69 at para. 250.

<sup>75</sup> *Methanex v US* *supra* n. 68, Part IV, Chapter B.

<sup>76</sup> *Methanex v US*, *supra* n. 68, Part IV, Chapter B at para 38.

<sup>77</sup> For example, Article III(1) of the Kazakhstan-US BIT provides: “Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization (“expropriation”) except for: public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles of treatment provided for in Article II(2).”

<sup>78</sup> *Middle East Cement Shipping and Handling Co. S.A. v The Arab Republic of Egypt*, *supra* n. 28 at para. 107.

<sup>79</sup> *Franz Sedelmayer v The Russian Federation*, *supra* n. 26 at page 73.

<sup>80</sup> *ADC Affiliate Limited and ADC & ADC Management Limited v. Republic of Hungary*, ICSID Case No. ARB/03/16, Award, 2 October 2006 at para. 476.



Most BIT expropriation provisions expressly protect against *indirect* expropriations or measures *tantamount* to expropriation.<sup>81</sup> These are measures which do not overtly expropriate property but have the same effect. There is no test for what amounts to an indirect expropriation. There is not even consensus as to whether tribunals hearing a claim for an indirect expropriation should only focus on the *effect* of the measures on the investment or whether they should also look at the *legitimacy* of the purpose behind the measures (for example, a legitimate public health purpose). While some tribunals focus on the effect of the measures on the investment,<sup>82</sup> one NAFTA tribunal found that a Californian law proscribing the use of an ingredient in gasoline was not an indirect expropriation because the law pursued a legitimate purpose.<sup>83</sup>

While there is no agreement on a test, some tribunals have identified what types of measures they might deem to be an indirect expropriation. A NAFTA tribunal said that a measure is more likely to be an indirect expropriation if the measure is inconsistent with specific commitments given to the foreign investor.<sup>84</sup> Another tribunal found a measure is more likely to be an indirect expropriation if the measure is disproportionate to the purpose the state hopes to achieve.<sup>85</sup>

Suffice to say that there is a lack of certainty as to how to draw the line between legitimate non-compensable exercises of government regulation and those actions which amount to an expropriation for which compensation must be paid. While debate continues to rage as to what amounts to an expropriation,<sup>86</sup> some governments have moved to provide more detailed written guidance in more recent treaties. For example, the United States now provides that “[e]xcept in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriation.”<sup>87</sup>

#### f. Observance of Obligations

Most BITs contain a provision requiring the state to “observe” its “obligations.”<sup>88</sup> Tribunals have sharply disagreed at times over the scope of this provision. In particular, tribunals disagree over the precise obligations a state must observe. One tribunal found

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<sup>81</sup> On indirect expropriation generally, see Andrew Newcombe, “The Boundaries of Regulatory Expropriation,” 20 *ICSID Review-Foreign Investment Law Journal* 1 (2005).

<sup>82</sup> See, for example, *Azurix v Argentina*, *supra* n. 38 at para 310.

<sup>83</sup> *Methanex v US*, *supra* n. 68, Part IV, Chapter D, Page 4, para. 15. See also *Saluka Investments BV (The Netherlands) v. Czech Republic*, Partial Award, 17 March 2006 at paras 254-5.

<sup>84</sup> *Methanex v US*, *supra* n. 68, Part IV, Chapter D, Page 4, para. 7.

<sup>85</sup> See *Azurix v. Argentina* *supra* n. 38 at paras. 311-312; *Tecmed v. Mexico*, *supra* n. 42 at para. 122; and *LG&E Energy Corp, LG&E Capital Corp and LG&E International Inc v. Argentine Republic*, ICSID Case; No. ARB/02/1, Decision on Liability, 3 October 2006 at para. 175.

<sup>86</sup> See, for example, the discussion in Newcombe *supra* n. 80.

<sup>87</sup> US-Chile FTA, Chapter 10, Annex 10-D, Article 4 (b).

<sup>88</sup> Article II(2)(c) of the Kazakhstan-US BIT, for example, reads: “Each Party shall observe any obligation it may have entered into with regard to investments.” Most US and UK BITs, for example, contain such provisions but the BITs of other capital exporting countries, such as Canada, do not.

Argentina breached the provision when it failed to fulfill a specific legislative commitment to maintain gas distribution tariffs in US dollars.<sup>89</sup> At the same time, other tribunals expressed doubt as to whether “observance of obligations” provisions elevate breaches of domestic legislation to the level of a treaty-breach.<sup>90</sup>

On its face, the provision also appears to protect *contractual* obligations. Indeed, the provision is often called an “umbrella provision” because it appears to bring contractual obligations within the BIT’s protective umbrella. Precisely which contractual obligations fall within the umbrella is unclear. Some tribunals say the provision protects all contractual obligations.<sup>91</sup> Other tribunals view such provisions as protecting only those obligations that a state makes in its sovereign capacity.<sup>92</sup> For example, one tribunal said that this provision “will not extend the Treaty protection to breaches of an ordinary commercial contract entered into by the State ... but will cover additional investment protections contractually agreed by the State as a sovereign inserted in an investment agreement.”<sup>93</sup> An agreement to refrain from changing certain regulations or laws affecting a particular foreign investor is an example of such a protection.

The *obligation* protected is not the only aspect of the provision that is unclear. Which *breaches* of contract breach the provision is also unclear. Some tribunals say the provision protects all breaches.<sup>94</sup> Other tribunals arguably say only breaches through sovereign act breach the provision.<sup>95</sup> A state implementing legislation extinguishing a contractual obligation is an example of a breach through such a sovereign act.<sup>96</sup>

Further aspects of the application of the provision to contractual disputes are also unclear. It is still unclear whether investors can rely on the provision where the investor’s

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<sup>89</sup> *LG&E v. Argentina*, *supra* n. 84 at para. 175.

<sup>90</sup> *El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Decision on Jurisdiction, 27 April 2006 at paras. 71-88. See also *SGS Société Générale de Surveillance S.A. v. Pakistan*, Decision on Jurisdiction, at paras. 166-168.

<sup>91</sup> *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6, 29 January 2004 at para. 128. See also *Fedax NV v. Republic of Venezuela*, *supra* n. 30 at para. 112, holding that the provision protected the contractual obligation to pay the debt on a promissory note and *Eureko v. Poland*, *supra* n. 45 at para. 260, holding that the provision protected the contractual obligation to issue shares.

<sup>92</sup> *El Paso Energy International Company v. Argentine Republic*, ICSID Case No. ARB/03/15, Decision on Jurisdiction, 27 April 2006 at para. 81.

<sup>93</sup> *Pan American Energy LLC and BP Argentina Exploration Company v. Argentine Republic*, ICSID case No. ARB/03/13, Decision on Preliminary Objections, July 27, 2006, at para 109. See also the discussion in *El Paso v. Argentina*, *ibid.* at paras 71-88.

<sup>94</sup> *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines* *supra* n. 90 at para. 128.

<sup>95</sup> *Joy Mining Machinery Limited v. Arab Republic of Egypt*, *supra* n. 30 at para. 72 and 81.

<sup>96</sup> See *CMS v. Argentine Republic* *supra* n. 46 at para 303, where the tribunal found Argentina breached the provision by passing legislation extinguishing Argentina’s contractual obligation to pay its debt. Note that Argentina has applied to annul this Award and a decision on that annulment application is still pending.

contract contains a clause choosing domestic courts to resolve the dispute.<sup>97</sup> The parties entitled to the protection of the provision also remain unsettled. Some tribunals have suggested that the provision only protects contracts to which the foreign investor and the state, themselves, are parties.<sup>98</sup> Other tribunals have arguably extended the provision's protection to contracts to which the foreign investor's local subsidiary and sub-state entities are parties.<sup>99</sup> On this approach, a foreign investor might claim that the state breached the BIT by failing to fulfill a contractual obligation – notwithstanding the fact that the foreign investor is not personally a party to the contract in question.

g. Free transfers

Many BITs contain a provision requiring the host state to allow investors to freely transfer money into and out of the country.<sup>100</sup> We are unaware of any arbitral decision considering the meaning of such a treaty provision. While the meaning of the provision appears plain on its face, future tribunals may read in restrictions.

h. Establishing investments

The above provisions all protect investments once they are established in the host state; they do not confer rights to establish investments. Indeed, a 1998 UN study notes that BITs “do not usually confer on investors of one contracting party the right to establish investments in the territory of the other contracting party.”<sup>101</sup>

However, a small but growing subset of these treaties does extend certain qualified rights of entry to foreign investors. For example, some BITs oblige states to “admit” investments in certain circumstances.<sup>102</sup> Other BITs oblige the host state to provide national and Most Favored Nation (“MFN”) treatment regarding “permitting” investments.<sup>103</sup> This seems to mean that if a host state permits its own domestic investors to establish or acquire an investment in its territory – or permits the investors of a favored third-country to do the same – then, as a matter of treaty obligation, that host state accords the same prerogatives to investors hailing from the other treaty party provided that the investors being compared are deemed to be “in like situations.”

ii. *Application of BIT protections to problems*

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<sup>97</sup> Compare *SGS v Philippines supra* n. 90 at para. 155 with, for example, *Eureko v Poland, supra* n. 45 at para. 112.

<sup>98</sup> *Azurix v. Argentine Republic, supra* n. 38 at para. 384; *Impregilio S.p.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/3, Decision on Jurisdiction, 22 April 2005 at para. 223.

<sup>99</sup> *CMS v. Argentine Republic, supra* n. 46 at paras 302-303; *SGS v. Pakistan, supra* n. 89 at para. 166; *Noble Ventures v. Romania, supra* n. 59 at para. 86.

<sup>100</sup> Article IV(1) of the Kazakhstan-US BIT, for example, reads: “Each Party shall permit all transfers related to an investment to be made freely and without delay into and out of its territory. ...”

<sup>101</sup> UNCTAD, *Bilateral Investment Treaties in the Mid-1990s* (United Nations, New York and Geneva 1998) at page 46.

<sup>102</sup> For example, Article II(2) of the Canada-Russia BIT provides: “Subject to its laws, regulations and published policies, each Contracting Party shall admit investments of investors of the other Contracting Party.”

<sup>103</sup> See Article 2(1) of the US-Kyrgyzstan BIT.

Several of the state actions against not-for-profit-organizations, described in Section II above, could breach these BIT obligations. Before explaining which actions might breach which obligations, it is important to note two general points. First, some of the state actions could be mandated by domestic law existing before the not-for-profit-organization begins operating in the country. At least one tribunal has said that government actions mandated by laws existing before an investment will not breach BIT obligations. The tribunal said that BIT tribunals can only evaluate new laws and how existing laws are applied to specific investors.<sup>104</sup> Any not-for-profit-organization impugning laws existing before the organization entered the country will need to confront this decision.

The second general point is that states sometimes justify those actions that interfere with investments on the grounds that they are necessary to protect such interests as national security or public order. We described above how such purposes can be considered within some individual BIT obligations.<sup>105</sup> Some BITs also contain provisions exempting such measures from the scope of the treaty.<sup>106</sup> Any not-for-profit-organization claiming that a state breaches its BIT obligations may need to respond to arguments that the measure falls within such an exception. Tribunals may be asked to review a wide range of circumstances where a state invokes a national security, public morals or other similar defense. It may fall to tribunals, in the absence of detailed treaty language, to develop tests which pass judgment on the legitimacy of such actions.

With these general points in mind, we will now identify which state actions against not-for-profit-organizations, described in Section II above, could breach BIT obligations.

a. Interfering with the formation of not-for-profit organizations

As a general matter, host governments have the discretion to admit investments (including not-for-profit ones). However, as was discussed above,<sup>107</sup> some small proportion of treaties, such as the Canada-Russia BIT, will oblige states to provide national treatment regarding the *establishment* of investments. Thus, if a host state were to prevent a not-for-profit-organization from *establishing* a presence in its territory, it will be relevant to determine whether nationals of that host state have, in similar situations, been granted the right to establish not-for-profit activities. Where similarly-situated locals receive more favorable treatment there may be grounds that the foreign entity has been denied national treatment as required by the treaty.

Where a host state has gone so far as to represent that it would allow a foreign organization to establish a presence in its territory, that state could breach its obligation to provide fair and equitable treatment if the state were to renege on those

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<sup>104</sup> *GAMI Investments, Inc v. Mexico*, Final Award, 15 November 2004 at para. 93.

<sup>105</sup> See sections III(B)(i)(d) and (e) above.

<sup>106</sup> Article X(1) of the Kazakhstan-US BIT, for example, reads: "This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests."

<sup>107</sup> See section III(B)(i)(h).

representations.<sup>108</sup> Indeed, the facts supporting the Salvation Army's successful claim that Russia breached its European Convention on Human Rights obligations by refusing to *re-register* its Russian branch might also provide the basis for a potential BIT claim – without speculating as to whether such a claim could be borne out on the merits. It is notable that the European Court found that Russia's conduct had “no legal or factual basis;”<sup>109</sup> tribunals have said that states breach their BIT obligation not to act arbitrarily through actions “founded on prejudice or preference rather than on reason or fact.”<sup>110</sup>

b. Denying and restricting foreign funding

A state prohibiting foreign funding of a foreign-owned not-for-profit-organization for no legitimate reason could breach various investment treaty obligations. First, a state may breach its treaty obligation to permit free investment-related transfers both into and out of the territory. In some treaties, this obligation specifically protects “additional contributions to capital for the maintenance or development of an investment.”<sup>111</sup>

Second, the state may run afoul of its obligation to not arbitrarily impair the organization's operation.<sup>112</sup> If the not-for-profit organization is dependent upon foreign funding to survive, and that foreign funding is choked off, then the denial could amount to an indirect expropriation.<sup>113</sup>

Fourth, a state denying foreign funding to a particular foreign-owned not-for-profit organization could breach its obligation to provide national treatment if other local organizations remain able to draw upon foreign funding or if the denial of foreign funding effectively disadvantaged foreign owned not-for-profit-organizations compared to their local counterparts.<sup>114</sup> A not-for-profit-organization that can establish it is treated less favorably than a local investor will still need to establish that the investor is in “like situation” or “like circumstances.” The organization should have little difficulty if similarly-situated local not-for-profit-organizations can obtain foreign funding. The organization may have problems if there are no local not-for-profit-organizations with which it can be compared or if those not-for-profit-organizations can also not obtain foreign funding. Tribunals adopting a narrow interpretation of “like situation” or “like circumstances” could deny the claim on this ground. Tribunals adopting a broader interpretation might compare the treatment of the foreign owned not-for-profit-organization with any local organization, regardless of whether it is not-for-profit.<sup>115</sup>

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<sup>108</sup> See, for example, *MTD v. Chile*, *supra* n. 44 discussed in section III(B)(i)(a) above.

<sup>109</sup> *Moscow Branch of the Salvation Army v Russia*, *supra* n. 1 at para 97.

<sup>110</sup> *Lauder v. Czech Republic*, *supra* n. 62 at paras. 221 and 232; *Occidental v. Ecuador*, *supra* n. 46 at paras. 162-163.

<sup>111</sup> See US-Kyrgyzstan BIT, Article IV(1).

<sup>112</sup> See section III(B)(i)(c) above.

<sup>113</sup> See section III(B)(i)(e) above.

<sup>114</sup> See *ADF Group Inc v USA*, ICSID Case No. ARB(AF)/00/1, Award, 9 January 2003 at para. 157.

<sup>115</sup> See section III(B)(i)(d) above.

Even if the state is not *denying* foreign funding, the state may still breach BIT obligations merely through *restricting* such funding. If there are no legitimate reasons for the restrictions, the state could breach its obligation not to arbitrarily impair the operation of the organization or breach its obligation to provide fair and equitable treatment through its failure to protect the organization's legitimate expectations.<sup>116</sup>

The state could also breach BIT obligations through banks interfering with not-for-profit-organizations' foreign funding. For example, foreign banks confiscating foreign funding before it reaches the local organization could directly expropriate the organization's intangible right to the money.<sup>117</sup> In such cases, the duration of such interference may be critical to proving an expropriation; brief delays in receiving foreign-originating funds will be viewed much differently than prolonged or indefinite delays. Indeed, there may be no need to argue that an expropriation has taken place, if the relevant investment treaty also obliges host governments to permit investment-related transfers *without delay*.<sup>118</sup>

While the above scenarios involve would-be *recipients* of foreign-funding, another scenario arises where foreign *funders* establish branch offices in a given host country with the intention of funding local development through grant-making activity. The Open Society Institute has complained of restrictions introduced in Uzbekistan, whereby a government committee would review all financial grant-making activity.<sup>119</sup> By preventing foreign funders from funding local actors, Uzbekistan might face BIT claims, including in relation to the obligation to provide fair and equitable treatment.

It bears reminding, however, that because of the architecture of investment protection treaties, such agreements provide no recourse for *domestic* not-for-profit organizations (that is, those not established or owned by a foreign entity) in cases where their own governments deny or delay the access of such groups to foreign funding. In this respect, it warrants repeating that investment protection treaties are no substitute for more broadly-cast human rights treaties, which squarely address the treatment of domestic actors at the hands of their own government.<sup>120</sup>

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<sup>116</sup> See sections III(B)(i)(a) and (e) above.

<sup>117</sup> See section III(B)(i)(c) above. A claim impugning such an action of a foreign bank would also need to establish that the actions of the foreign bank are attributable to the foreign state.

<sup>118</sup> See US-Kyrgyzstan BIT, Art IV (1).

<sup>119</sup> Open Society Institute, "Uzbek Government Forces Closure of Local Soros Foundation", Press Release, April 18, 2004, [http://www.soros.org/newsroom/news/uzbekistan\\_20040418](http://www.soros.org/newsroom/news/uzbekistan_20040418).

