

TAI-HENG CHENG, STATE SUCCESSION AND COMMERCIAL OBLIGATIONS (2006)

BOOK REVIEW ESSAY

HENRY H. PERRITT, JR.*

Professor Tai-Heng Cheng has written a valuable new book that will stand alone on the shelves of lawyers, policy makers, and negotiators seeking useful guidance from the law when they confront the realities of adjusting commercial relations in the wake of fundamental changes in the boundaries or governments of states. Until now, a chasm existed between the policy arena and the stock of useful intellectual capital on state succession.

After careful review, Professor Cheng wisely abandons the arcane metaphysics of personality and territoriality theories of state succession, with their distinctions between governmental and state succession and their disdain for commercial disputes. Instead, he offers a new definition and develops a new legal framework: “[s]uccession occurs when a state fundamentally changes its structure of power and authority, and an authoritative international response is needed to manage disruptions to international arrangements that may result from that change.”¹ Professor Cheng’s novel approach to understanding state succession recognizes that commercial and political relations in the international community can be disrupted by a continuum of changes in individual states. This continuum ranges from the routine passing of power from one established party to another in a mature democracy to the total dissolution of an existing state, as happened with the Soviet Union and Yugoslavia. In between lie revolutions that supplant an existing political ideology with another; territorial secessions often accompanied by violence, as occurred in East Timor and is in progress in

* Professor of Law and former Dean, Chicago-Kent College of Law. Member of the bar: Virginia, Pennsylvania, District of Columbia, Maryland, Illinois, Supreme Court of the United States. Professor Perritt has worked intensively since 1998 on succession issues in Kosovo.

¹ TAI-HENG CHENG, STATE SUCCESSION AND COMMERCIAL OBLIGATIONS 3 (2006).

Kosovo; consensual territorial divisions, as in Czechoslovakia; and territorial accessions or reunifications, as occurred in Germany.

In all these cases, the potential exists for political arrangements (expressed in treaties) and commercial arrangements (expressed in contracts for the supply of goods and services, shareholder agreements, joint venture agreements, financing agreements, and government franchises and loan guarantees) to be thrown into question.

Such uncertainty poses a potential threat to international peace and security and widely shared goals of democratization and prosperity. Democratization depends on growth because economic development produces a middle class with the leisure and self-interest to begin erecting the features of a civil society.² Growth depends on foreign direct investment because domestic savings flows ordinarily are not sufficient in a less developed economy to finance investment.³ Foreign direct investment and other prerequisites for development depend on institutions that permit markets to function effectively and fairly. Those institutions, as Professor Cheng recognizes, include a wide variety of permanent and ad-hoc systems for assuring that, as a society develops and reorganizes, mechanisms exist to balance the often competing goals of honoring investment-backed commercial expectations and relieving players of outdated arrangements that may impose significant barriers to the economic viability of a newly revitalized economy, often without serving adequate countervailing values.

The necessary institutions include substantive law, private and public dispute resolution mechanisms, and frameworks for negotiations. Cheng recognizes the role that all of these play in what has been a basically pragmatic process of dealing with the major succession controversies of the late twentieth and early twenty-first centuries. As he points out, the established doctrines of state succession “do not account for the realities of international decision making.”⁴ State practice, in the sense the term is used to discover customary international law, is inconsistent. “Depending on the parties’ relative geopolitical strengths and interdependencies, the new equilibrium of rights and obligations may

² See Sunil Khedkar, *The Role of Economic Development in the Transition to Democracy* (Dec. 15, 2006), <http://www.kentlaw.edu/perritt/courses/seminar/sunil-khedkar-final-Seminar%20Paper.htm>.

³ See Brad Faber, *Economic Growth of Developing Countries: Is Foreign Direct Investment Really Necessary?* (Dec. 21, 2006), <http://www.kentlaw.edu/perritt/courses/seminar/brad-faber-final-Updated%20FDI%20Seminar%20Paper.htm>.