<sup>120</sup> Note that not-for-profit-organizations may be able to overcome this problem in some instances by incorporating in a foreign state with a favorable BIT with the country in which the organization intends to operate. Recent BIT decisions indicate that foreign companies can claim against a state even if the corporation is controlled by entities within that state and pursues all its activities there. However, this practice is not without its critics, particularly as it may be used by nationals of a given state to detour around national courts, and to bring disputes to international fora. See, generally, *Tokios Tokelès v Ukraine*, *supra* n. 28 and Markus Burgstaller, "Nationality of Corporate Investors and International Claims Against the Investor's Own State", 7(6) *Journal of World Investment and Trade* 857 (December 2006).

c. Dissolving not-for-profit-organizations and seizing assets

States failing to renew the licenses of not-for-profit-organizations already operating in the country may, in some circumstances, breach BIT obligations. A state denying a not-for-profit-organization a license could breach its obligation to provide fair and equitable treatment if the state represented that it would renew the license.<sup>121</sup> A tribunal could also view the state's conduct as an expropriation of the investment.<sup>122</sup> For example, if Egypt reneges on a representation to grant a license in accordance with its law on not-for-profit-organizations, it might face potential claims for breach of Egypt's BIT obligations.<sup>123</sup>

In bringing such a claim, the not-for-profit organization's precise investment protected by the treaty is important. A not-for-profit organization, whose license to operate is a protected investment, is more likely to succeed in such a claim than an organization whose license is not.

In addition to potentially breaching their BIT obligations by interfering with a not-for-profit organization's license, states dissolving not-for-profit-organizations without reason could breach their obligations, including the obligation to provide fair and equitable treatment or the obligation not to arbitrarily impair the operation of investments.<sup>124</sup> Arguably, even states which dissolve not-for-profit organizations with reason may breach BIT obligations if the organization has a license allowing it to operate for a certain period of time. Tribunals could view the dissolution as inconsistent with the organization's legitimate expectations and, therefore, a breach of the obligation to provide fair and equitable treatment or even as an expropriation of the intangible rights inherent within the license.<sup>125</sup> However, tribunals might consider the legitimacy of the policy objectives being pursued by the host government in weighing a potential treaty breach.

Even states imposing particularly onerous reporting requirements could breach BIT obligations. Such states could breach the state's obligation not to arbitrarily impair investments or to treat investments fairly and equitably.<sup>126</sup> The application of the administrative requirements in Russia's new not-for-profit-organization law, which some allege make it "impossible" for organizations to operate,<sup>127</sup> might give rise to potential BIT claims by not-for-profit organizations. Indeed, it is easy to conceive that organizations whose activities are hobbled might bring claims for *indirect* expropriation

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<sup>121</sup> See, for example, *Tecmed v Mexico*, *supra* n. 42, discussed in section III(B)(i)(a) above.

<sup>122</sup> See, for example, *Tecmed v Mexico*, *supra* n. 42, discussed in section III(B)(i)(e) above.

<sup>123</sup> Article 54, Associations and Non-Governmental Institutions Law (2002).

<sup>124</sup> See sections III(B)(i)(a) and (c) above.

<sup>125</sup> See section III(B)(i)(a) and, for example, *Middle East Cement Shipping v Egypt*, *supra* n. 28 discussed in section III(B)(i)(e) above.

<sup>126</sup> See section III(B)(i)(c) above and *Pope & Talbot v Canada*, *supra* n. 49, discussed in section III(B)(i)(a) above

<sup>127</sup> Adrian Blomfield, "Russia silences human rights group," *Daily Telegraph* (London), 22 December 2005.

of their investment in Russia – without speculating as to the merits of such claims.<sup>128</sup> At the same time, not-for-profit organizations might pursue claims for *direct* expropriation if the state seizes their assets.<sup>129</sup>

d. State officials attending and monitoring meetings of not-for-profit organizations and other forms of harassment or intimidation

It is unclear whether a law forcing a not-for-profit-organization to allow state officials to attend meetings, of itself, breaches any BIT obligations. The organization could argue that such interference goes beyond its legitimate expectations and, therefore, breaches the state's obligation to provide fair and equitable treatment. The authors are unaware of any decisions or literature addressing these sorts of expectations and such a claim would, therefore, need to overcome the hurdle of not having any real authority from which to draw. Such a claim would also need to confront the authority of an International Court of Justice decision finding that the state did not breach its obligation to provide full protection and security by failing to prevent workers from occupying the investor's factory.<sup>130</sup> However, if state officials caused some physical damage or impeded the meeting, then their conduct could rise to the level of a BIT breach.<sup>131</sup>

More generalized harassment or intimidation might breach the host state's obligation to provide for the physical protection and security of not-for-profit organizations or the obligation not to arbitrarily interfere with an investment.<sup>132</sup> For example, Zimbabwe's reported harassment of not-for-profit organizations could expose that country to claims for breach both of these obligations. States could even face claims for failing to prevent private parties from harassing not-for-profit organizations.<sup>133</sup>

e. Failing to fulfill obligations

States breaching contracts or other agreements with not-for-profit-organizations could be liable for breach of BIT provisions requiring states to "observe" their obligations.<sup>134</sup> Even if the not-for-profit-organization is not protected by a contract or some other written agreement, the organization could also mount a claim for breach of investment treaty obligations which prohibit arbitrary impairment or which require fair and equitable treatment (and, thus, may protect the investor's legitimate expectations).<sup>135</sup> States breaching contracts or other legal agreements and effectively preventing the not-for-profit-organization from claiming in the contractually chosen forum could also expropriate the organization's contractual rights.<sup>136</sup> Indeed, a Croatian investor is currently claiming that the Czech Republic expropriated the investor's contractual rights

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<sup>128</sup> See section III(B)(i)(e) above.

<sup>129</sup> See *Sedelmayer v Russia*, *supra* n. 26, discussed in section III(B)(i)(e) above.

<sup>130</sup> See *ELSI*, *supra* n. 58, discussed in section III(B)(i)(b) above.

<sup>131</sup> See sections III(B)(i)(a), (b) and (e) above.

<sup>132</sup> See section III(B)(i)(c) above.

<sup>133</sup> See section III(B)(i)(b) above.

<sup>134</sup> See section III(B)(i)(f) above.

<sup>135</sup> See sections III(B)(i)(a) and (c) above.

<sup>136</sup> See, for example, *Waste Management v. Mexico*, *supra* n. 60 at paras. 175-177.



in a long-term rental agreement for non-residential space.<sup>137</sup> The precise details of the claim are not public and, depending upon the formulation of the treaty in question, other claims might be alleged, including that the host state has failed to observe contractual obligations as required under the terms of the relevant investment treaty.

Even if the not-for-profit organization does not have a contract or agreement with the state, the state may breach a BIT by failing to fulfill obligations contained in legislation. A not-for-profit organization would have a potential claim that a given country breached its BIT obligations to observe its obligations and provide fair and equitable treatment if that country failed to fulfill specific obligations in the state law applicable to not-for-profit organizations.<sup>138</sup> For example, a not-for-profit organization could have a claim if that country reneged on its commitment to exempt organizations from paying certain taxes.<sup>139</sup>

### **C. BIT remedies for not-for-profit organizations**

#### *i. Remedies*

A tribunal finding a state breached its BIT obligations can, generally, order the state to:

- a. stop breaching its obligations;
- b. perform a certain act in order to fulfill its BIT obligations<sup>140</sup>; or
- c. compensate the foreign investor for any monetary damages suffered by the investor as a result of the breach.

Claimants overwhelmingly claim only monetary damages. Damages awards vary. One NAFTA tribunal, for example, awarded the claimant US\$450,000, a small fraction

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<sup>137</sup> See Luke Eric Peterson, "Croatian firm invokes investment treaty to challenge Czech eviction notice," October 1, 2004, INVEST-SD News Bulletin, available on-line at: [http://www.iisd.org/pdf/2004/investment\\_investsd\\_oct1\\_2004.pdf](http://www.iisd.org/pdf/2004/investment_investsd_oct1_2004.pdf).

<sup>138</sup> See, for example, *LG&E v Argentina*, *supra* n. 46, discussed in sections III(B)(i)(a) and (f) above.

<sup>139</sup> Egypt, for example, offers such exemptions in Article 13 of its Associations and Non-Governmental Institutions Law (2002). As always, such a claim's likelihood of success depends on the wording of a particular treaty. In some cases, governments move to limit the applicability of treaty protections in cases where taxation is at issue. See for example, how Article 19 of Japan's investment treaty with Vietnam limits the reach of the treaty where taxation measures are involved: <http://www.mofa.go.jp/region/asia-paci/vietnam/agree0311.pdf>.

<sup>140</sup> Some treaties limit remedies to monetary damages. See, for example, Article 10.15 of the US-Chile and US-Singapore Free Trade Agreements and Article 34 of the 2004 US Model BIT, which restrict compensation to monetary damages and restitution of property, while giving the respondent state the ability to pay monetary damages instead of restitution. On BIT tribunals' ability to order performance or injunction, see, for example, *Enron Corp. and Ponderosa Assets, LP v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on Jurisdiction, 14 January 2004 at para 79: "An examination of the powers of international courts and tribunals to order measures concerning performance or injunction and of the ample practice that is available in this respect, leaves this Tribunal in no doubt about the fact that these powers are indeed available." See also *Antoine Goetz v. Burundi*, Award, 10 February 1999, (2000) 15 ICSID Rev-FILJ 457 at page 516 and *Siemens v. Argentina*, *supra* n. 38 at para. 387.

of its original claim.<sup>141</sup> Conversely, another tribunal awarded the claimant almost US\$300 million in a case where the state interfered with the control of a large broadcasting enterprise.<sup>142</sup>

Not-for-profit organizations claiming monetary compensation through a BIT need to demonstrate they have suffered quantifiable damages. In some instances, this will be straightforward. For example, a state:

- a. seizing assets causes damages amounting at least to the value of the assets;
- b. physically harming assets causes damages to the extent of the harm; and
- c. renegeing on a commitment to apply a favorable taxation rate to the organization will damage the organization to the extent of the new tax that it imposes.

Identifying the damages of a not-for-profit organization arising simply from the inability to continue to operate is not so straight forward. The organization could likely claim for the amount it has invested in the country minus the proceeds from the sale of any assets. While BIT tribunals sometimes award future profits to foreign investors crippled by state interference, most not-for-profit organizations will, by definition, not earn any future profits. However, an organization could claim the loss of future profits of an arm earning profits to fund the organization's other activities. Such a claim would need to demonstrate that future profits are not speculative.<sup>143</sup>

Not-for-profit-organizations claiming remedies for breach of a BIT need to be aware of the high cost of BIT arbitration. Simply registering a claim at the ICSID will cost a claimant US\$25,000,<sup>144</sup> and each of the three arbitration tribunal members will charge hundreds of dollars an hour for their time.<sup>145</sup> BIT disputes often last several years, in which time, lawyer, arbitrator and institution fees can amount to several million dollars.<sup>146</sup> Losing claimants are sometimes ordered to pay the entire fees of the winning respondent state.<sup>147</sup> Even "victorious" claimants are not always awarded their legal costs,<sup>148</sup> which may diminish the attraction of arbitration over smaller claims.<sup>149</sup>

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<sup>141</sup> *Pope & Talbot v. Canada*, Damages Award, 31 May 2002 at para. 91.

<sup>142</sup> *CME v. Czech Republic*, *supra* n. 56.

<sup>143</sup> See, for example, *PSEG Global Inc. and Konya Ilgin Elektrik Uretim ve Ticaret Limited Serketi v Turkey*, ICSID Case No. ARB/02/5, Award of 19 January 2007, at paras. 310-315.

<sup>144</sup> ICSID Schedule of Fees, 6 July 2005, paragraph 1.

<sup>145</sup> See, for example, paragraph 3 of the ICSID Schedule of Fees, 6 July 2005, which provides that arbitrators can charge US\$3000 per day.

<sup>146</sup> For example, the lawyer, arbitrator and ICSID fees in the recent *PSEG v. Turkey* dispute amounted to US\$20,851,636.62: *PSEG v Turkey*, *supra* n. 142 at para. 352.

<sup>147</sup> See, for example, *Methanex v United States*, *supra* n. 68, Part VI.

<sup>148</sup> See, for example, *CMS v Argentina*, *supra* n. 46 at para. 472; *MTD v Chile*, *supra* n. 44 at para. 252.

<sup>149</sup> On costs generally, see Stephan Schill, "Arbitration Risk and Effective Compliance: Cost-Shifting in Investment Treaty Arbitration," 7 *Journal of World Investment and Trade* 653 (2006).

*ii. Enforcement*

Even if a not-for-profit organization successfully claims a state breached a BIT, a state may refuse to provide the remedies ordered by the tribunal. The state may refuse to cease its act breaching the treaty or may refuse to undertake the actions necessary to comply with its BIT obligations. The authors are unaware of a BIT tribunal ordering a state to cease or undertake action, let alone a state refusing to comply with such an order and, therefore, we can only speculate on the consequences of such a refusal. It is difficult to identify the recourse of a not-for-profit-organization in those circumstances. However, there is a debate as to whether the ICSID's status as a World Bank agency might give added weight to political and diplomatic pressure on a recalcitrant state.<sup>150</sup>

A state may refuse to pay the compensation ordered by the tribunal. It seems unlikely that a state would refuse to comply with a BIT in this way. Indeed, the authors are only aware of one instance of a state refusing to pay compensation ordered in a BIT award. Russia refused to pay the compensation to the German investor, Franz Sedelmeyer, for breaches of the Germany-Russia BIT.<sup>151</sup>

If the state does refuse to pay then the claimant can seek to enforce the award. ICSID awards are easier to enforce than others. The ICSID Convention requires states party to the Convention to enforce ICSID awards as if they were "a final judgment of a court in that State."<sup>152</sup> By contrast, investors seeking to enforce non-ICSID awards, or seeking to enforce ICSID awards in states not party to the ICSID Convention, must rely on the *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards*. The New York Convention allows local courts to refuse to enforce arbitral awards on a number of grounds.<sup>153</sup>

Not-for-profit organizations may face additional obstacles because of the "commercial" reservation to the New York Convention. Article I.3 of the Convention entitles contracting states to declare that they will only apply the Convention to disputes arising from relationships which are "commercial" under the country's domestic law.<sup>154</sup> Approximately a third of signatories to the Convention have made this reservation.<sup>155</sup>

Courts in these countries could find that an organization's charitable purpose renders the organization's disputes non-commercial. It is difficult to precisely identify the size of this obstacle. The few courts addressing the meaning of the reservation have not considered a dispute involving a not-for-profit-organization; courts have generally

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<sup>150</sup> Edward Baldwin, Michael Nolan, and Mark Kantor, "Limits to Enforcement of ICSID Awards," 23(1) *Journal of International Arbitration* 22 (2006).

<sup>151</sup> See *Sedelmeyer v Russia*, *supra* n. 26, discussed in section III(B)(i)(e) above.

<sup>152</sup> ICSID Convention, Article 54(1).

<sup>153</sup> New York Convention, Article V.

<sup>154</sup> See, generally, Alan Redfern and Martin Hunter, *Law and Practice of International Commercial Arbitration* (3<sup>rd</sup> edn, Sweet and Maxwell, 1999) at page 457.

<sup>155</sup> Of the 120 signatories to the Convention, 49 have made this reservation: see [www.sice.oas.org/DISPUTE/comarb/uncitral/nysig\\_e.asp](http://www.sice.oas.org/DISPUTE/comarb/uncitral/nysig_e.asp).

considered whether the dispute is “personal” rather than “commercial.”<sup>156</sup> Nevertheless, with the exception of Tunisia, courts have interpreted “commercial” disputes broadly,<sup>157</sup> which augurs well for not-for-profit-organizations claiming their dispute is commercial. Some treaties specifically provide that all claims under the treaty are commercial, for the purposes of the Convention, and claimants under these treaties will not face this problem.<sup>158</sup>

#### **IV. Conclusion**

Not-for-profit organizations appear to enjoy protection under the some 2500 BITs which have been concluded over the last half century. While these instruments were often developed with for-profit investment in mind, some of these agreements expressly contemplate commitments of capital made on a not-for-profit basis. Furthermore, many other investment treaties are silent on such questions, and therefore susceptible to interpretations which would place not-for-profit investments under the protective canopy of the treaty.

Claims under the ICSID dispute resolution system might encounter some tribunals supplementing the definition of investment found in a given investment treaty with that believed to be implicit in the ICSID Convention. Nevertheless, there are strong arguments for holding not-for-profit investments to meet this heightened jurisdictional test imposed by some ICSID tribunals. Moreover, where potential claimants have the option of bringing a claim under the UNCITRAL or ICSID “Additional Facility” arbitration rules they would not need to contend with the “objective” criteria sometimes imposed by tribunals operating under the ICSID rules.

Where claims can clear the jurisdictional hurdles set forth in the treaties and relevant arbitration rules, the substantive protections of BITs may be relevant to a range of different scenarios faced by not-for-profit organizations engaged in foreign activities. Perhaps most obvious, where not-for-profit organizations are subject to the outright seizure of their assets, they may bring a claim for direct expropriation of their property. However, other treaty obligations such as those on the free transfer of capital, fair and equitable treatment, full protection and security and national treatment could prove valuable where organizations encounter interference with their right to transfer funds into and out of the host state; where they are discriminated against when seeking to establish a presence in a new territory; where they are denied re-registration on arbitrary grounds or contrary to prior representations from state officials; or where organizations and their principals suffer harassment, abuse or other forms of intimidation at the hands of state or non-state actors.

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<sup>156</sup> See, for example, the decision of the Tunisian Court de Cassation, 10 November 1993, finding that the relationship between a company and an architect was personal rather than commercial (Reported in Albert Jan van den Berg (ed.), *Yearbook Commercial Arbitration* (Vol. 28, 2003)).

<sup>157</sup> See Albert Jan van den Berg, *ibid.* at 574: “In practice, the commercial reservation generally has not caused problems as the courts tend to interpret the coverage of ‘commercial’ broadly. The only court that interprets the commercial reservation narrowly at present is the Tunisian Supreme Court.”

<sup>158</sup> See, for example, Article 26(5)(b) of the Energy Charter Treaty.

At the same time, certain treaty protections are not always ideally suited to the problems commonly faced by not-for-profit organizations. For example, provisions requiring the free transfer of funds protect not-for-profit organizations bringing capital into and out of the host state but do not protect the free disbursement of funds within a targeted host country. Another problem is the lack of clarity as to what constitutes an “indirect expropriation”. Investment treaties give little guidance as to which exercises of government authority are legitimate non-compensable measures, and which would trigger liability for expropriation of an investment. Further, the quantification of damages may be vexing in some cases where certain activities of not-for-profit organizations are at issue.

Despite such problems, where not-for-profit organizations feel themselves to be victim of mistreatment, they might have recourse to their potential treaty rights and protections in discussions with their host states. Indeed, many disputes which might give rise to formal arbitration may be susceptible to informal resolution provided that state authorities are made aware of the potential for a treaty claim. Here it should be acknowledged that not-for-profit organizations may have reasons to shy away from recourse to formal arbitration – particularly where the organizations are committed to the long-term development of the host state and wish to remain active in that territory – however, the potential for such arbitration appears to be a genuine option.

In addition to qualms about fracturing a relationship with a host government, not-for-profit organizations may harbor differing views as to the legitimacy of investment treaties as instruments of global governance. Some policy-based organizations have leveled criticism at these treaties – including the perceived failure to provide sufficient latitude for governments to regulate foreign investment activity in the public interest.<sup>159</sup> In some cases, this has led to outright opposition to the negotiation of such agreements,<sup>160</sup> while in other instances it has stimulated efforts to design new international agreements which strike a different balance between investor protection and legitimate government regulation.<sup>161</sup>

While the policy debate over investment treaties continues, there are signs that certain not-for-profit organizations (for example those with extensive on-the-ground operations in developing countries) may be experimenting with different legal arrangements to protect their own investments. Moreover, due to the fact that arbitrations under some rules may proceed without any public announcement or disclosure, it is possible that not-for-profit organizations have already begun to invoke investment protection treaties in certain instances. Indeed, there is a vigorous policy debate as to whether investment treaty lawsuits ought to be arbitrable without any public disclosure –

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<sup>159</sup> See, for example, Oxfam International, *The Emperor’s New Clothes: Why Rich Countries want a WTO Investment Agreement*, Briefing Paper No. 46, May 2003, at page 9.

<sup>160</sup> See, for example, the various actions against bilateral investment agreements (and trade agreements with investment provisions) discussed on the activist website, *Bilaterals.org*, at: [http://www.bilaterals.org/rubrique.php3?id\\_rubrique=74](http://www.bilaterals.org/rubrique.php3?id_rubrique=74)

<sup>161</sup> See, for example, the IISD Draft Model Investment Agreement for Sustainable Development, a template co-drafted by one of the co-authors of this present paper at: [http://www.iisd.org/investment/model\\_agreement.asp](http://www.iisd.org/investment/model_agreement.asp).

not least because such disputes often implicate important legal, policy and financial matters - however in the absence of mandatory disclosure of such cases, an unknown number of them will be proceeding without public notice.<sup>162</sup> In the course of researching this paper, the co-authors have learned of at least one arbitration brought on behalf of an undisclosed European not-for-profit organization against a host state. There may be other such cases proceeding without publicity.

Ultimately, international investment treaties appear to protect not-for-profit actors and activities in some circumstances, and may supplement the international protections afforded to development agencies, human rights organizations and the myriad other not-for-profit actors with an international presence. While not tailor-made for such actors and activities – and, as such, prone to certain shortcomings and omissions – investment treaties may offer a surprising amount of recourse and redress in a range of different circumstances.

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<sup>162</sup> On the case for more transparency see: Fiona Marshall and Howard Mann, “Good Governance and the Rule of Law: Express Rules for Investor-State Arbitration Required,” International Institute for Sustainable Development briefing paper, September 2006, available at: [http://www.iisd.org/pdf/2006/investment\\_uncitral\\_rules\\_revision.pdf](http://www.iisd.org/pdf/2006/investment_uncitral_rules_revision.pdf). On the case against more transparency see, Noah Rubins, “Opening the Investment Arbitration Process: At What Cost for What Benefit?” 3(3) *Transnational Dispute Management* (June 2006).

**ARTICLE**

**Notification or Registration?  
Guarantees of Freedom of Association in Non-  
Democratic Environments: Case Studies of Lebanon  
and Jordan**

**Marc Makary<sup>1</sup>**

**Executive summary**

This study analyzes the two main systems of incorporating associations – notification and registration – to determine which offers greater guarantees for the right to incorporate associations in non-democratic environments. It is based on a case study of Lebanon, which has adopted the notification system, and Jordan, which has adopted the registration system, bearing in mind that in Lebanon (especially in the post-war period through late 2005) and in Jordan, the activities of associations and civil society in general have been subject to tight controls. The analysis recognizes the conflict between each of the two registration systems as conceived in democratic environments, on one hand, and the practice of the two systems by authoritarian regimes on the other. This is a comparative review based on the law, case law and administrative practice in the two countries.

The study shows that the notification system offers greater guarantees for the right to incorporate associations due to the fact that the administration plays a passive role. The registration system, in contrast, proves to be more vulnerable to an administration's interference and control in a non-democratic environment. Both Lebanon's and Jordan's systems are flawed, however, and their weaknesses undermine the freedom of association and require us to think about substantial reforms, which could be premised upon existing case law. The study also reveals a common weakness in the regulations governing the incorporation of associations: the banning of undeclared associations.

**Background**

Citizen participation in public life is a basic characteristic of democracy, and must be carried out not just on an individual basis, but more and more through groups such as associations. Associations represent a basic pillar of democracy in most developed countries, and thus respecting and defending the freedom of association should be an objective of all emerging democracies. It is important to recognize that civil associations

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<sup>1</sup> Marc Makary is a lawyer and member of the Beirut Bar. This paper is the product of Mr. Makary's Senior Research Fellowship with the International Center for Not-for-Profit Law (ICNL) and was researched and written in the summer of 2007.

in authoritarian countries such as those of the Middle East as well as in more democratic countries represent an important vehicle for ideas and debates, and constitute the real space for promoting reform.

The importance of associations in a democracy was described by Alexis de Tocqueville during his journey in the United States: *“In democratic countries, the science of association is the mother of science; the progress of all the rest depends upon the progress it has made. Among the laws that rule human societies there is one which seems to be more precise and clear than all others. If men are to remain civilized or to become so, the art of associating together must grow and improve in the same ratio in which the equality of conditions is increased.”*<sup>2</sup> According to Tocqueville, citizens must act collectively and take on new initiatives collectively. Therefore, the degree of associations’ growth in general, and their freedom of action in particular, reflect the level of democratization of a country.

This philosophical perspective has helped to shape many international declarations and conventions. It was also repeated by the European Court of Human Rights in its seminal decision on freedom of association, *Sidiropoulos v. Greece*, which stated that: *“The way in which national legislation enshrines this freedom and its practical application by the authorities reveal the state of democracy in the country concerned.”*<sup>3</sup>

The legal documents binding even the most authoritarian of Arab states defend, in one way or another, the freedom of association.<sup>4</sup> Paragraph XIV of the Universal Islamic Declaration of Human Rights, dated September 19, 1981 states, *“Every person is entitled to participate individually and collectively in the religious, social, cultural and political life of his community and to establish institutions and agencies meant to enjoin what is right (ma’roof) and to prevent what is wrong (munkar).”* Article 28 of the Arab Charter of Human Rights of September 15, 1994, which is close in its content to Article 11 of the European Convention of Human Rights (ECHR), provides, *“All citizens have the right to freedom of peaceful assembly and association. No restrictions shall be placed on the exercise of this right unless so required by the exigencies of national security, public safety or the need to protect the rights and freedoms of others.”* Furthermore, many regional conferences have been held in the Middle East, and the participants have issued a number of declarations that seek greater protection for the freedom of association.<sup>5</sup>

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<sup>2</sup> Alexis De Tocqueville, *Democracy in America*, 1864, t. II, chap. V, p. 182.

<sup>3</sup> European Court of Human Rights, *Sidiropoulos and Others v. Greece*, July 10, 1998, N° 40.

<sup>4</sup> In fact, freedom of association in international law figures in numerous fundamental legal instruments related to human rights and public liberties. It is consecrated in Article 20 of the Universal Declaration of Human Rights and Article 22 of the International Covenant on Civil and Political Rights of 1966. On the European level, freedom of association is consecrated in Article 11 of the European Convention of Human Rights. Moreover, this freedom is the subject of an entire declaration, the Convention Concerning Freedom of Associations and Protection of the Right to Organize, adopted on July 9, 1948 by the General Conference of the International Labour Organisation.

<sup>5</sup> See, for instance, the Final Declaration of the representatives of Arab Civil Society at the 2006 Forum for the Future.



It is clear that these texts attempt to provide a guarantee and draw the general framework for protecting the freedom of association, leaving the task of developing detailed guarantees to national level legislation and case law. Should the states that ratified these international instruments not develop such guarantees, the right to the freedom of association and to form associations is ineffective and devoid of content.

Guarantees and protections offered by international instruments and constitutions are not the only components of a legal framework that governs associations. In fact, the legal regime for incorporating associations and recognizing their legal personality plays a major role in the protection of the freedom of association and, in particular, the right to incorporate associations. There are two principal systems for incorporating associations:

- The *notification* system, also known as the *declaration* system (adopted by France, the Netherlands, Belgium, and Lebanon, among others). This system is premised on the theory that associations are formed solely by the will of their founders without any intervention by the administration; the latter plays a passive role and notes the formation of the association by virtue of a declaration presented to the competent administrative authority by the founders. The notification is finalized by the delivery of a receipt for the declaration.
- The *registration* system, also known as the *acknowledgment* system (adopted by the majority of the countries, and particularly common in the Middle East).<sup>6</sup> Under this system, the formation of the association is subject to registration before the competent authority. Registration only occurs with the approval of this authority; thus, the administration plays an active role since it must acknowledge the existence of the association.<sup>7</sup>

Lebanon has adopted the *notification* system. Lebanon has a parliamentary regime and a fragile democracy that suffers from a lack of democratic culture. The Lebanese experience is interesting due to the paradoxical confrontation between the liberal laws and case law, on the one hand, and the authoritarian administrative practices on the other.

As for the *registration* system, it has been adopted in the majority of the Arab countries, including the Hashemite Kingdom of Jordan. This paper uses Jordan's civil society law as a case study, because legal reform efforts are being carried out in the context of the recent development of the civil society sector in Jordan and the sector's resistance to the repressive measures adopted by the government.

This study aims to analyze the legal protections of the right to incorporate associations in the two Arab countries under study in order to determine which offers

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<sup>6</sup> Other incorporation systems exist with regard to the formation of particular types of associations, for example, licensing systems for associations involved in special activities (e.g., health or education).

<sup>7</sup> This paper uses the term, "registration," but "prior authorization" or "licensing" may also be used to describe the active role of the state in the system of incorporation. It is the state's decision to "register" the association which determines the birth of an association's legal status. A state with a passive notification system may have laws providing for *a posteriori* registration procedures (in an association registry, for example) following an association's delivery of its declaration. Under the notification system, however, this subsequent act of registration has no bearing on the legal status of the association, which is acquired at the moment of the declaration.

greater guarantees when applied in a non-democratic environment: the notification or the registration system. The study will investigate each of the two systems of incorporation by reviewing the law, the case law and the administrative practice in each country under study.

This paper includes five main sections: Section one is an introduction that offers a general background on the legal regulations for associations in Lebanon and Jordan. Section two describes and analyzes the notification system in Lebanon in an attempt to determine whether or not the Lebanese experience can serve as a good model for reform in other Arab countries. Section three explores the registration system in the Jordanian case and highlights the hazards of the application of a registration system in such a non-democratic environment. Section four describes one common violation of the freedom of association in both countries under study – specifically, the banning of undeclared associations. Section five puts forth recommendations based on the analysis for legal rules that will guarantee the freedom of association.

## **I. Legal regulation of associations in Lebanon and Jordan.**

In order to analyze how the freedom of association is protected, it is important to draw attention to the current legal framework that governs associations in both Jordan and Lebanon. This scrutiny will take into consideration four sources of law and practice on incorporating associations: the constitution, the law, the case law and the administrative practice.

In Lebanon, the freedom of association is consecrated in Article 13<sup>8</sup> of the Constitution,<sup>9</sup> although it was earlier guaranteed by the Ottoman Law, dated August 3<sup>rd</sup>, 1909, that governs the incorporation of associations in Lebanon (hereinafter referred to as the “Ottoman Law” or the “1909 Law”). The Ottoman Law is directly inspired by the French Law on Associations, dated July 1, 1901. Known for its liberal bent, the Ottoman Law adopted a *notification system*, also called a *declaration system*, for the incorporation of associations.

The Lebanese notification system is applied to all associations except those governed by special legal regulations which require a prior authorization (addressed below). Despite its liberal nature, however, the Lebanese law prohibits undeclared associations and cedes power to the government to refuse to receive an association’s declaration and dissolve it by virtue of a decree issued by the Council of Ministers. In addition, Lebanese legislation contains repressive requirements with respect to the

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<sup>8</sup> The current official text of Article 13, in Arabic, mentions the “freedom to form associations,” whereas the original text of this article that was drafted in French mentions “freedom of association.” Despite the restrictive nature of the Arabic translation, Lebanese doctrine recognizes that Article 13 consecrates the general principle of freedom of association.

<sup>9</sup> The Lebanese Constitution was adopted in 1926 under the French Mandate and was inspired by French Constitutional Law. For more information about this topic, see Antoine Hokayem, *The Genesis of the Lebanese Constitution of 1926*, Les Editions Universitaires du Liban, Beirut (1996) (original title: *La Genèse de la Constitution Libanaise de 1926*), and Marc Makary, “*The Lebanese Constitution of May 23<sup>rd</sup>, 1926 and the Constitutional Laws of the 3<sup>rd</sup> French Republic, A comparative approach*,” 2006, Thesis, Library of the Saint Joseph University School of Law and Political Sciences (Original title: *La Constitution libanaise du 23 mai 1926 et les lois constitutionnelles de la IIIème République française, Approche comparative*).

following particular types of associations, the incorporation of which requires a prior authorization: foreign associations,<sup>10</sup> youth and sports associations,<sup>11</sup> and syndicates of employees and employers.<sup>12</sup> Furthermore, the law has obliged such associations, in particular youth and sports associations, to adopt specific forms of statutes and by-laws.

The case law in Lebanon is liberal. It includes numerous decisions designed to keep intact the enabling provisions of the 1909 Law and to ensure the conformity of administrative practice to the law and to the Constitution. The Constitutional Council has not had the occasion to render a verdict directly addressing the freedom of association. It has, however, issued two 1997 decisions<sup>13</sup> that granted authority equivalent to the constitutional to the Universal Declaration of Human Rights (UDHR) and the International Covenant on Civil and Political Rights (ICCPR), which is a fundamental source of human rights protection in Lebanon.<sup>14</sup>

On the other hand, the State Council<sup>15</sup> has issued several decisions since 1946 with respect to the protection of freedom of association. Despite the liberal legal environment established through the laws discussed above and refined by the case law, the administrative practice in Lebanon has reflected a repressive attitude towards associations, violating the Constitution and the law by imposing a prior authorization requirement on the incorporation of associations.

Unlike the Lebanese case, while freedom of association in Jordan is protected by the Constitution, its laws are contrary to the standards for freedom of association set by International Law. Article 16 of the Constitution grants Jordanians the right “*to establish societies and political parties provided that the objects of such societies and parties are lawful, their methods peaceful, and their by-laws not contrary to the provisions of the Constitution.*” While Article 16 seems to provide space for individuals to establish associations, its paragraph (iii) places the establishment of associations and political parties under the control of the law. Jordanian Law N° 33 of 1966 (hereinafter referred to

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<sup>10</sup> Law N° 369/L.R., dated December 21, 1939.

<sup>11</sup> Law N° 16/72, dated December 15, 1972.

<sup>12</sup> Articles 86 et seq. of the Code of Labor, dated September 23, 1946, and Decree N° 7993, dated April 2, 1952.

<sup>13</sup> Lebanese Constitutional Council, Decisions N° 1/97 and N° 2/97, dated September 12, 1997, related to the Law prorogating the mandates of the Municipal Councils and the *Moukhtar* (mayors).

<sup>14</sup> In Lebanon, the highest source of law is the Constitution; and the next-highest source is international treaties, which take precedence over national law. Nevertheless, following the 1997 Constitutional Council decision, the UDHR of 1948, the International Covenant for Civil and Political Rights (ICCPR) and the International Covenant for Social and Economic Rights) of 1966 (ICCSER) have been accorded the same authority as the provisions of the Constitution because they are referenced in the Preamble of the Constitution, which was incorporated by the Constitutional Council into the text of the Constitution in 1997.

<sup>15</sup> The State Council is the highest administrative judicial authority with jurisdiction over the administrative acts executed by public authorities. [www.statecouncil.gov.lb](http://www.statecouncil.gov.lb)

as the “1966 Law”) specifically regulates the creation of associations and social bodies and imposes a registration system of incorporation.