⁴ CHENG, *supra* note 1, at 22.

be slightly or vastly different from the processor state's obligations."⁵ Moreover, "behind the thin veil of objectivity, juristic works" on state succession often are directed by political agendas.⁶

While commercial stability could be assured by prohibiting state succession altogether, "law often has insufficient authority or power to diffuse the overwhelming centrifugal forces that cause state successions."⁷

Cheng's contribution is rooted in the realities of how state successions are actually handled. His work explores the handling of succession issues incident to transformations in East Timor, Hong Kong, Macau, the Soviet Union, Yugoslavia, and, more summarily, the unification of Germany. In East Timor, the geopolitical interests of third parties, particularly Australia, trumped theory in the International Court of Justice and in diplomatic arenas. In the case of the Soviet Union, Russian desires to control former Soviet military assets, coupled with creditor realization that Russia (unlike most of the smaller fragments of the former USSR) would be in a position to satisfy debts, short-circuited elaborate and protracted multilateral negotiations to develop a formula for allocating debt and assets to the new states. Yugoslavia was attacked with a more conventional legal approach, but many of the most important decisions were made in other, commercial forums such as the London and Paris Clubs,⁸ and Cheng appropriately suggests that artificial legal conceptions may have hurt more than helped a prompt resolution.

Professor Cheng identifies five major factors in determining a succession's outcome: the density of international relationships, the relative power and authority of decision makers, the "minimum requirements of human rights," supervening geopolitical factors, and limitations on collective decision making. Density is the most important factor, Cheng says, because dense international commercial relations increase the incentive to successor states to reach agreement on succession in order to be eligible for additional international financing. Moreover, higher density provides more opportunities for cooperation; controversies are less likely to be zero-sum.

⁵ *Id.* at 23.

⁶ *Id.* at 25.

⁷ *Id.* at 27.

⁸ The London Club is an association of international commercial banks with significant holdings in states confronted by succession disputes. The Paris Club is an association of states concerned with succession.

The second factor, the relative power and authority of the negotiating parties, varies considerably depending on the succession. Cheng points to Hong Kong and Macau as examples of a pattern of convergence of interests and positions; the USSR is used as a case in which one party—Russia—was unilaterally able to achieve its objectives, including ultimate forgiveness of 35 percent of total USSR debt and a thirty-year rescheduling of the rest. In contrast, Yugoslavia serves as an example in which one party, Serbia, was overpowered by a coalition of parties with views that differed from Serbia's.

As for the third factor, human rights, he points out, can trump preferences for continuity of agreements, as they did in East Timor.

Cheng's analysis of geopolitical factors focuses mostly on the Cold War. This factor is likely to influence succession issues in Iraq, Afghanistan, and Kosovo.

Finally, in his collective action section, Professor Cheng points to the pre-agreement on succession before Hong Kong was handed back to China. He also points out that national court decisions deferring to, or refusing to defer to, national executives on succession issues significantly alter the possibilities for collective action among states and commercial entities. Any time a disputant thinks she can get a second bite at the apple in court, she is less likely to make the compromises necessary to reach a negotiated agreement.

Cheng's factors are more useful than purported rules of the international law of succession. He urges lawyers to analyze the factors in particular situations rather than being pre-occupied with the artificial rules, which, in any event, have little practical power to shape the actions and decisions of major powers.⁹ In other words, good lawyers analyze politics and economics as well as law.

The book is not without its flaws. For example, Professor Cheng repeatedly characterizes the ouster of Slobodan Milosevic in Serbia as the objective and the result of the NATO bombing campaign. Instead, it was the result of Serbian elections almost a year after the bombing campaign ended. When a reader encounters errors such as these, he cannot help but wonder what other errors went undetected.