The 1966 Law’s provisions do not protect the right to freedom of association: they grant absolute discretion to the Minister of Social Affairs or the Minister of Interior to register associations, ban undeclared associations, and establish long and burdensome administrative procedures. Notwithstanding these harsh circumstances, Jordanian civil society organizations persist in presenting a draft law to improve their legal environment.<sup>16</sup> However, it is disappointing that this draft law, presented to the Jordanian Parliament in 2006, also contains many repressive and arbitrary provisions and follows the example of the 1966 Law in many aspects.

Civil society organizations also mounted legal challenges to the restrictive 1966 Law, but the Courts did not show any courage: several decisions confirmed the absolute discretion of the Minister’s powers. Administrative practice conformed to the 1966 Law, and institutionalized a restrictive attitude towards the incorporation of associations.

This quick overview of the status of the freedom of association in the two countries under study shows that the right to form associations freely suffers from a lack of guarantees and repressive administrative practices. The two countries’ practices violate four fundamental aspects of the right to free association which constitute, we believe, the core of the right: first, the right to form associations without inappropriate administrative obstacles; second, the right to form undeclared or informal associations; third, the right to choose the goals of the association without any restriction other than those provided by the law in a democratic society (e.g., public order, national security); and finally, the ability to draft the association’s statutes and by-laws freely without detailed requirements and restrictions.

## **II. The notification system: is the Lebanese law a good model?**

The application of the notification system in Lebanon is a rare legacy transferred by the Ottomans to the Lebanese State.<sup>17</sup> The 1909 Law is considered a liberal law and is the oldest law still in force in the region with regard to associations. However, the liberal character of the Law has not always been welcomed by the Lebanese authorities. In fact, since Lebanese independence in 1943,<sup>18</sup> the administrative practice towards associations

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<sup>16</sup> This draft law was supported by a coalition of civil society organizations, among which figure Partners Jordan and Adala Center.

<sup>17</sup> The Ottomans occupied the current Lebanese territory during more than five centuries (from 1516 to 1918), but they granted Lebanon a high degree of autonomy, and did not build institutions in the territory. On the legal level, the main legacy left by the Ottomans to the Lebanese is the Millet system of government, based on communitarianism and, in particular, on internal legal autonomy of the historical religious communities, also called “personal federalism,” as opposed to “geographical federalism.” This internal autonomy is consecrated in two articles of the Lebanese Constitution: Article 9 (the exercise of cult and Personal Status), and Article 10 (the right granted to communities to have their own schools and educational institutions). Moreover, Article 9 is directly copied from Article 11 of the 1876 Ottoman Constitution.

<sup>18</sup> Lebanon was founded as a State by French authorities in 1920. It gained its independence from the French Mandate on November 22, 1943.

has often been arbitrary, particularly in the post-civil war period,<sup>19</sup> during which administrative practice instituted a system of control vis-à-vis the emerging civil society. Challenges to this arbitrary administrative practice provided the Courts with opportunities to issue opinions on numerous aspects of Lebanon's protection of the right to freedom of association.

#### A. The incorporation process according to the Ottoman Law of 1909 in Lebanon

The notification system of incorporation of associations has two main requirements: (1) the formation of the association is accomplished by the sole will of its founders; and (2) the declaration of the founders makes the association's legal status presumptive. The notification system, when properly implemented, suggests that (3) the administration is *obliged* to receive the declaration – an obligation also referred to as a “binding authority” – and finally, (4) that the birth of the legal capacity of the association occurs at the moment of declaration.

##### 1. The formation of the association

Following the example of companies (commercial or civil) which are primarily an agreement between two or more partners, the association is an agreement between a certain number of individuals (specified by the law) who “*decide to unite their knowledge and efforts in order to reach certain goals which are not to divide profit.*”<sup>20</sup> As mentioned before, this provision is heavily inspired by French law. In fact, the contractual nature of the association appears clearly in Article 1 of the 1901 French Law on the Contract of Association, which defines the association as being a *convention* between a number of individuals and subjects the contract of association, with respect to its validity, to the general principles governing agreements and obligations.

Accordingly, associations are founded by virtue of the sole will of their founders, which is evidenced by the signing of the association's by-laws by its founders. The administration plays a passive role limited to receiving a declaration presented by the association, and hence being notified of its formation.

Moreover, Article 2 of the 1909 Ottoman Law in Lebanon confirms these principles and clearly states that “*no permit is initially needed to found an association.*” “*However,*” states the same article, “*in all cases, the government must be notified of the association after it is founded in accordance with Article 6.*” This principle is a direct recognition of the right to freedom of association, confirmed by the French Constitutional Council in its founding decision on the freedom of association dated July 16, 1971:

*“Considering that freedom of association must be placed among the fundamental principles acknowledged by the laws of the Republic, and*

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<sup>19</sup> Lebanon was torn by a civil war from 1975 to 1990. The Taëf Agreement put an end to the conflict and instituted a typical power-sharing regime under which the main powers were concentrated in the hands of the Council of Ministers, a collegial body that represented all of the religious communities. The constitutional regime proved to be inefficient, which resulted in the consolidated authority of the Syrian trusteeship in Lebanon from 1990 until 2005, when the Lebanese people protested massively against the Syrian presence after the assassination of the Prime Minister Rafic Hariri. As a result of this popular movement and under intense international pressure, the Syrian army withdrew from the country.

<sup>20</sup> Article 1 of the 1909 Law.

*solemnly reaffirmed by the Preamble of the Constitution; that this principle is the basis of the provisions of the law of 1901 regarding the contract of association; based on that principle, associations are created freely and may be made public with the sole requirement of a prior declaration deposit; therefore, except measures that could be taken regarding specific categories of associations, the formation of associations, even if they appear to be null or pursue an illegal purpose, may not be submitted for its validity to a prior intervention of the administration or even of the judiciary branch.”<sup>21</sup>*

However, and in order to enjoy legal capacity, associations should be subject to a formal requirement: a declaration to the public authorities.

## 2. The declaration to the public authorities:

Lebanese law requires that associations, once formed, declare themselves to the public authorities; otherwise they are considered to be secret associations and hence subject to legal proceedings. Article 6 of the 1909 Law states explicitly that the founders (or their legal representatives) “*must immediately provide a signed and stamped statement which includes the address of the association, a statement of its goal, its main office, the names of those in charge of running its affairs as well as their titles and location, to the Ministry of Interior (...). A receipt shall be delivered to them in return. Along with providing this attestation, two copies of the statutes must be attached, to which have been endorsed the official seal of the association.*”

The declaration mentioned in Article 6 is not an *application* for registration which should lead to the issuance of an administrative decision to approve or to reject the registration of the incipient association. Under the notification system, the association is formed *before* any contact with the public authorities. Thus, the declaration to the public authorities is just a fulfillment of the association’s legal duty to make public its establishment in order to acquire legal capacity. In return, the association is entitled to receive a receipt from the public authorities designated by the law -- the “*receipt of Ilm wa Khabar,*” which literally means “*information and notification*” (referred to hereinafter as the “*Receipt*” or the “*Ilm wa Khabar*”).<sup>22</sup>

It is notable that the Ottoman Law does not fix any deadline for the administration with respect to the delivery of the Receipt, whereas the French law fixes a five day limit from the date of the declaration. Although the delivery of the Receipt does not have a

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<sup>21</sup> French Constitutional Council, Decision N° 71-44 DC, July 16, 1971, *Freedom of association*. This principle was also confirmed by the Lebanese State Council in numerous decisions. See, for instance: State Council, N° 135/2003-2004, November 18, 2003, *Association for the Defense of Rights and Liberties v. State*, Al Adl, 2004, vol. 2, p. 191.

<sup>22</sup> For an extensive analysis of this issue, refer to Ghassan Moukhaiber, Marwan Sakr, Ziad Baroud, Karim Daher, *Associations in Lebanon: between the freedom, the law and the practice*, Association of Defense of Rights and Liberties (Arabic). This book constitutes one of the most important references concerning associative rights in Lebanon, and is one of the main sources of information in this paper. See also: Ghassan Moukhaiber, “*Associative Rights in Lebanon and the Arab countries,*” 2004, CEDROMA Conferences, Saint Joseph University, Beirut (French).

legal impact on the association's legal capacity, which is acquired by the declaration only, the omission of a time limit has been exploited by the administration, as we will see in the following section. The latter refrains from issuing the Receipt before it has carried out investigations and inquiries regarding the objectives of the association. Additionally, following the example of the French system, the Lebanese administration instituted the custom of publishing the Receipt in the Official Gazette. This obligation is not prescribed by the 1909 Law, but is mentioned in Article 5 of the French Law of 1901. Through this practice of publication of the Receipt, the public authority acquires the possibility of refraining from issuing the Receipt directly to the association in order to later publish it.

For these reasons, it is important to shed light on the weakness of the Law due to the absence of a deadline for issuing a Receipt, and to put in perspective the powers of the public authority. These points will be addressed in the analysis of Lebanese administrative practice.

### 3. The powers of the administration upon reception of the declaration: a binding authority

Article 6 of the 1909 Law explicitly states that the administration *shall issue the Receipt upon reception of the association's declaration*. Therefore, the powers of the administration in this respect are restricted, and the latter is bound to issue the Receipt. This obligation of the administration regarding the issuance of the Receipt has been confirmed by Lebanese case law. In its decision dated November 18, 2003, the State Council stated that, upon the reception of the declaration mentioned in Article 6, the "*Ministry of Interior is obliged to issue the *Ilm wa Khabar* in return without any delay and it does not enjoy any discretionary powers with this respect.*"<sup>23</sup> The obligation has also been extensively confirmed by French administrative case law.<sup>24</sup>

This does not mean in any sense that the administration should never refuse reception of a declaration. The 1909 Law mentions that the competent authority can refuse to deliver the Receipt in two limited circumstances: first, if the declaration does not include all the required information as indicated in Article 6; and second, if the goals of the association are illicit according to Article 3 of the Law, which states that the goals of the association shall not:

- violate the provisions of the laws and public morals;
- aim to jeopardize the comfort of the monarchy and the integrity of the state property;
- aim at changing the form of the government; or
- politically discriminate between all Ottoman citizens.

According to the same article, should any association violate the aforementioned provisions, the association must be dissolved immediately by virtue of a decree issued by

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<sup>23</sup> State Council, N° 135/2003-2004, November 18, 2003, *Association for the Defense of Rights and Liberties v. State*, *op. cit.*

<sup>24</sup> Administrative Tribunal, Paris, January 25, 1971, *Dame de Beauvoir et Leiris*, AJ 1971, p. 229; CE, January 25, 1985, *Assoc. Les amis de St-Augustin*, AJ 1985, p. 228, DA 1985, n. 120.

the Council of Ministers. This type of refusal could constitute fertile ground for abuse by the authorities, who wield great discretion in determining the compliance with the law of the association's goals. However, the nature of the notification system substantially reduces this risk of abuse. In fact, the administration cannot refuse or reject the incorporation of the association by a simple decision, issued by a Court or by an official of the Associations Registry, for instance, since the association has been already incorporated and has a legal existence under the notification system. In order to ban an association, the administration must refuse to deliver the Receipt and take an administrative decision executed by a decree issued by the Council of Ministers to dissolve the association. The issuance of a decree is a complicated and burdensome procedure for the administration. Furthermore, the decree is potentially of greater significance than the simple refusal of the administration to register the association under the registration system. In fact, the decree is an administrative decision that requires an affirmative vote in the Council of Ministers; once approved, the decree is officially declared by the Minister of Information as a Council of Ministers' decision and then published in the Official Gazette. Therefore, since the decree is issued by the Council of Ministers as a political body, the latter is highly accountable for its decision before the Parliament and public opinion. Consequently, a decision to dissolve an association following the refusal to issue a Receipt could provoke a political crisis or great criticism of the Council of Ministers if the decision was not legitimately grounded. This constitutes a practical guarantee against the abuse of the administration with respect to reception of the declaration and issuance of the Receipt. Moreover, since the end of the civil war in 1990 and during the fifteen years of the Syrian Lebanese dictatorship in Lebanon, the Council of Ministers did not issue a single decree according to the procedure described above, although thousands of associations were incorporated during this period.<sup>25</sup>

Nevertheless, the administration's abuse of power could result from another flaw in the Ottoman Law: the law does not fix any time limit for the administration's decision to dissolve the association by virtue of a decree issued by the Council of Ministers. Thus, associations may find themselves in a situation of uncertainty during which they do not enjoy legal capacity, which is acquired only by issuance of the Receipt. The solution to this weakness can be found in Lebanese administrative law. Should the Ministry of Interior refuse to issue the Receipt, the Ministry is deemed to have issued an implicit decision of refusal on the date the declaration was made. This implicit decision of refusal can be challenged before the State Council within a period of two months from the date of the implicit decision.<sup>26</sup>

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<sup>25</sup> A review of the Official Gazette from January 1, 1992 until December 31, 2006, showed that the Administration issued 42 decrees dissolving associations. These associations had submitted their declarations to the Ministry, which issued the receipts in conformity with the 1909 Law. However, they were dissolved for reasons that arose after the associations first enjoyed legal capacity.

<sup>26</sup> See for instance: Court of Cassation, Administrative Section, N° 54, dated May 30, 1952, Lebanese Judicial Review, 1953, p. 817.



4. The effect of the declaration: the birth of legal capacity

It is clear from what has been stated above that associations are formed upon the signing of by-laws by their founders, but associations do not enjoy legal capacity before presentation of their declaration to the public authorities. Thus, it is necessary to fix the moment of the birth of the legal capacity: is it at the moment of the declaration or the moment of the issuance of the Receipt?

This question was examined by the State Council in its founding decision, dated September 25, 1946. In that case, the association presented its declaration to the administration in compliance with Article 6, but the administration refused to issue the Receipt. The association then challenged the implicit decision of refusal by the Ministry of Interior before the State Council. The Ministry of Interior contested the legal capacity of the association but the State Council rejected the Ministry's allegations and confirmed that the association enjoyed sufficient legal capacity to present the lawsuit before the administrative court. In order to reach this verdict, the State Council based its reasoning on Articles 2 and 8 of the Ottoman Law of 1909. Article 2 states that "*no permit is initially needed to found an association*"; and Article 8 states that "*each association having provided a statement according to article 6 can advance to the courts through an intermediary as either plaintiff or defendant ..., and can manage and administer ... : 1) the monetary shares given to it by members ...; 2) the location designated for administering and the meeting of its members; [and] 3) the non-moveable assets necessary for carrying out the intended goal as given in its own statutes...*". The State Council then considered that these two Articles imply that the "*incorporation of an association does not require a license or an acknowledgement from the government; [the association] just has to inform the government after its incorporation, which happened in the present case,*" and therefore, the association enjoys legal capacity since it has fulfilled the obligations prescribed by Article 6.

This principle has been reconfirmed in the aforementioned decision, dated November 18, 2003, in which the State Council declared that, "*according to the explicit terms of Article 8, the association enjoys legal capacity solely upon the deposit of the declaration mentioned in Article 6 of the law on associations.*"<sup>27</sup>

The significance of this question increases in view of Lebanese administrative practice, which considers that the birth of an association's legal capacity is subject to publication of the *Ilm wa Khabar* in the Official Gazette, as we will see in the following discussion.

B. The distortion of the notification system in Lebanese administrative practice versus the courage of the Courts

Despite the clarity of the text and the case law, the administrative practice in Lebanon has generally been authoritarian and contrary to the law. It is important to note that in the post-war period under the Syrian occupation of Lebanon, the government adopted a repressive attitude towards civil society organizations. It worked to have broad control over the formation and incorporation of new associations. This practice was

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<sup>27</sup> State Council, November 18, 2003, *op. cit.*

overcome, however after the Syrian Army's 2005 withdrawal. In fact, under the pressure of and in close collaboration with the civil society organizations, particularly the Lebanese Association for the Defense of Rights and Liberties (ADDL),<sup>28</sup> the Minister of Interior issued Circular N° 10/AM/2006, dated May 19, 2006,<sup>29</sup> which establishes a process of incorporating associations in conformity with the liberal spirit of the 1909 Law. The administrative practice was also rehabilitated under the influence and the pressure of liberal case law that condemned the recent illegal and unconstitutional practices. Unfortunately, this reform did not last for more than one year. In fact, the current Minister of Interior<sup>30</sup> adopted a substantially controlling attitude<sup>31</sup> towards the incorporation of associations which violates the law and the Ministerial Circular. This practice is illegal at three levels: (1) the distortion of the *Ilm wa Khabar* concept and the denial of legal capacity; (2) the insertion of approval of the security services as a requirement for the "formation" of an association; and (3) the abuse of power of the administration with regards to the reception of the declaration.

1. The distortion of the *Ilm wa Khabar* concept and the denial of legal capacity: declaration or prior authorization?

The Lebanese government has transformed the declarative nature of the Receipt into a *de facto* prior authorization requirement. The simple declarative statement mentioned by the law has been construed as a "request," or an "application," subject to scrutiny by the Ministry of Interior, which shall "approve the incorporation" of the association or reject it. As result of this distorted process, the Ministry issues a "decision" to "grant" the *Ilm wa Khabar* to the association. This illegal administrative practice is illustrated in this text of the *Ilm wa Khabar* published in the Official Gazette:

*"The Minister of Interior,*

*Based on the Law on Associations dated August 3, 1909 and in particular Article 6 thereof,*

*Based on the Request presented by the founders of the association named (...), registered before the Political and Administrative Affairs Department under the number (...) dated (...),*

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<sup>28</sup> The ADDL was founded in late 1995 by a group of eight lawyers, the majority of whom were members of the "Committee of Human Rights" in the Beirut Bar Association. Their objectives were focused on the protection of human rights and public liberties. The ADDL greatly contributed to the protection of the freedom of association in Lebanon and particularly to defending and explaining the liberal character of the 1909 Law. For further information on this issue, please refer to: Karam Karam, *The Civil Movement in Lebanon*, 2006, Karthala, Paris, p. 105 et seq.

<sup>29</sup> Lebanese Official Gazette, 2006, vol. 26, dated May 25, 2006, p. 2962. Members of the ADDL participated closely in writing the Circular.

<sup>30</sup> The current Minister of Interior, (who is a former officer in the General Security Forces) resigned in February 2006 under pressure from public opinion, including popular riots, following revelation of a serious flaw in the security service's actions. He was temporarily replaced by the Minister of Youth and Sports, who adopted liberal attitudes towards the incorporation of associations and issued the Circular. He returned to his functions as Minister of Interior in December 2006.

<sup>31</sup> This controlling attitude appears essentially in the long and burdensome investigation procedures preceding the issuance of the Receipt. As we will see below, however, the practice has been rehabilitated in many respects.

*Following the approval of the General Security Services in its letter N° (...) dated (...),*

*Based on the proposal of the General Director of the Ministry of Interior,*

*Decides the following:*

*Article 1: The association named (...) is granted the *Ilm wa Khabar*. ”<sup>32</sup>*

Consequently, should the Ministry refuse to grant *Ilm wa Khabar*, the association is considered illegal and hence subject to legal proceedings or Ministerial dissolution. Furthermore, the administration considers that the approval does not enter into force unless it is published in the Official Gazette, publication of which occurs at the end of the “incorporation procedure,” a long process abusively extended by the administration, and which is subject to the sole discretion of the Ministry. The association in practice only enjoys legal capacity at the moment of publication of the *Ilm wa Khabar*.

This administrative practice has been very harmful as a practical matter to many civil society initiatives in Lebanon. Associations have been paralyzed and deprived of the capacity to conduct the legal acts that allow their existence and operations: opening bank accounts, entering into agreements such as leases for premises with third parties or employment agreements, receiving donations, and in general, carrying out any act or transaction. Nevertheless, in the last decade, awareness regarding the rights of associations has grown and many banks open accounts for associations that lack *Ilm wa Khabar*.<sup>33</sup>

This authoritarian practice is very well described in the allegations of the Ministry in the context of a seminal case that was examined by the State Council.<sup>34</sup> This case, *Association for the Defense of Rights and Liberties v. State*, dated November 18, 2003, produced one of the most liberal and important decisions in Lebanese administrative case law by the State Council.

The plaintiff, the Association of Defense of Rights and Liberties, requested the nullification of a circular issued by the Ministry of Interior on January 16, 1996, which imposed special organizational requirements upon penalty of withdrawal of an association’s *Ilm wa Khabar*. The plaintiff claimed that the Ministry refused to register the minutes of an association meeting on the grounds that the association “*does not have a license*” due to a violation of the contested circular. Before the State Council, the Ministry first contested the legal capacity of the association because “*it has not been*

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<sup>32</sup> Hundreds of *Ilm wa Khabar* were published in this form, especially in the post-war period that witnessed an intensive development of civil society organizations. See, for instance, *Ilm wa Khabar* N° 61/AD, dated April 11, 1998, Official Gazette, vol. 19, dated April 30, 1998, p. 1503. (Text translated and emphasis added by author.)

<sup>33</sup> This issue carries particular importance for associations, given the fact that the majority of the foreign institutions (such as the European Union Mediterranean Partnership or the World Bank) that provide funding for Lebanese associations require that grantees have bank accounts.

<sup>34</sup> State Council, N° 135/2003-2004, November 18, 2003, *Association for the Defense of Rights and Liberties v. State*, *op. cit.*

*granted the Ilm wa Khabar yet due to the fact that the investigations necessary for the confirmation of its lawfulness and its conformity to the laws according to Article 3 of the Law on Associations have not been achieved yet.” The Ministry also contended that “the Ilm wa Khabar is not a receipt but it is a license issued by the authority with appropriate jurisdiction (the Ministry of Interior) and that incorporation is subject to the issuance of Ilm wa Khabar ....”<sup>35</sup>*

The response of the State Council to these ill-founded allegations was sharp and in total compliance with the liberal spirit of the law. The State Council declared that “*contrary to the allegations of the State, the association enjoys the legal capacity by force of the explicit terms of Article 8 solely upon the deposit of the declaration mentioned in Article 6 of the Law on Associations, and by force of the law, the Ministry of Interior is obliged to issue the Ilm wa Khabar in return without delay, and it does not enjoy any discretionary powers with this respect.*”<sup>36</sup>

Furthermore, the State Council confirmed the declarative nature of the *Ilm wa Khabar*, the latter being a simple receipt and not an administrative decision. In fact, in a decision dated May 22, 1967, *Syndicate of the Owners of Audit and Accounting Offices*,<sup>37</sup> the State Council confirmed that the *Ilm wa Khabar* is not an administrative decision. In this case, the Syndicate requested before the State Council, “*the invalidation of Declaration N° 58/AD, dated March 12, 1964, granted by the Ministry of Interior with respect to the formation of an association with similar goals to the Syndicate’s.*” The State Council rejected the Syndicate’s demand on the ground that the administrative court lacks jurisdiction to examine the demand of the Syndicate. It explained that the “*Ilm wa Khabar is not a prejudicial administrative decision (which the State Council would be competent to examine) as long as the prejudice results from the formation of an association prior to the Ilm wa Khabar.*” Consequently, the State Council decided that the competent judicial authority is the Civil Court, given the fact that associations are private entities and that the claimed prejudice resulted from the existence and founding of the association, not from the *Ilm wa Khabar*.

Following the issuance of the above mentioned Circular of May 19, 2006, the administrative practice was rehabilitated and the Ministry of Interior corrected the illegal practice related to *Ilm wa Khabar*. Many *Ilm wa Khabar* published in the Official Gazette after the issuance of the Circular reflect this rehabilitation, as the text is in compliance with the 1909 Law:

*“The Minister of Interior,*

*(...)*

*Based on the Law on associations dated August 3, 1909 and in particular Article 6 thereof,*

*Based on the Circular N° 10/AM/2006 dated May 19, 2005,*

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<sup>35</sup> *Ibid.*

<sup>36</sup> *Ibid.*

<sup>37</sup> State Council, Third Section, Decision N° 912, dated May 12, 1967, *Syndicate of the Owners of Audit and Accounting Offices, Al Adl*, 1967, p. 65.

*Based on the Declaration presented to the Ministry of Interior and Municipalities by the founders of the association named (...), and registered before the Common Administrative Administration under the number (...) dated (...),*

*Based on the proposal of the General Director of the Ministry of Interior,*

*Decides the following:*

*Article 1: The Ministry of Interior and Municipalities have been informed and notified of the incorporation of the association named (...)*<sup>38</sup>

2. The abuse of power of the administration with regard to the reception of the declaration

As mentioned above, the administration unlawfully assumed discretionary powers regarding the delivery of the Receipt, in particular during the last fifteen years. This abuse of discretion is reflected on numerous levels. The first example is the execution of investigations and inquiries, the results of which influence the Ministry's approval or rejection of an association's incorporation (addressed below). Second, the administration has ignored its binding authority and assumed an extensive margin of discretion in refusing to receive the declaration of certain types of associations and deliver the Receipt in return. This has been the case particularly with regard to what the Ministry calls "political associations," and to associations with political goals and activities according to the sole discretionary judgment of the Ministry.<sup>39</sup>

However, some associations have creatively adopted a legal tactic consistent with the core nature of the system of notification to counter these illegal practices by the Ministry. In order to avoid the risk of refusal of their declaration by the Ministry of Interior, the founders of an association may have a bailiff operating under orders from a Notary Public deliver the declaration to the Ministry. According to Article 399 of the Civil Procedure Code, this serves as proper notification of the declaration to the Ministry. As for the Receipt, according to Article 400 of the Civil Procedure Code, the bailiff is obliged to write the result of the notification on an official document; that document officially serves as the Receipt. Should the Ministry refuse to be notified, the bailiff would leave the declaration with the Ministry and state on the document serving as the

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<sup>38</sup> See, for instance, *Ilm wa Khabar* N° 336/AD dated July 4, 2006, Official Gazette, vol. 35 July 13, 2006, p. 4177. (Translated and emphasis added by author.)

<sup>39</sup> The Lebanese Association for Democratic Elections (LADE) is a notorious example of a victim of this illegal practice. The LADE was founded on March 13, 1996, on the eve of the 1996 parliamentary elections. Its main objective was to monitor the elections and watch transparency and conformity to the requirements of the law and democratic principles. The Ministry of Interior refused to receive the declaration of the association and to deliver the Receipt. It tried to ban LADE from operating given the fact that it "carries out political goals and it interferes in the government's scope of powers," according to the Ministry. LADE resorted to the tactic also used by ADDL, as described below – notification of the Ministry through a clerk. However, the Ministry refused to acknowledge the lawfulness of the association's existence. LADE nonetheless has continued its activities publicly through the present day. For further information on this issue, please refer to K. Karam, *The Civil Movement in Lebanon*, p. 106 *et seq.*, *op. cit.*

Receipt that the latter has refused to be notified. Utilizing this method, the declaration is made in compliance with the 1909 Law; the association thus enjoys legal capacity starting at the moment of notification of the Ministry. This method avoids the whole illegal and burdensome process of Ministry investigations and inquiries and the hazards of the administrative practice.<sup>40</sup>

In fact, the administration plays a passive role. Under the registration system, in contrast, the administration cannot be forced to register an association since the competent authority plays an active role and must make a decision with respect to the approval or refusal of the registration.

3. The approval of the security services: a “condition of formation of the association”

The Ministry of Interior has instituted a phase of investigations and inquiries following the deposit of the association’s official documents and preceding the issuance of the Receipt. During this phase the Ministry sends the documents to the security services for scrutiny and investigation.<sup>41</sup> Before the end of the investigation period, the Ministry refuses to deliver a Receipt based on the fact that the “licensing” of the association depends on the outcome of the investigations. Should the investigation result in negative findings, the Ministry refrains from delivering the Receipt and the association does not enjoy legal capacity for an undefined period of time.

The approval of the investigation authorities, in particular the General Security, forms an integral part of the notice of the *Ilm wa Khabar* published in the Official Gazette by the Ministry of Interior. In fact, some publications make a general reference to the competent authorities: “*After the approval of the competent authorities.*”<sup>42</sup> Others refer explicitly to the approval of the General Security services: “*After the approval of the General Security Services in its letter number 5417/AAR dated March 1, 1998.*”<sup>43</sup>

As explained above, this arbitrary practice is contrary to the law given the fact the administration has a binding authority to issue the Receipt provided that the formal legal requirements are satisfied. Although it is clearly understood that it is within the scope of powers of the administration to conduct any type of security investigation or other inquiry, the administration does not have the power to condition the issuance of the Receipt on the result of any investigation or inquiry. It is worth noting that the United States has taken a different approach with regard to investigations of associations, relying

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<sup>40</sup> This legal operation was carried out for the first time by ADDL on November 15, 1995 in order to counter the repression of the administration. It is described in Moukhaiber and others, *Associations in Lebanon: between the freedom, the law and the practice*, Association of Defense of Rights and Liberties, p. 45.

<sup>41</sup> Namely, the General Security, the State Security, the Security of Interior, and the Secret Services.

<sup>42</sup> See, for example, *Ilm wa Khabar* N° 17/AD, dated February 15, 2000, Official Gazette, vol. 9 dated February 24, 2000, p. 1036; *Ilm wa Khabar* N° 156/AD, dated December 30, 2004, Official Gazette, vol. 1, dated January 6, 2005, p. 33. Hundreds of similar publications can be found in the Official Gazette, especially in the post-war period starting in 1990.

<sup>43</sup> *Ilm wa Khabar* N° 61/AD dated April 11, 1998, Official Gazette, vol. 19 dated April 30, 1998, p. 1503.

on control *ex post* rather than control *ex ante*. In the United States, if after granting the registration approval, the administration determines that an organization is operating in an illegal manner, the attorney general can petition the courts to revoke the organization's corporate charter. "*It is easiest to tell whether an organization is abusing its privileges once it has actually commenced operations.*"<sup>44</sup>

Moreover, the investigation and inquiry procedure has not been limited to the security services. In fact, before the issuance of the Receipt, the Ministry of Interior requests official "advice" from administrative entities that are involved in the field in which the association is active. For example, the Ministry may request the advice of the Ministry of Social Affairs with regards to associations that have social goals or the Ministry of Public Health concerning associations that are engaged in public health issues.

As we have seen above, the reference to the General Security services and other authorities' approvals have been removed from the official notice of the *Ilm wa Khabar* following issuance of the May 19, 2006 circular. However, the investigations and inquiries have gained ground recently, and the Ministry accords this step crucial importance. The current administrative practice is not as objectionable as the one that prevailed during the post-war period – it is close to meeting the requirements and the spirit of the 1909 Law, but it is characterized by unjustified delays due to the investigations phase.

### C. Exceptions to the notification system: licensing of certain types of associations

Despite the liberal character of the Law of 1909, one facet of the Lebanese legal system for the incorporation of associations is very authoritarian: the licensing system. This system is applied to foreign associations and to youth and sports associations.

#### 1. Foreign associations

The incorporation of foreign associations in Lebanon is governed by legislative decree N° 369/LR, dated December 21, 1939, issued by the High Commissioner of the French Republic in Lebanon under the French Mandate. This law formalized a prior licensing system established through a Council of Ministers decree.<sup>45</sup> It is necessary to mention *a priori* that legislative decree N° 369/LR, like the majority of the laws issued under the French Mandate, is directly inspired by a French law dated April 12, 1939. It is a typical example of "irrational imitation"<sup>46</sup> that characterizes many legal institutions in Lebanon. The issuance of this law under special circumstances in France, to be specific,

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<sup>44</sup> W. Cole Durham, Jr., Brett G. Scharffs, and Michael W. Durham, "*The United States law of charities: a summary*," in *International Charity Law Comparative Seminar*, Collection of Papers, Beijing, 2004, p. 82.

<sup>45</sup> According to the text of the law, the license should be granted by the High Commissioner of the French Republic, the highest authority in Lebanon under the French Mandate in Syria and Lebanon.

<sup>46</sup> This expression was used by Edmond Rabbath, a specialist in the Lebanese legal system, to describe the adoption by the Lebanese constitutional practice of the concept of *legislative decrees*: norms of a hybrid nature (law and regulation) having the force of a law but issued by executive authorities and not by the Parliament. While there are several examples of these norms in the Lebanese legal system, they are still generally considered to be an anomaly. For further information on this issue, see: E. Rabbath, *The Lebanese Constitution, Text and Commentary*, 1982, Lebanese University Publications, Beirut.

the imminence of the War and the national socialist propaganda, reflects the worries of the French government at that time regarding the proliferation of national socialist associations and parties in the country.

According to Article 2 of the legislative decree, which is still in force today, the government can both issue a temporary license and also withdraw the license at any time by virtue of an “administrative decision” issued by the High Commissioner or his representative. Despite the high degree of authoritarianism that characterizes this system, the regulation of foreign associations in Lebanon does not constitute a serious concern for civil society advocates in Lebanon. In fact, the “infiltration” of foreign associations in the Lebanese civil society is contested by numerous parties in Lebanon who claim that these associations may have political agendas and that their development in the country might be a “security threat.”

## 2. Youth and sports associations:

The second class of organizations requiring a license encompasses youth and sports associations. These associations are governed by law N° 16/72, dated December 15, 1972 and decree N° 6997, dated December 24, 2001. Article 1 of the law excludes youth associations from the scope of application of the 1909 Law, and subjects them to the supervision of the Ministry of Education, Youth and Sports. The law also fixes a prior licensing system for the incorporation of these entities involving very strict control of their activities. Furthermore, the 2001 decree obliges the associations to use detailed, standardized forms of articles of association prescribed by the law, without which a license will not be granted.

After this description of the notification system and the ambiguities that surround it, we turn to another legal system that regulates associations: the registration system adopted by the Hashemite Kingdom of Jordan.

### **III. The registration system and its abusive application: the Jordanian example.**

The registration system is one of the most common systems of incorporating associations in the world. It is adopted by both democratic and developed countries and also by non-democratic ones. In its purest form, the system of registration is characterized by a simple and quick administrative procedure, the obligation or binding authority of the administration to act on an association’s registration, and limitations on acceptable association aims based on notions of public order, national security, good morals and similar factors. However, as liberal as this system can be, in countries like Jordan with weak democratic cultures, this system can be applied in a manner that jeopardizes the legal guarantees of associations and transforms registration into an administrative act of prior authorization. The Jordanian experience is of capital importance given the fact that Jordanian courts have issued several decisions that confirm the repressive components of the registration law. The Jordanian case is also interesting because the country is now considering a new draft law which, unfortunately, is only slightly less repressive than the current law.



A. A democratic formula within a democratic system

1. A simple and quick procedure adapted to the requirements of freedom of association

Unlike the notification system of incorporation, the registration system prescribes that incipient associations must apply for registration before a competent public authority, submit all the required documents, and fulfill other formal legal requirements. The competent authority scrutinizes the application and issues a decision of approval or refusal. The main difference between the notification system and the registration system lies in the date of the birth of the association's legal capacity. Under the notification system, the association is formed at the moment of signature of the association's by-laws by the founders without any intervention from the administration, and it acquires legal capacity at the moment of the declaration to the public authorities, who play a passive role. Under the registration system, in contrast, the formation of the association and the birth of its legal capacity are not effective before the decision of the relevant public authority to approve the registration of the association, *i.e.*, to acknowledge the association. The public authorities play an active role.

Germany provides a good example of the registration system. In Germany, associations are regulated by Articles 21 to 80 of the Civil Code. According to these provisions, not-for-profit associations enjoy legal capacity through their registration in the registry of associations, which is administered by the Court of First Instance in the same jurisdiction as the headquarters of the association (Articles 21 and 55). The association must have at least seven members (Article 56) who will elect a board that may contain one or more members. An association's registration application must be accompanied by the association's original statute signed by at least seven members, a copy thereof, and a copy of the minutes of meeting regarding the election of the board members (Article 59). *"The registration may be rejected if the registering court holds that the papers presented are not sufficient according to the law. The court must provide a substantive reason for rejection, which can only be based on formal deficiencies, for reasons of illegal purpose or public safety or if the association's purposes are considered to be economic."* An association has the right to appeal a rejection of its registration application.