More substantively, Professor Cheng might have given greater emphasis to two other facets of dealing with post-succession disputes. First, and most broadly, he could have provided deeper analysis of the role of "political trustees," or third parties, in the form of international

⁹ CHENG, *supra* note 1, at 379-82, 402.

bodies, as in the case of the United Nations in East Timor and Kosovo, or in the form of states, as in the case of the United States' "Coalition of the Willing" in Iraq. Such political trustees must have greater power to negotiate with debtors and creditors of the predecessor regime and to transform the legal order of the territory than belligerent occupants have under customary international law.¹⁰ Belligerent occupants are obligated to leave the pre-existing legal order more or less intact, except insofar as strictly necessary to protect the security of the occupants or to serve urgent humanitarian needs of the territory's population. Professor Cheng appropriately credits the UN administration in East Timor as asserting the power to renegotiate treaties to bind the successor state.

Professor Cheng also should have given more attention to the role of private-law dispute resolution mechanisms. As all of his case studies recognize, national court litigation is inevitable; even the smoothest succession case studies were punctuated by lawsuits brought in national courts. Professor Cheng astutely analyzes the resulting judgments and judicial opinions. He fails to offer sufficient guidance on how private international law should work in this context beyond a brief observation that, in the absence of agreement, third-party adjudication is desirable.¹¹ What respect should national courts, where assets are located, give to the judgments of international bodies or specialized succession dispute-resolution bodies? How should national court jurisdictional concepts be adjusted, if at all, to give elbow room to judicial and quasi-judicial bodies directly involved in the succession? How should choice of law doctrines be molded and applied to serve larger international goals?¹²

Private-law dispute resolution is inherent in privatization. Privatization is a feature of almost all of the recent succession controversies, occurring as they did in the context of a global movement toward greater reliance on markets rather than state planning as the framework for allocating resources and managing economic activity. When a new state privatizes former state-owned or -controlled enterprises, how should it handle private claims so as to avoid encumbering new investors with indefinable and indefinite burdens? Typically, new investors bidding on the enterprises to be privatized are

¹⁰ See Henry H. Perritt, Jr., *Structures and Strategies for Political Trusteeships*, 8 UCLA J. INT'L L. & FOREIGN AFF. 385, 414 (2003).

¹¹ CHENG, *supra* note 1, at 402.

¹² See Henry H. Perritt, Jr., *Resolving Claims When Countries Disintegrate: The Challenge of Kosovo*, 80 CHI.-KENT L. REV. 119, 123-24 (2005).

entitled to take the enterprises or their assets free and clear of liabilities. The liabilities (claims) must be satisfied from a pool of funds generated from privatization bids and proceeds from other liquidation of assets.

Several issues commonly present themselves in such privatization structures: How far back should the window go for recognizing the legitimacy of claims in situations like that throughout the former communist world, when most private property was nationalized in the middle part of the twentieth century? For example, when enterprises are privatized in an evolving Cuba, as they surely will be as the Castro regime fades from control, should the claims of the Batista era be given priority?¹³ How can investors be protected from civil litigation by disappointed claimants who would rather, for example, have a civil judgment against an investor such as General Electric than a claim against a privatization fund, which almost certainly will satisfy claims for less than a hundred cents on the dollar? What are the best mechanisms for adjusting inconsistent claims, as for example by persons who claim that their employment with the enterprise being privatized were wrongfully terminated based on ethnic, ideological, or political prejudice?

Of course, no work can cover everything completely. Perhaps Professor Cheng will do a companion work exploring some of these other important issues. That would be a welcome addition to the literature as well.

Professor Cheng has authored a welcome and serious guide for people who must make decisions in the real world. He appropriately and explicitly encourages lawyers advising corporations and governmental negotiations to engage the opportunity to recommend a careful analysis of geopolitical realities, media attention, and public sympathies, along with the available legal tools in aid of developing effective strategies. One can only hope that international and local decision makers involved with Kosovo read and heed his book before it is too late to organize a constructive approach to working out the complicated succession issues embedded in a decision over the final status for Kosovo. Participants in “final status negotiations” have largely ignored these issues until now.

¹³ See Edward Pauker, *Foundations and Flexibility: The Keys to Successful Privatization in Cuba* (2006), <http://www.kentlaw.edu/perritt/courses/seminar/edpauker-Privatization%20in%20Cuba-FINAL.htm> (last visited May 4, 2007).