Clearly the registration system when properly applied is not a system of prior authorization. Although an association presents an application before the public authorities and has to wait for its approval or rejection, the law features many guarantees that aim at protecting the freedom of association:

- the decision of the administration or the court, as in the German case, must be issued within a short deadline;
- the administration is bound to act within its authority because the administration may not reject an application unless formal legal requirements are unmet;
- the administration shall not have any margin of discretion with respect to the objectives of the association; and

- the requirements imposed by the administration on the content of the statutes and the articles of an association are limited to the basics, and therefore the content of the statutes cannot be contested by the administration unless they omit specific required information.

2. The aims of associations: between legitimacy and illegitimacy

The aims of an association constitute fertile ground for abuse in non-democratic environments when it comes to approval or refusal of registration. As we will see in the following section related to the Jordanian case, refusals of registration are often based on the alleged unlawfulness of an association's aims. It is understood, however, that every democratic country has to balance the two requirements that constitute basic pillars of every constitutional order: on one hand, the respect and protection of human rights and on the other, the protection of public order. Both principles enjoy constitutional protection in the majority of the states around the world. In France and Lebanon for instance, the provisions protecting human rights constitute an integral part of the constitution, whether cited in the text of the constitution, in the preamble or consecrated by the constitutional case law. As for public order, it constitutes an objective of constitutional value (*objectif à valeur constitutionnelle*) in France and a principle of constitutional value (*principe à valeur constitutionnelle*) in Lebanon.

Therefore, restrictions on the freedom of association in the name of the protection of public order or related concerns must be based on legitimate grounds. These grounds are defined in Article 11 of the European Convention of Human Rights, which states the following:

*"1. Everyone has the right to freedom of peaceful assembly and to freedom of association with others, including the right to form and join trade unions for the protection of his interests.*

*2. No restrictions shall be placed on the exercise of these rights other than such as are prescribed by the law and are necessary in a democratic society in the interest of national security or public safety, for the prevention of disorder or crime, for the protection of health or morals or for the protection of the rights and freedom of others. This Article shall not prevent the imposition of lawful restrictions on the exercise of these rights by members of the armed forces, of the police or of the administration of the State."*

Accordingly, restrictions on the freedom of association are possible, but only when three conditions are each fulfilled: the restriction must be prescribed by law, must pursue a legitimate aim and must be necessary in a democratic society.<sup>47</sup>

The first condition derives from a legal principle consecrated by the majority of the constitutions around the world and consolidated by case law: the exercise of human

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<sup>47</sup> Zvonimir Mataga, "The right to freedom of association under the European convention on the protection of human rights and fundamental freedoms," Strasbourg, October 2006, p. 14.

rights and fundamental freedoms shall be regulated by law. In France for example, this principle is consecrated by Article 4 of the Constitution which states that “*the law fixes the rules that concern: (...) – civic rights and fundamental guarantees granted to citizen for the exercise of public liberties.*” The same principle is consecrated by the Lebanese Constitution, which states in its Article 13 that “*the freedom of association [is] guaranteed within the limits fixed by the law.*” Consequently, the limitation of interference in the freedom of association to circumstances permitted by law is a constitutional requirement.

Concerning the second condition, according to paragraph 2 of Article 11, the freedom of association may only be restricted for the following reasons:

- in the interest of national security or public safety,
- for the prevention of disorder or crime,
- for the protection of health or morals, or
- for the protection of the rights and freedom of others.

The main problem with these motives is in the difficulty of defining their content, and thus their vulnerability to abuse. In fact, many countries have adopted similar enumerations, though the precise wording varies from one country to another depending on the nature of the society, the nature of the legal system, the judicial policies of the courts, etc. Therefore, it is important to shed light on the guarantees adopted by various international courts to prevent abusive interpretations of the exceptions.

Among the guarantees established in the international case law figures the necessary legal basis of the restriction, the principle of proportionality, which will be addressed below, and the principle of the narrow interpretation of the laws and the legal principles related to the exercise of human rights and public liberties. This last principle requires a restrictive interpretation in favor of human rights every time a restriction on a public liberty or a fundamental right is considered. This principle has been confirmed by the European Court for Human Rights in the decision, *Sidiropoulos and Others v. Greece*, dated July 10, 1998: “*Exceptions to freedom of association must be narrowly interpreted, such that the enumeration of them is strictly exhaustive and the definition of them necessarily restrictive.*”<sup>48</sup> In the same decision, the Court confirmed this principle by stating that “*the exceptions set out in Article 11 are to be construed strictly; only convincing and compelling reasons can justify restrictions on freedom of association.*”<sup>49</sup> The principle has also been confirmed by the Lebanese State Council, as reflected in Decision N° 134, dated March 25, 1970, that “*the freedom of incorporation of associations is guaranteed by virtue of Article 13 of the Constitution and that it is regulated by the law; nevertheless, this liberty cannot be restricted except in cases restrictively provided for by the law.*”<sup>50</sup>

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<sup>48</sup> *Sidiropoulos and Others v. Greece, op. cit.*, N° 38.

<sup>49</sup> *Ibid.*, N° 40.

<sup>50</sup> State Council, N° 134, March 25, 1970, *Judicial Review*, 1971, p. 241.

Finally, should the restriction be prescribed by law and have a legitimate aim, the European Court for Human Rights requires that it be necessary in a democratic society. This requirement allows the Court to examine the proportionality between the interference and the legitimate aim that it pursues. *“A measure will be proportionate (and thereby necessary) if it fulfills a pressing social need and if it does not restrict the freedom of association to a larger extent than is necessary for satisfaction of that need. It is therefore essential to carefully find the appropriate balance between the fundamental right of the individual and the interests of the community as a whole.”*<sup>51</sup>

B. Application of the system in a non-democratic environment: the abusive transformation of the registration system into a prior authorization system

1. A long and burdensome procedure

In Jordan, the incorporation of associations is governed by Law N° 33 on Associations and Social Bodies, issued in 1966 (hereinafter referred to as the “1966 Law”). Despite some minor amendments, this Law is still in force. In 2006, a coalition of associations<sup>52</sup> prepared a draft law intended to replace the old law and submitted it to the Prime Minister’s Office, where it is currently blocked for “legal review” before being sent to the Parliament. The draft law includes some technical improvements, but both the current and the draft laws are authoritarian and far from meeting the requirements of freedom of association.

a) The 1966 Law: an archaic and non-democratic system

The incorporation procedure instituted by the 1966 Law is characterized by two elements that make it non-democratic: first, it gives the administration an unlimited margin of discretion; second, the procedure is long and burdensome.

On one hand, the 1966 Law grants the Minister of Social Development unlimited discretion to refuse a registration application. In fact, paragraph 3 of Article 7 does not place any restrictions on the Minister’s authority to refuse or approve registration, and does not even prescribe mandatory reasons for the decision. These powers have been widely affirmed by case law. In fact, the Jordanian High Court of Justice has stated on numerous occasions that *“the powers of the Minister regarding the approval of the registration of the ordinary association is a discretionary power that aims to the achievement of the public interest and is only restricted by the obligation of its good use: it shall not be vitiated by an abuse of power.”*<sup>53</sup> In other decisions, the Court has confirmed the principle in similar terms: *“The powers of the Minister are discretionary and are determined according to the circumstances governing the country and to the aims of the association requesting the registration.”*<sup>54</sup> Notably, the Court has not defined

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<sup>51</sup> Z. Mataga, *op. cit.*, p. 18.

<sup>52</sup> The main associations were Partners Jordan ([www.partners-jordan.org](http://www.partners-jordan.org)) and the Adala Center.

<sup>53</sup> High Court of Justice, N° 13/2004, March 15, 2004, Adala Center Publications. See also: High Court of Justice, N° 205/1997, March 29, 1998, Adala Center Publications.

<sup>54</sup> High Court of Justice, N° 67/2000, July 10, 2000, Judicial Review, vol. 7, January 1, 2001, p. 357. See also: High Court of Justice, N° 138/2000, February 21, 2001, The Bar Review, 2002, p. 113.

“abuse of power,” and has not chosen to exercise its interpretive authority to limit the Minister’s discretion.

On the other hand, it is clearly stated in paragraph (a) of Article 5 of the 1966 Law that the incorporation of associations is subject to a “written license” issued by the Minister. As for the licensing procedure, consistent with Article 7, it involves the following steps:

- The registration request involves three administrative stages: first, the application is presented to the Office of Social Affairs; second, the latter examines the application and provides its recommendations, taking into account the advice of some governmental agencies prior to transferring the application to the Minister; finally, the Minister approves or refuses registration.
- This procedure may take more than four months: the transfer of the file from the Office of Social Affairs to the Minister shall be accomplished within 30 days of its presentation, and the Minister shall make the decision regarding the application within three months of the date of receiving the file. It is clear, however, that these timeframes are subject to abuse, given the fact that the administration can extend deadlines by requesting additional documents. In fact, Article 12 of the 1966 Law addresses the risk of abuse by providing that as of three months from the date of reception of the application, an association is deemed registered and shall enjoy legal capacity unless it receives a notice from the Minister requesting additional information. In 1993, the High Court of Justice reached a verdict on this issue and affirmed that *“the expiration of a period of three months as of the date of reception by the Ministry of Interior of the application for registration of an ordinary association grants the founders the right to start working as if the association has been duly registered, should the founders not receive a notice regarding the result of the application or the necessity of additional information or incomplete documents in the application or in the association’s by-laws.”*<sup>55</sup>

b) The 2006 draft law: a disappointing reform attempt

Compared to the archaic and authoritarian 1966 Law, the 2006 draft law is a positive evolution. However, the incorporation system that would be instituted by the draft law includes some flaws and weaknesses that make it inconsistent with the freedom of association, principally because the powers of the administration regarding the registration refusal are discretionary and unlimited.

On one hand, the draft law simplifies the registration procedure. This simplification is visible on two levels: the proposed creation of a National Registry of Associations and the reduction of the time frame. In fact, a National Registry is the

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<sup>55</sup> High Court of Justice, N° 209/1992, January 10, 1993, *The Bar Review*, 1993, p. 2338.

competent body for registration of associations. The draft law removes power to approve or to refuse the registration of an association from the Minister (of Interior or Social Affairs) and grants it to the Registrar. Thus, the registration procedure would be limited to one administrative stage and removed from the Minister, who is a political actor and whose actions are mostly influenced by political considerations.

Concerning the time frame, paragraph 3 of Article 8 of the draft law fixes a period of forty days during which the decision of the Registrar shall be issued; if the time frame is not met, the association is deemed registered and thus enjoys legal capacity. The shorter deadline is one of the most important differences between the draft law and the 1966 Law. As discussed above, the latter fixed a time limit of four months that could be easily extended.

On the other hand, despite the procedural evolution that would be achieved by the draft law, the text consolidates the discretionary powers of the Registrar regarding refusal or approval of the registration of an association. Following the example of the old repressive law, the new draft law does not contribute in any way to repairing the lack of liberalism of the law: the discretion of the administration remains absolute and unrestricted. The only contribution of the draft law is the requirement that the administration provide the reasoning behind its decision (paragraphs 3 and 4 of Article 8) which, however, does not limit the discretion of the administration. The absence of substantial limitations on the administration's discretion to refuse registration in the draft law is a lost opportunity, as such restrictions are acknowledged by international instruments such as Article 11 of the European Convention on Human Rights, mentioned above, and are prescribed by the majority of the laws on associations in democratic states.

2. Discretionary powers of the administration regarding the aims of an association: disappointing case law

The discretionary powers of the administration regarding the refusal of registration of associations based on an association's objectives have been affirmed by the High Court of Justice. In fact, the Court has endorsed an excessively narrow interpretation of what constitutes abuse of power, and has supported decisions of the administration that were clearly contrary to international standards on the freedom of association.

On March 15, 2004, the High Court of Justice of Jordan issued a decision that confirmed the discretionary powers of the Minister with respect to the approval or refusal of associations' registration applications. In this case, the plaintiffs presented an application before the Minister of Interior requesting the registration of the Association for Legal Assistance for Human Rights. The latter's aims are essentially to provide legal support for victims of human rights violations and to spread the culture of respect for human rights among all citizens. The Minister rejected the application and refused to register the association. The Ministry's position on the application can be reduced to two main arguments: first, by taking the decision, the Minister merely exercised the powers granted to him by Article 7 of the 1966 Law; and second, there are other registered associations that carry out the same objectives of support for human rights as the incipient association.

The Court upheld the Minister's decision, basing its judgment on the following Articles of the 1966 Law: Article 3, which states that the Minister of Interior holds the powers of the Minister of Social Affairs with respect to ordinary associations and committees; Article 5, which provides that *"No charitable societies or social bodies may be formed except by a written license issued by the Minister according to the provisions of the present law;"* and Article 7, paragraph 3, which states that *"the Minister should issue the decision of approval or refusal of the registration request within a period of three months as of the date of reception of the application."* The Court considered that these Articles imply that *"the powers of the Minister of Interior with respect to the approval of the registration application of ordinary associations is a discretionary power that aims to realize the public interest, and which is not limited by any restriction except the obligation of using it in a good manner, which means without any misuse of power."* The Court specified then that *"the meaning of discretionary power granted to the administration implies that the latter shall have the power to take the decision that it deems necessary in compliance with the aims of the law."*<sup>56</sup>

Besides the fact that the Court's ruling is disappointing due to its acknowledgement and consolidation of the Minister's discretionary powers and the waiver of detailed restrictions, the decision developed a very dangerous precedent with regard to the aims of an association. In fact, the argument regarding the denial of registration of an association because of the existence of other associations that carry out the same objectives is a flagrant violation of the right to freedom of association.

This same question was, in fact, examined by the Lebanese State Council in its founding decision of 1946. The Ministry of Interior refused to issue the Receipt to a dentists' association given the fact that there was already an association working in the same field. The plaintiff requested the nullification of the Ministry's implicit decision of refusal to issue the Receipt. The Ministry's argument was that the refusal to issue a Receipt was based on a *"governmental policy that tends to prevent the existence of several associations adhering to the same profession."* The State Council rejected the Ministry's allegations and stated that *"the said governmental policy, that aims to unify the efforts of professionals adhering to the same profession, does not constitute a legal justification to suspend the natural right acknowledged by the law to individuals to incorporate associations provided that such associations do not carry out illicit objectives or undermine the country's internal or external security."*<sup>57</sup> Furthermore, the State Council developed a general principle applicable to any similar case that can stand as a response to Jordan's High Court of Justice. In fact, the State Council stressed the fact that since the association's aims are legitimate, there is no reason to consider that its existence would contravene the existence of other associations working in the same field given the fact that every association works for the interest of its members.

The Jordanian Court's lack of liberalism is reflected in another decision, dated January 15, 2001, upholding the Minister of Interior's refusal to register an association that aims to *"stop the different violations of the owner towards the tenant and to*

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<sup>56</sup> High Court of Justice, N° 13/2004, March 15, 2004, Adala Center Publications. See also: High Court of Justice, N° 205/1997, March 29, 1998, Adala Center Publications.

<sup>57</sup> State Council, June 28, 1946, *Lebanese Judicial Review*, 1947, p. 39.

*participate in the drafting of any law, regulation, or instructions that concern the tenant, etc.”* The founders of the association challenged the Minister’s decision, alleging that it violates the constitution and the law. However, the Court rejected the request to nullify the decision because the Minister enjoys discretionary power regarding approval or refusal of registration of an association. Moreover, the Supreme Court considered that the aims of the association are “*in contradiction with the Owners and Tenants Law, which constitutes a basis for the protection of the owner and the tenant equally, and which makes the request of registration of the association illegal.*”<sup>58</sup>

Following this comparative review of the legal regulations in Jordan and Lebanon, we turn to administrative practice in the two countries, specifically with regard to undeclared associations. This perspective is critical, because these laws, whether just or not, are totally different from common practice. In fact, in a country where the institutions of the judiciary are subject to political intervention and the civil society is oppressed and manipulated by the establishment, drawing a line between the deficiencies of the law and the practice of regulation of associations remains a missing link toward the protection of freedom of association.

#### **IV. A common deficiency in both countries under study: the banning of undeclared associations**

##### A. Arguments

The issue of undeclared associations was discussed at length by the French Parliament when drafting the 1901 Law.<sup>59</sup> Opinions ranged from extreme liberal positions that supported full legal capacity for such associations to a repressive proposal that aimed to ban undeclared associations. The opinion that prevailed and that was adopted by the Parliament was an intermediate solution: undeclared associations should exist but could not have legal capacity (Article 2 of the 1901 Law). The debate surrounding the question of undeclared associations continues, featuring three main arguments:

##### 1. Freedom of association

Should a declaration or registration be mandatory for every association, two or three persons would not be able to meet permanently without being exposed to legal proceedings. The freedom to incorporate associations, as mentioned above, is one of the basic pillars of a democracy. This right supposes that several individuals can form an entity and organize themselves freely in order to realize common goals without enjoying legal capacity, provided that such goals are in compliance with the law. Being unknown to the public, the only restriction on undeclared associations would be the denial of legal capacity; this is the solution adopted by most of the liberal legal systems like France, the Netherlands, and Germany. Freedom of association also supposes that some groups of people do not wish to subject themselves to administrative procedures such as the registration of an association before the relevant authorities. Moreover, it is a fact that not

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<sup>58</sup> High Court of Justice, N° 370/2001, January 15, 2001, Adala Center Publications.

<sup>59</sup> Lucien Crouzil, *Freedom of associations ; theoretical and practical comments on the July 1, 1901 law*, Paris, Bloud, 1907 (original title: *La liberté d'associations; commentaire théorique et pratique de la loi du 1er juillet 1901*).



every association or group of people needs legal capacity to operate and realize its goals. Forbidding this aspect of the freedom of association would result in suppressing numerous small associations and groups which carry out very useful and efficient initiatives.

## 2. Association is a contract

Since an association is first of all a contract between its members, it must therefore be governed by the same provisions that govern contracts in general. Neither the Civil Code in France nor the Code of Obligations and Contracts in Lebanon makes a declaration or publication a legal requirement for the formation and validity of contracts. It is obvious, however, that publication of some types of contracts<sup>60</sup> remains an essential condition for third parties to contest the contract, but publication does not constitute a condition for a contract's validity.

## 3. The State's interests and public security

Some argue that criminalizing "secret associations" or undeclared associations and requiring a declaration or an acknowledgment of their existence aims at preserving the state's interests and to ensure national security. This argument has been upheld by some countries, mainly Arab states, to justify repression of criminal movements such as terrorists or Islamic movements. Such a requirement would be an illusionary guarantee for many reasons:

- An association that wishes to carry on illegal projects would not mention its goals in the by-laws subject to acknowledgement by public authorities. Such associations would simply execute illegal activities, disregarding the prescriptions of the law and the content of their by-laws.
- The objective of laws governing civil society organizations is not to fight criminality. Forbidding secret associations is not necessarily the domain of associations law. In fact Criminal Codes clearly provide sanctions against all terrorist factions and groups. Besides, the state already has at its disposal the necessary means to fight criminality through police and security forces.
- Experience has shown that the repression of undeclared associations has not produced a desirable result.

### B. The legal regime of undeclared associations: the French and German cases<sup>61</sup>

The legal regime of undeclared associations generally rests on the same pillars in all comparative experiences. In the French law, Article 2 of the 1901 Law is very explicit: "*Undeclared associations do not have any legal capacity and thus they cannot acquire real estate, goods or any patrimony; they cannot go to court; enter into*

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<sup>60</sup> In Lebanon for example, Management Agreements are subject to publication in the Commercial Registry in order to acquire full legal effect. Similarly, the publication of agreements that include real estate rights in the Property Registry is a requirement for the existence of such rights.

<sup>61</sup> We have chosen these two countries since they are two democratic countries in which the legal systems, based on civil law traditions, are close to the legal systems adopted in Lebanon and Jordan.

*agreements with third parties; be the heir to an inheritance; or receive donations.”* However, undeclared associations can receive dues to pay their own day-to-day operational expenses. Furthermore, since undeclared associations do not have full legal capacity, their members are personally liable for the association’s obligations. Finally, undeclared associations have absolute freedom with respect to the by-laws that define their structure, governing system, and their guiding principles, which are beyond any government control.

Following the example established under French administrative case law, the Lebanese State Council acknowledged the right of undeclared associations to challenge certain decisions and measures that obstruct their enjoyment of legal capacity. In fact, in its November 18, 2003 decision, the Lebanese State Council *“adopts an extensive interpretation of the provisions related to the legal capacity of moral persons in private law and considers that undeclared associations or dissolved associations enjoy the necessary legal capacity ... to file a nullification action against certain decisions and measures necessary to complete [the association’s] formation, or that undermine the goals it defends, as for example, the decision to refuse to issue the Ilm wa Khabar receipt or the decision of its dissolution.”* The same principle was earlier confirmed by the French State Council.<sup>62</sup>

The German law, however, adopts an intermediate position. On one hand, Article 54 of the German Civil Code states that such associations shall be governed by the provisions on partnership. Therefore, *“when a transaction is entered into with a third party in the name of such association, the person acting is personally liable.”* On the other hand, although such associations do not enjoy full legal capacity, it is possible for them to obtain tax concessions under German tax law.<sup>63</sup>

#### C. “Secret associations” under Lebanese law: a breach of the right to freedom of association

Undeclared associations are characterized by Lebanese law as *“secret associations.”* This concept is grounded, at the legislative level, on the 1909 Law and the Criminal Code, which take two different approaches to secret associations. In addition, two different approaches to undeclared associations have been enforced in practice by the Lebanese administration (a repressive approach) and Lebanese case law (a liberal approach).

According to Article 6 of the 1909 Law, associations which fail to submit a declaration to the designated government authority are secret associations. Secret associations are exposed to the penalties instituted by Articles 12 and 13 of the Law:

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<sup>62</sup> State Council, dated October 31, 1969, Syndicat de défense des canaux de la Durance, The State Council’s Decisions p. 462; State Council, dated October 21, 1970, Dame de Beauvre, The State Council’s Decisions, p. 600; State Council, dated January 6, 1983, Camillon, The State Council’s Decisions, p. 404.

<sup>63</sup> Michael Ernst-Porksen and Til Porksen, *“Third Sector Organizations in Germany: Legal Forms and Taxation,” International Charity Law Comparative Seminar, Collection of Papers, Beijing 2004, p. 314.*

dissolution and banning of the association by the government and a monetary fine of five to 25 gold pounds.<sup>64</sup>

As for the Criminal Code, under Article 337, running a secret association may be a crime that exposes its perpetrators to imprisonment. According to the Criminal Code, two conditions are required to qualify an association as a “secret association:” first, the association’s goals must be *illegal*; second, the association must not have informed the authorities of its statutes or the identities of its members despite an explicit administrative request to do so, or provided false information.<sup>65</sup> The requirement of a prior official request for information about an association’s members constitutes a sort of guarantee against abuse by the authorities in this regard. Furthermore, in a decision dated June 26, 1946, the Lebanese State Council affirmed that the two conditions cited in Article 337 of the Criminal Code are cumulative. This is contrary to the 1909 Law, which does not require the two conditions, and deems an association secret if it does not present the required declaration, even if its aims are in conformity with the law.<sup>66</sup>

In spite of these provisions of Lebanese law, the administration has in practice developed a precarious concept of secret associations. This was brought to light in Decree N° 2231, dated February 15, 1992,<sup>67</sup> which dissolved 138 associations, and which states in its preamble: “*Whereas certain political, social and charitable associations exercise activities in a secret manner, contrary to the licenses given to them and without informing the Ministry of Interior of any of their activities for a period exceeding ten years, violating the laws and regulations that govern the incorporation and the operating of the associations’ activities, and the principle of public order.*” Article 1 of the Decree states the following: “*The licenses (Ilm wa Khabar) granted to the associations mentioned below and that operate contrary to these licenses have been withdrawn.*”

This official statement constitutes a blatant example of repressive authoritarian practice and requires two observations: first, the Decree makes a reference to the “license” issued by the Ministry in favor of the associations, which completely contradicts the law; and second, the definition of secret associations being “associations that did not inform the Ministry of any of their activities during a period exceeding ten years” is an invention of the administration and does not have any legal basis.

Contrary to the stipulations of the 1909 Law on this issue and the archaic, repressive practices of the administration, case law in Lebanon offers a liberal conception of undeclared associations, based on an interpretation of the 1901 French Law that inspired the 1909 Law. The most important case on point is the Court of Cassation decision N° 70, dated July 25, 1963, *Assaa v. Turk*,<sup>68</sup> which remains an isolated and little-known opinion. The case involves an association named *Mahfal Al Salam* which was incorporated in 1900, but did not present the declaration stipulated in the 1909 Law after that Law became effective. Three members of the association purchased a plot in Beirut

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<sup>64</sup> This amount has not been changed since 1909, which renders the fine obsolete.

<sup>65</sup> Moukhaiber and others, *op. cit.*, p. 40.

<sup>66</sup> State Council, June 28 1946, *Lebanese Judicial Review*, 1947, p. 39.

<sup>67</sup> Lebanese Official Gazette, 1992, vol. 8, dated February 20, 1992, p. 150.

<sup>68</sup> Court of Cassation, N° 70 dated July 25, 1963, *Assaa v. Turk*, Recueil Baz, 1963, p. 281.

in the name of the association's members. A few years later, the seller contested the purchase agreement before the Court of Cassation, arguing that the association lacked legal capacity due to the fact that it had not presented its declaration to the competent authorities and was therefore a secret association.

Concerning legal capacity, the Court stated that *"despite the fact that the non-presentation of the declaration to the authorities deprives the association of legal capacity and consequently of the necessary capacity to undertake and satisfy legally binding agreements, the association can exist as a group of individuals comprising a de facto entity that allows it to acquire some goods and rights such as subscriptions, equipment, properties consecrated for the meetings of the members and for the achievement of their common goals."* This statement by the Court is an explicit acknowledgement of the lawfulness of undeclared associations. This legitimacy is confirmed by another paragraph in the Court's decision regarding the notion of "secret associations." In fact, the Court rejected the plaintiff's allegations and considered that *"the associations banned by virtue of Article 2 of the Law on associations [are] secret associations and the Mahfal al Salam is not a secret association given the fact that it has acquired a plot and that it has appeared in social life and has organized parties, some of which were attended by a group of persons from the governmental authorities."* The Court did not consider the failure to present the *Ilm wa Khabar* as rendering the association secret. It interpreted the term "secret" restrictively, with an explicit reference to freedom of association principles and, by analogy, to the French 1901 Law that tolerates undeclared associations. According to the Court's conception, should an association exercise its activities publicly and operate in a public manner, it is not a secret association despite the fact that it has not fulfilled the legal requirement of submitting the Declaration to the Ministry. This holding of the Court of Cassation is in perfect harmony with the principles of freedom of association, the Constitution, and the 1909 Law. It is worth mentioning that numerous undeclared associations operate in Lebanon without enjoying legal capacity. This, after all, may be a choice of the concerned groups, who may prefer to remain informal and avoid the administrative procedures and legal requirements for operating the association.

In light of this analysis, the provisions banning "secret associations" in the 1909 Law in Lebanon are obsolete and should be removed. This conclusion is supported on two levels: first, the case law has exceeded even the restrictive and repressive approach adopted in the 1909 Law; and second, the concrete situation on the ground shows the existence of undeclared associations as an expression of the popular will to associate.

## **V. Conclusion and Recommendations**

In recent years, civil society has become a main pillar of reform efforts in the Arab World. Thus, protecting the right to incorporate associations and facilitating their establishment remains a basic requirement for assuring civil society's freedom to maneuver and enhancing its capacity to successfully pursue reforms. Civil society, in supporting reforms, thus constitutes a key challenge to governments especially in the Arab region which has one of the biggest concentrations of authoritarian regimes.

In this paper, we have described from a legal perspective the two main systems regulating the incorporation of associations in any country. We have identified examples

in legislative history and favorable case law – particularly in the Lebanese experience – that can serve as models for liberal reforms on associative rights in any of our Arab countries. This history should be the main source of guidance for assuring prosperity for our reform efforts in the region.

The case studies, as summarized below, support the conclusion that the notification system offers more guarantees than the registration system regarding the right to incorporate associations in non-democratic environments. Therefore, we recommend that the notification system be adopted in those Arab countries where the reform of the laws governing civil society is possible.

- a. **Notification:** The association is formed as a legal entity solely by virtue of the will of its founders, prior to any intervention or interference of any kind whatsoever by the administration. In order to ban the association, the administration has to dissolve it by virtue of a decree issued by the Council of Ministers.

*Registration: The association does not exist as a legal entity unless it is registered before the competent public authority. In order to ban the incipient association, the administration just has to refuse its registration application.*

- b. **Notification:** In order to enjoy legal capacity, formed associations only need to present a declaration to the competent authority which plays a passive role in this respect: it just has to receive the declaration. Should the administration refuse to do so, it can be forced to do so by a clerk of the Court. The administration does not have any margin of action and is obliged to act.

*Registration: Whether or not an association obtains legal capacity depends on the administration's decision to approve or reject the registration application, i.e. to acknowledge its existence. The administration plays an active role in this respect which gives it a margin of discretion and consequently leaves the fate of the association in the hands of the public authorities.*

- c. **Notification:** The administration has binding authority regarding reception of the declaration, which cannot be refused except for very limited reasons provided for by law. Should the administration refuse to receive the declaration, whether based on an abuse of its authority or not, the administration must dissolve the association by virtue of a decree issued by the Council of Ministers, since the association already exists as a legal entity.

*Registration: The administration has binding authority regarding the registration of the association. However, should the administration abuse its powers in this regard, which often occurs under authoritarian regimes, the fate of the association remains in the administration's hands and the association has no legal existence.*

This study also supports the conclusion that some modifications should be introduced to the Lebanese 1909 Law:

- a. The competent authority to receive the Declaration, currently the Ministry of Interior, should be changed. Such authority could be transferred to the Notary Public (*notaire*) or an independent judicial authority such as the Tribunal of First Instance located in each district.
- b. All classes of associations should be subject to a unified incorporation system as set forth in the 1909 Law, including youth and sports associations. All laws that impose a prior authorization system for incorporation shall be removed except for certain types of associations that carry out particular activities, such as health or education. The concerned associations shall be subject to the 1909 Law.

The comparative study identifies common deficiencies characterizing both systems. The banning of undeclared associations constitutes a main issue that requires reforms, and therefore we recommend the following measures:

- a. Remove the provisions that ban informal associations from the 1909 Law and the Jordanian law. Introduce special provisions in each law that state clearly that undeclared associations are not banned by the law and are permitted under the standards governing the freedom of association. However, such associations will lack legal capacity until such time that they are rendered public, whether by presenting a declaration to the public authorities or by registering before the competent authority.
- b. Remove the provisions of the Lebanese Criminal Code that incriminate “secret associations.”

Moreover, this study reflects that the detailed requirements regarding the content of incipient associations’ by-laws as a condition for their incorporation constitutes another deficiency that should be reformed. Therefore, we recommend reducing the requirements on the content of associations’ statutes to basic information:

- a. Remove all legal provisions that require the adoption of certain forms of articles of associations, such as those contained in the Lebanese Law on Youth and Sports Associations.
- b. Remove the provisions that impose on associations detailed requirements regarding the content of their statutes, notably in the Jordanian Law of 1966 and in the draft law of 2006.

Finally, we recommend that any limitations on the permissible goals of associations be defined explicitly and restrictively. These limitations should be reduced to those provided for in Article 11 of the ECHR: national security or public safety, the prevention of disorder or crime, the protection of health or morals, or the protection of the rights and freedoms of others.

ARTICLE

## Somewhere in Between: Conceptualizing Civil Society

Benny D. Setianto<sup>1</sup>

The notion of civil society reemerged in political and sociological theories during transitions from authoritarian rule toward more liberal democratic governments in Eastern and Central Europe, South America, and, recently, Asia and Africa. Many struggles against communist and military dictatorships have revived the concept of civil society.

Despite wide use of the term *civil society*, its definition remains unclear, or at least, in Cohen's words, "there is no sufficiently complex theory that is available today" (Cohen & Arato, 1992). In characterizing the difficulties in defining *civil society*, some quote U.S. Supreme Court Justice Potter Stewart's remark about obscenity: "I know it when I see it." (Levin, 1997; Meis, 2004). Some further believe that fundamental differences exist between civil society in the developed and the developing world (Bestor, 2004; Scott, 2003). Others contend that civil society varies at the conceptual level: because it is historically bounded, different societies have different concepts (Rosenblum & Post, 2002). Commentators have noted the vagueness of the terminology and the variations in what it connotes for different thinkers (Beem, 1996; Green, 1999). The London School of Economics and Political Science (LSE) has tried to capture the "conceptual essence" of civil society, yet LSE's definition, like everyone else's, remains contentious (LSE, 2001).

Furthermore, the revival of the notion of civil society has occurred in tandem with attempts to theorize the new formal and informal institutional arrangements of society beyond the state (Jessop, 1998; Swyngedouw, 2003). Based on the distinctions between civil society as a movement and an institution, Arato concludes that civil society must be securely institutionalized before becoming a key, long-term terrain of participatory politics (Arato, 2000). Considered theoretically dead after Marx, civil society has become "the new cause célèbre in political thought" (Beem, 1996) as the arena for arranging society with or without the government. Again, this tends to simplify the relationship between civil society movements and democracy.

The revival of civil society in opposing military and communist regimes is seen as opening the door to more liberal democracies. However, it is not easy to sustain that position. Once the civil society participants changed roles and became "founding fathers" of the new state, they obviously no longer opposed the state. Therefore, Lindahl suggests that we distinguish the roles of civil society before and after a democratic transition (Lindahl, 2002). Vaclav Havel or Lech Walesa, in this view, is "a dissident-intellectual-turned-politician."

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In this article, I will examine the meaning of civil society from the perspectives of different thinkers. First I will compare civil society theory with the state of nature, political society, and economic society theories. Then I will examine the role of civil society in different democratic transitions.

### **Civil Society *vis-à-vis* the State of Nature**

Current understanding of civil society usually refers to the public sphere, set apart from the state and the market; however, it was not always so. In the Greek city-state, Polis, Socrates asked how people should reconcile their individual needs with the needs of the society. In addressing this question, Socrates employed a dialectic method in which the arguers test propositions against other propositions in hopes of uncovering the truth (O'Brien, 1999). Individuals' arguments were tested against societal arguments to find the proper balance – a civic virtue that would produce a society called a *societas civilis*, in contrast to barbaric society.

Concurrently, in Rome, the individual who participated in the public realm was viewed as participating toward *civitas* (city-state). The fulfillment of civic duties determined the civic virtue of individuals (MIHAN, 2000). It could be concluded that some societies existed outside *civitas* and others inside *civitas*. Those inside *civitas* might be called *civitas* societies, in which each individual is bound by civic duties as civic virtue.

Going further, Plato asserted that in a just society, citizens dedicate themselves to the common good, act virtuously and wisely, and practice the occupation for which they are most suited. Such a society should be led by "the enlightened one." The philosopher-king, who returned to the cave after seeing the light outside, could make decisions based solely on the common good (McClean, 1997).

Contrary to the suggestions posed by Plato, Aristotle first recommended that a state be governed by the middle class, those who are likely to strive for equality and who are moderate in their individual aspirations. Later, though, he asserted that governance must be performed for the common good, in which all can participate (Aristotle, 1967). Hence, democracy is preferable to oligarchy. Moreover, he stressed two aspects of liberty served by democracy: the opportunity for the individual to participate in making public policy, and the individual's freedom, protected by constitutional law, from intervention by the State. Societal governance, in his view, induced the lower units to achieve their goals through responsible, cooperative action, goals that they could not achieve by acting alone. He also strongly stated that the individual depends on the community in order to live a truly human life, and even that the State is a natural creation that precedes the individual (McClean, 1997). In this way, Aristotle identified the nature of the sociopolitical order as a *koin nia politika*, or civil society. He presupposed that society had multiple forms of interaction, association, and group life.

St. Augustine shifted the natural law of society from one based on reason to one based on divine rule. Fear of God (and of churches) became the basic foundation of civic virtue, law, and order of the society. To be a civilized society was to be the city of God. Therefore, churches were seen as representatives governing the society. Civil society meant simply society under the protection of God and submitting to God's divine rule as manifested in the church's decisions and policies.



The differences in the concepts of God's society and Aristotle's civil society were reconciled through the work of Thomas Aquinas in the thirteenth century. He proposed that "love thy neighbor" provided a guideline to treat all people alike. Furthermore, building upon Aristotle's *Nicomachean Ethics*, Thomas proposed that human life was more than a cyclical return to nature; rather, each life had sacred meaning and eternal import. By combining Plato's participation and Aristotle's ethics, Thomas stressed civic manners: each individual must consciously commit to cooperatively strive toward a common goal in order to create a civil society.

In the sixteenth and seventeenth centuries, Thomas Hobbes and John Locke argued that society was not a work of nature but rather the result of a social contract (Colas, 2002). For Hobbes, the state of nature was the natural order, in which people followed their emotions rather than reason. Such people would fight, "all against all," to protect their freedom. They would need agreements in order to create peace, and then an institution to preserve it. This institution arose through a contract between individuals. Then and only then could human freedom flourish under the protection of the State, which kept the peace and guarded civil society (Pietrzyk, 2001).

In the state of nature, individual fought individual, whereas in civil society, the State maintained peace in a community of people acting in a civic manner. By contrast to the Aristotelian assertion that people entered society because they were naturally sociable, Hobbes asserted fear drove people to the covenant. The covenant created a condition in which the state of nature gave way to civil society. Thus, civil society was not merely the opposite of the state of nature; it represented an escape from the state of nature, achieved when free, rational people entered into an agreement. For Hobbes, civil society integrates all lawmaking and executive power in a single body.

John Locke moved forward, arguing society results from a social contract. Locke argued that the State should not be seen as a single body, as Hobbes had done. Instead, Locke differentiated between government and society, with the goal of preventing the power of government from threatening the rights of the society (O'Brien, 1999). Locke viewed government as a unitary outgrowth of the freedom to form an association. Thus, he juxtaposed civil society against both the state of nature and the government:

Wherever therefore any number of men are so united into one Society, as to quit every one his Executive Power of the Law of Nature, and to resign it to the publick, there and there only in a Political or Civil Society.... And this puts Men out of the State of Nature into that of a Commonwealth

[Locke as cited in (Colas, 2002)]. He tried to step away from Hobbes by viewing the state of nature as potentially peaceable, whereas the Hobbesian, lawless state of nature represented the state of war.

Locke was inconsistent when he compared the dissolution of legislative power to the dissolution of society (Cohen & Arato, 1992). He asserted that dissolution of legislative power did not necessarily mean the end of society. Therefore, one could conclude that he simply distinguished the State from the society. In particular, he separated religious doctrine from the State. Churches remained autonomous. This represented an embryonic idea of civil society as a model for government.

By contrast to Locke's expansion of the rights of man into the rights of property, Rousseau argued that the introduction of private property, which focused on the rights of the individual and neglected the common goods, ignited the state of war among the people. To avoid such war, he proposed a new social order that would provide equality and freedom for all. This new social order collected individual forces into a supreme power that could govern, enact laws, protect its members, and maintain harmony. The State, as a supreme power, would be the arena for defining the common good and the institution through which individuals would willingly obey the general will (Colas, 2002; O'Brien, 1999). In this view, then, the passage from the state of nature into civil state procedures coincides with the replacement of instinct with justice.

Ferguson, differing with Hobbes, believed that "society is the natural state of men" (Pietrzyk, 2001). He saw political society as the natural result of men's experiences since birth. Civil society was, then, a society polished and refined, characterized by a certain stage of social, political, and economic advancement. For Ferguson, not all society could be called "civil." Only those in which individuals enjoy civil liberties protected by the government could qualify.

Although Ferguson considered commercial society the most advanced stage of social development, he acknowledged the dialectic of virtue and corruption in that society (Ferguson, 1966; Pietrzyk, 2001). Thus, civil society might decline if commerce corrupted individuals' republican virtues. In this respect, Ferguson implicitly distinguished an economic society that still practiced republican virtue, which he called civil society, from one that did not, which he called "tribesman" (Ferguson, 1966). He also did not view civil society as opposing the state of nature, in Hobbes's terms, but as opposing the rude nation. He believed that through governmental policies, education, gradual knowledge and development, rude society might be transformed into civil society.

Thus, while rejecting the idea of social contract as the basis of civil society and the asserted Aristotelian civic tradition, Ferguson envisioned the shift of society from rude or barbaric one into civil society. In doing so, some might say he viewed civil society face to face with the state of nature or barbaric nations. Additionally, he developed a new discourse about modern commercial society, in which active participation and citizen virtue intertwine with concepts of freedom, property, and justice derived from the natural law tradition.

Kant's position differed somewhat from Ferguson's. Kant insisted on the ideas of social contract and property as the just and moral bases of civil society (Kant, 1995; Pietrzyk, 2001). He took no position on whether humans are inherently bad, as Hobbes believed, or good. In balancing the use of coercive power by the State with individual freedom, Kant suggested the need to accept a political authority to achieve a condition of justice and rights. Accordingly, the main purpose of civil society is to force human beings to respect one another's rights. Kant might also be included among scholars who see civil society as more or less a civil state, with no sharp separation between state and society. Regarding Kant, Pietrzyk concluded that "civil society cannot exist without the state and is often meant by him as a political society with its institutions such as a public law or the representative authority."

To sum up, this section traces the historical idea in which civil society is seen as a model of societal governance, arising in the shift from the state of nature to the contractual society and forming a government based on civil liberties and rights.

### **Civil Society and Political Society**

Like Ferguson, Smith believed that the binding principle of civil society is a private morality, predicated on public recognition by one's peers, joined through bonds of shared moral sentiment (O'Brien, 1999; Smith, 1976). He went further by developing the idea of civil society as a necessary "safety net" for those endangered or damaged by the interplay of market forces and the dislocation and unemployment that they generate. In aiming at social promotion and protection of the economically disadvantaged, Smith saw civil society as a realm of altruistic activity guided by moral affectivity (McLean, 1997).

Using the invisible hand argument, moreover, Smith conceived civil society as not only a refuge from the economic realm but also a wellspring of economic abilities. Civil society emerged as a sphere in which individuals could express their human existence as well as show that commercial society has not corrupted their humanity. Smith also recognized what Marx later called alienation, the sick condition faced by the laboring poor unless the government takes some pains to prevent it (Smith, 1981). However, instead of relying on the authoritarian State, as Hobbes did, Smith believed that each individual has an innate tendency to respect the rules of natural justice. This tendency goes along with the natural human desire to better one's condition, the accomplishment of which requires some private liberty to deploy resources and skills. The role of the government, then, is not to suppress liberties but to guarantee them.

Thus, in Smith's view, liberal commercial society requires and encourages civic virtue. For him, government emerged gradually, restrained by rules. In this respect, Smith laid the foundation for civil society as an economic society separate from the State.

Hegel acknowledged the rights of individuals and stressed that those rights can thrive when they belong to the actual ethical order. He distinguishes, first, the family, the natural sphere of the ethical world; second, civil society, the achievement of the modern world and ethical life; and finally, the state, an objective guarantor of universal freedom. Therefore, Hegel put civil society somewhere between family and state (McLean, 1997). He considered civil society "the embodiment of universal egoism," in that, as in economic life, individuals use the needs of others to satisfy their own needs. Civil society was seen simply as society minus the State, which meant the so-called economy was part of civil society (Shaw, 1999). Primarily in the economic sphere of private affairs, individuals would seek to satisfy their needs. He considered corporations, outgrowths of the freedom to associate, essential to the structure of modern freedom. Further, he included public authorities in civil society, because they ensure the safety of persons and property. Following Smith, Hegel underlined the importance of the conflicting nature of the division of labor (Pietrzyk, 2001).

Because the State represented universal freedom, civil society depended upon the State for its existence and preservation. Hegel believed that as the embodiment of egoism, civil society is unstable. For him, individual freedom originates in the State, whereas modern-day liberals put freedom outside the State. This freedom, in which individuals and groups pursue conflicting interests, can be overcome only by an ultimate

authority. Furthermore, for Hegel, civil society cannot be separated from economic society. Social conflicts over rights and needs have to be solved; this is a job for the State, society's supreme entity. The State is an end in itself, as the highest morality, whereas civil society's ultimate end is to protect its members. Later, this idea was used by Hefner, who included business associations as part of civil society, entitled to protection of their rights and interests (Hefner, 1998).

Thus, for Hegel, the interests of individuals in civil society could be distinguished from the interests of the State. Civil society might be seen as on par with the State, although if their interests conflicted, the State would prevail.

Using Hegel's description of civil society, especially of the first part of the system of needs, Marx prefigured his analysis and critique of the capitalist State. He asserted, that "Civil Society embraces all the material relations of individuals within a definite stage of development of productive forces" (Bobbio, 1987). In contrast to Hegel's suggestion that the state prevails upon civil society, Marx saw abolition of the state as a desideratum to be achieved after revolution.

Marx asserted that civil society is bourgeois society, in which people treat one another as means to their own ends. Furthermore, he saw civil society as a means to weaken the feudal order and concentrate power in the hands of the new class, the bourgeois.

Furthermore, Marx saw civil society as the arena of class conflict between the bourgeoisie and the proletariat. In this way he tried to highlight how socioeconomic distinctions constituted "*the differentia specifica* of stratification of modern civil society" (Colas, 2002). This *differentia specifica* provided a crucial precondition for the emergence of civil society: the separation of the private sphere of production and exchange from the public arena of the State. In this way, civil society is associated with the private realm, the relations among individuals that developed in the bourgeoisie only. For Marx, too, this also resulted in the evolution of the State as an institution separate from economic society.

Gramsci, also following the Hegelian approach in distinguishing civil society from the State, has located those two entities in the super-structural sphere, unlike Marx, who placed civil society in the structural sphere. Bobbio asserted that for Gramsci, civil society is "not all material relationship (which means a base) but all ideological and cultural relationship; not the whole of commercial and industrial life but the whole of spiritual and intellectual life" (Bobbio, 1987). In other words, Marx saw Hegel's civil society as economic relationships (the system of needs) and therefore on the structural level, whereas Gramsci understood it as a super-structural concept that, along with the family, constituted the ethical roots of the State.

In this respect, both Gramsci and Marx believed the historical development of society occurred in civil society and not in the State, as Hegel had suggested. In civil society, all economic relationships shape history (as Marx suggested) or the interpretation of history (ideological and intellectual life), which in turn influences the future. The State, "which is exist up to now, is a dialectical unity of civil society and political society." Moreover, the State's ultimate end is the absorption of political society into civil society, as a result of civil society's enlargement as a hegemonic force.

Furthermore, Gramsci suggested that civil society occupies an autonomous space in the system and “appears as the third term, due to its being identified, no longer with the state of nature, nor with industrial society, nor generally with the pre-state society but with the factor of hegemony” (Hoare & Smith, 1989). Thus for Gramsci, civil society became a complex entity, standing on equal footing with not only the state of nature and the civil state, but also the church and political society.

### **Civil Society as “Somewhere in Between” the Economy and the State**

As mentioned earlier, Gramsci portrays civil society as the arena, separate from state and market, in which ideological hegemony is contested. This implies a spectrum of social organizations as well as community organizations, which both challenge and uphold the existing order (Lewis, 2001).

The current revival assigns civil society various functions. Arato notes the evolution of civil society from social movement to political party and finally to ruling party (Arato, 2000). In Russia, Zbigniew Rau, as quoted in Hikam, suggests viewing civil society as a historical development that requires a public space for individuals or groups to join, discuss, or compete to advance their private interests (Hikam, 1999).

Reflecting on the struggle to achieve democracy in South Korea, Han Sung Joo views civil society as a legal framework that provides the following: a space to protect individual rights; freedom of assembly apart from the state; a public sphere in which people can express their views; an organized society that respects specific norms, identity, and culture; and a space for independent and responsible social movements to become the "core group" of society.

Joo further cites four requirements for the emergence of civil society (Rozak, Sayuti, & Syafrani, 2003): (1) recognition and protection of human rights, especially the right to assemble, guaranteed by the rule of law; (2) a public sphere that allows anyone to articulate their political opinions; (3) social movements, based on specific norms and culture, which work to advance their interests in the public sphere; and (4) a core group of people, rooted in the society, who can mobilize others.

Kim Sun Hyuk, also drawing on the South Korean experience, describes civil society as independent movements and free associational groups that, through political actions, can defend their interests in the public sphere (Rozak et al., 2003). This description stresses the importance of free and independent associational groups apart from the state. It also requires a public sphere as an arena for political contestation.

In portraying the current movement in Japanese village areas, Suwondo similarly uses Chandhoke’s theory to set forth four conditions for civil society to emerge (Suwondo, 2003): (1) civil society must be seen as a politically participatory realm that helps ensure state accountability; (2) civil society comprises representatives of free associations; (3) the state must recognize and protect human rights; and (4) all individuals must be protected by law as members of civil society.

Suwondo also asserts civil society must be positioned carefully between state and market. Otherwise, civil society may enfeeble the state and provide opportunities for the dominant class to control society (Suwondo, 2003). If that class controls it, as neoliberals suggest, then civil society will be seen as nothing more than a space for promoting the

dominant class's principal cause, the laissez-faire approach to markets. Civil society will thus come to mirror the supply-and-demand characteristics of the free market.

Learning from the eruption of violence in Indonesia, Suwondo also suggests a danger in promoting the civil society through maximizing individual freedoms: namely, that the dark side of human nature may turn to violence. Civil society organizations may adopt violent means for advancing their interests and settling their differences in particular circumstances: democratic values are inadequately understood; the collapse of an authoritarian regime has led to a weak state; and freedom has ignited euphoria. Violence in turn will jeopardize democratization (Suwondo, 2003).

The North South Institute in Canada similarly defines civil society using “the notion of terrain, a place where the state, the people, and the market interact and where the people wage war against the hegemony of the market and the state” (Institute, 1999). Whereas civil society is customarily viewed as a force opposing the state, the Institute emphasizes that it must likewise be viewed as a force opposing the market.

The Institute then distinguishes civil society as structure from civil society as process. As structure, civil society is a component of society, along with the state and the market. Citing UNDP, the Institute also notes that civil society organizations are shaped to fit their social base, constituency, thematic orientations, and types of activity (Institute, 1999; UNDP, 1993). Though civil society organizations participate in the political arena, observes Diamond, they do not necessarily strive for political power, unlike political parties (Diamond, 1991). Diamond also distinguishes civil society, which focuses on public life, from economic society (the market), which focuses elsewhere.

Diamond further suggests characteristics of civil society that hold particular significance in terms of advancing democracy (Diamond, 2003).

First, how do civil society organizations govern themselves? If they practice democratic governance internally, operate transparently, and remain accountable to their constituency, then they are likelier to play an important role in democratizing society.

Second, do civil society organizations respect democratic values as they pursue their goals? Democracy's prospects decrease if civil society organizations reject the rule of law or undermine the state by corrupting democratic methods.

Third, what underlies the power of civil society organizations? If the power rests on charismatic leaders, rather than internal democratic processes, organizations are less effective at consolidating democracy.

Fourth, how have civil society organizations defined their relationship with the state? If the organizations try to change policy by gaining more power than the state, they will simply become political parties. Civil society organizations protect the public sphere by allowing members to pursue diverse interests, whereas political parties try to focus members on the party's goals.

If these four characteristics are present—if, that is, civil society is strong, whether through structures or processes—then it can help consolidate and develop democracy.

## **Conclusion: Daring to Define Civil Society**

Based on the foregoing, civil society remains a vague, ill-defined concept, notwithstanding its frequent application to the wave of democracy in Latin America, Asia, and Eastern Europe (Anheier, Priller, & Zimmer, 2000). Even so, civil society can be defined by three characteristics.

First, it operates under the rule of law, not the state of nature.

Second, civil society lies between the state and the market, where state interests and market interests are contested. Civil society thus stands in opposition to the market as well as to the state, and civil society is also influenced by both forces. When a variety of civil society organizations emerge, some may be arms of the market, such as business associations and entrepreneur organizations; others may be arms of the state, such as government-owned non-governmental organizations (GONGO). Salamon terms this space between the state and the market the third sector (Salamon & Anheier, 1997).

Third, voluntary associative relations dominate civil society. As a consequence, civil society is a sphere of free public debate. Civil society is thus more than associations, because any association might be influenced by the market or the state (Warren, 1999). Rather, the members of civil society organizations hold diverse interests. As a result, civil society's pluralism is maintained.

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